Letter of Comment No: 4808
File Reference: 1102-100

June 25, 2004

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116
Attention: Director of Major Projects

Dear Director of Major Projects

This letter is in response to your Exposure Draft "Proposed Statement of Financial Accounting Standards-Share-Based Payment" which is an amendment of FASB No. 123 and 95. By way of background, I have been a Certified Public Accountant for 20 years. I have served in public accounting with a big four CPA firm as an auditor, as well as many years of industry experience in increasing roles with in the accounting department of both large and small companies as well as public and private firms. I am currently a Chief Financial Officer of a publicly held corporation. I have also worked for companies that do offer stock options as a form of compensation as well as companies that offer no such plans. I was eager to read your Exposure Draft in hopes that you would finally put together a proposal that would solve this on going division among accountants and Corporate America.

I first want to tell you that I do not agree with the FASB's desire for American accounting standards to be consistent with international accounting standards if international accounting standards pertain only to European communities. This effort would make much more sense if Asian and other countries would also join to make worldwide accounting standards and reporting uniform. I understand that many Asian countries for example do not currently comply with the expensing of stock options, therefore having American standards comply with Europe only seems to create the illusion that the world is uniform when it is not. I am troubled that this may cause further confusion in the marketplace. This should be done as a joint effort with key Asian and other communities.

My main reason for responding to this Exposure Draft is that I am surprised as a CPA that this proposal has no mechanism to true up expenses recorded to the actual value that the employee receives from the compensation. I am not here to say that stock options are not a form of compensation to the employee, because they are. I understand that the company pays no cash to the employee upon exercise of the option, but there is an opportunity cost that the company could have raised equity in the open market rather than exercising options to the employee and generating newly created stock. Shareholders interests are diluted when this occurs, so there is a real expense of the option. My concern is that in every other area of accounting theory, an expense is ultimately based on the actual economic value given by the company. Therefore, I would expect the expense to be measured ultimately based upon the actual amount that the option is exercised for less the option price paid by the employee. The option price paid by the employee would be a component of shareholder equity. This is the most accurate reflection of the expense. If the company had to sell the shares on the open market, this would be the price paid. While I understand that this is what the FASB is trying to achieve with this Exposure Draft, I think the calculation is grossly missing the mark. The black-scholes or binomial methods are very difficult and are prone to extreme error and estimate. And what I find the most incredible about the proposal is that there is no true up to the actual benefit gained by the employee. I know no other area of accounting where the expense is not eventually trued up to reflect the accurate economic value. In my opinion, the FASB would be better off to propose that companies make a best faith effort to estimate an option's value based on a uniform set of assumptions for the future such as if the stock option will vest over 3 years, the company expects the options to be exercised on average one year after the options vest. Therefore, the company's stock price is estimated based on where the company anticipates the stock price to be one year after the stock vests based on historical or peer average returns. In addition, every quarter the estimate would need to be revised based on current market conditions. As options are exercised, the expense would then be trued up to reflect the actual benefit received by the employee. What makes this Exposure draft especially difficult is that options may eventually be underwater and the employee would never see any value, yet the company's financial statements reflect an expense for this item. How is this any worse than not recording an expense at all?

In general, I believe that Corporate America would accept the concept that stock options should be expensed if there were an easier calculation that was eventually trued up to the economic value received by the employee. Short of this, this standard is very difficult to implement. As a CFO that has to certify my company's financial statements each quarter, the contemplation of this Expose Draft makes me very concerned since the black-scholes or binomial methods are overly complex and the resulting value does not mirror my expectation of what the eventual value of the option will be to my employee. These days there is an equal chance that every option granted would eventually be underwater when the employee leaves the company. Ask several technology employees in Silicon Valley about the amount of money that they have made on stock options over the last three years! Yet under this proposal, those companies would have an expense recorded that was never realized by anyone. I think no expense would be just as accurate and comparable and much easier to reflect in the financial statements. Under APB 25 guidelines, at least financial statements among peer companies in the industry would be comparable. With this proposal, expenses can vary widely based on the volatility index selected! Is this something that you would have individual investors try to figure out on their own? This is difficult for me, a 20 year CPA!

In conclusion, I believe that the proposed accounting treatment of stock options is the worst estimation method of expenses that I have ever seen from the FASB or any other accounting body. I am an accounting theorist and enjoy making assumptions about practical accounting matters, but this suggested treatment does not put financial statements on an even playing field and I think it will add more confusion, especially when Wall Street analysts take stock option expenses out of the numbers for some companies. Then the reader will not know if the recommendations are made with or without options and it leads again to non-GAAP financial statements. How is an individual shareholder expected to understand this any better. I think this proposal is worse than today's accounting. I also believe that you underestimate the economic impact to our economy of expensing stock options. Small companies, which have been the segment where most of the job growth in America has been the last 10 years, will fade very quickly as companies will no longer give out options and they wont be able to attract top scientists and engineers. Many of these jobs will go overseas and America will no longer be the home of innovation, or Americans will simply take their ideas to China or India. In addition, the Federal government and certain state governments will not easily be able to replace the tax dollars that have been generated by stock options. As a CPA, I hate to see Congress and the Senate debating accounting issues. I agree that these conversations belong among accountants, but I also believe that the FASB needs to arrive at an easier method to estimate stock option expense and true the expense up for actual economic impact received by the employee. This is the way accounting standards work in every other case. I hope that you will appreciate my comments and try to come up with a better and easier approach that at a minimum, records expense to the actual cost in the end.

Thank you,

Cynthia B. Merrell, C.P.A.