

## Financial Accounting Standards Board

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DENNIS R. BERESFORD  
Chairman

April 6, 1994

The Honorable Robert F. Bennett  
United States Senate  
Dirksen Senate Office Building  
Room 241  
Washington, D.C. 20510-4403

Dear Senator Bennett:

Thank you very much for your letter of March 22. In keeping with our due process, your letter has been included in the public record on this project. All letters received are reviewed by Board members and staff and are incorporated into our analysis of comments received.

The Exposure Draft, *Accounting for Stock-based Compensation*, is a *proposal* for new accounting, and there are more steps in our due process from this stage to publication of the final standard. We do not issue an Exposure Draft until we have reached a considered judgment on every proposed requirement in the draft. Our Exposure Drafts are not "trial balloons." They expose our conclusions for public comment and encourage all interested parties to challenge our conclusions and reasoning. But, until we issue a final standard, all conclusions are tentative.

We have analyzed over 1400 comment letters received in response to the Exposure Draft; we have summarized the results of a field test of the proposal that involved over 25 companies; and have recently completed six days of public hearings. In April, we are planning a roundtable meeting with investment bankers, academics, and others interested in option valuation to discuss the measurement of employee stock option value. All of these steps take place before the Board's reconsideration of all the issues in the Exposure Draft in working toward a possible final statement. This extensive due process involves constituent input at every step.

Many of the comment letters have raised concerns about the measurement methods proposed in the Exposure Draft, a point raised in your letter. The Board is especially interested in those concerns. Accountants have wrestled with the problem of accounting for stock options for over 45 years, and measurement has always been one of the most troublesome issues. The valuation models proposed in the Exposure Draft are used every day to manage billions of dollars of financial transactions. The Board understands the differences between employee stock options and other financial instruments. It may be that the adjustments included in the Exposure Draft do not adequately compensate for those differences. We expect to consider that point in depth, beginning with the April meeting described above.

Your letter suggests that the proposed accounting for employee stock options is not "in the best interest of promoting and expanding businesses." Many of the comment letters expressed similar views. Still, the only way to achieve that objective is to bend the rules and color the information to benefit one interest, companies that use stock options in this case, against companies that do not.

Some of the Board's critics seem to favor just this type of skewed accounting. They raise worthy public-policy objectives (in this case, competitiveness and high employment) and suggest pursuing those goals by slanting the accounting rules. They evidently believe that if they can have (or keep) accounting rules that show higher net income, investors will provide them with more capital than they would otherwise attract. Indeed some assert that the growth or even the viability of their companies is critically dependent on the accounting for stock options.

In a recent letter to Senator David L. Boren, SEC Chairman Arthur Levitt addressed concerns about the independence and neutrality of the FASB and the accounting standard-setting process. He stated:

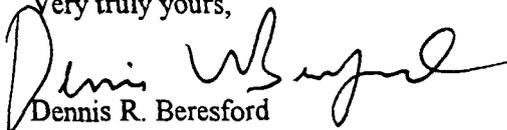
The existing process for setting accounting standards, with its emphasis on providing neutral, unbiased information to investors and policy makers, has been successful and should continue....

....[T]he true role of accounting standards-setting bodies should not be to judge whether an economic goal or political or social policy is good or bad, but to create the means for communicating reliable and complete information to investors and to the public in general. This information should permit knowledgeable investment decisions, assist in public debates, and allow public policy makers to formulate well-informed and real solutions to problems....

Financial statements are a basic tool used for communicating information about economic events to capital markets. An efficient economy requires good financial information because investors, creditors, regulators, and others base decisions on information contained in financial statements. To make the best economic decisions, they must have financial statements that neither omit information nor color the message to influence behavior in a particular direction. The U.S. capital market system is well-developed and efficient because of users' confidence that the financial information they receive is reliable.

I appreciate your interest in this issue and the standard-setting process, especially your offer to work with the Board. Members of the Board and staff are regularly in Washington. We would be pleased to meet with you or your staff. Please feel free to contact me, Diana Willis, or Wayne Upton if you need more information or would like to discuss our proposal further. In the meantime, please accept my assurance that the Board will fully consider all the alternatives suggested. We will do so, as we always have, in open, public meetings. If you, or any of your constituents, have an alternative that has not yet been presented, I encourage you to present it so that it can be included in the Board's deliberations.

Very truly yours,

  
Dennis R. Beresford