

Len Tatore**Letter of Comment No: 1686**
File Reference: 1102-100

From: Maclean, Eric [eric.maclean@intel.com]
Sent: Thursday, April 22, 2004 9:05 PM
To: Director - FASB
Cc: Maclean, Eric
Subject: File Reference No. 1102-100

Dear Sir

I am responding to the request for comments regarding the matter of stock option expensing. I urge you to eliminate your proposal on expensing stock options because it is not in the best interests of US investors or the US economy.

1. Stock option expensing is contrary to sound financial accounting principles - it creates precedents that do not make sense and absurd results. There is no using up of assets of the company, no incurrence of liabilities by the company, nor is there any expected future cash outflow (or equivalent) as a result of granting stock options. Therefore, expensing options is contrary to the fundamental financial accounting concepts which define an expense. Implementing such a requirement would create the undesirable precedent of a regulatory regime which is arbitrary and unpredictable, where fundamental concepts are undermined or swept aside at any time, where financial accounting is perceived as being defined only by the political expediency of the day. This is not in the best interests of investors. In addition to booking "expenses" which are not company expenses, other examples of absurd results which might be created by stock option expensing:

- Two companies are identical in all respects including the number of options being granted - one forecasts high profit growth, one low growth. The one with the low growth forecast has higher profits in the current year. This cannot be intuitive for investors.
- Companies are likely to book material "expenses" for options that are never exercised.

In addition, there is currently full disclosure of options in the notes to the financial statements, EPS is shown both diluted and undiluted, so company investors are already fully informed about dilution.

2. Stock option expensing by the company does not reflect the economic reality of the transaction. Stock options are not an expense of the company - they are the individual expense (through dilution) of those who own the company at the time options are granted. This dilution of ownership only occurs if the value of the company increases, and is more than offset by the increase in value. Current owners of the company are willing to allow the contingent dilution because of cause and effect - they believe that the incentives represented by stock options will cause the company's value to increase, and thus the value of their ownership to increase.

Here is an illustrative example in a small partnership situation. A, B are the only partners in a partnership worth \$200,000. They offer C a one-sixth share of the partnership if C generates sufficient business to increase the value of the business to \$300,000. After a year, C has been successful. A's share is now worth \$125,000, B's share is worth \$125,000, and C's share is \$50,000. Without C's efforts, A and B would not have increased the value of their holding. Without the offer of a share in the business, C would not have made the effort. There is no expense in the partnership P&L relating to the partial transfer of ownership from A and B to C. The entries would be simply to debit each of the partnership accounts for A and B with \$25,000, and credit C's new partnership account with \$50,000. The same accounting principles should apply in a corporate situation - this is an equity transaction between

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investors.

3. Expensing options will make financial statements less transparent, less comparable, and more prone to manipulation by unscrupulous executives. This is a direct contradiction of FASB's stated purpose and mission and harms investors, especially less sophisticated ones. It is also highly inappropriate given all the recent corporate scandals involving misleading financial statements.

Given the lack of a freely tradable market in employee options, there is no way to value such options which does not involve massive use of judgement, including the prediction of events and circumstances years into the future. No method of valuation is even prescribed. Therefore, company executives wishing to mislead their investors as to their actual performance will find it much easier to do so by varying their estimates, inputs and methods to suit their purpose, without any non-compliance. Furthermore, the lack of prescribed method and the massive use of judgement will reduce comparability between companies as they choose differing methods and estimates of future events and circumstances. This is not in the best interests of investors.

4. Expensing stock options would create a competitive disadvantage for American companies. In its latest five-year economic plan, the Chinese government explicitly calls for broader use of stock options to attract and retain key talent in China. It is ironic that a communist country, the People's Republic of China, is encouraging the wider use of stock options, while in the U.S. the FASB proposes to make option grants to employees much more difficult and expensive. This FASB proposal will harm the ability of Americans to innovate and drive the nation towards second tier status.

Sincerely
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