

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

August 19, 2004

The Honorable Bill Frist
Majority Leader
United States Senate
Washington, DC

Dear Majority Leader Frist:

From March to June of this year, the Financial Accounting Standards Board solicited public comment on a proposal that, if adopted, would require companies to record as compensation expense the fair value of all stock options granted to employees. The FASB currently is analyzing the input it received from more than 13,700 comment letters, four public roundtables, numerous Congressional hearings, and meetings with representatives of many groups, including investors and the small business and high technology communities. While the public comment period has ended, the FASB continues to receive input on its proposal. On August 4th, the FASB began what will be a series of weekly public meetings, which will continue into September, to re-deliberate each tentative conclusion expressed in its proposal. The FASB, with careful monitoring and oversight by the Securities and Exchange Commission (SEC or Commission) staff, has spent thousands of hours considering the issues, and the broad range of views and opinions that have been expressed. I believe that FASB's effort has been and continues to be a constructive, thoughtful and productive way of deliberating and carefully considering the complexities associated with the issues, and I feel strongly that it is in the best interest of investors and our markets for the FASB's deliberative process to continue.

As is often the case With proposed changes in accounting practice, this proposal has generated significant debate. Over the years, the SEC has encouraged such debates because they lead to better standards. I believe that will be the case for this issue as well.

The Federal securities laws give the SEC broad authority over the accounting principles to be followed in the preparation of public company financial statements.¹ Practically since its inception, however, the SEC, while preserving its full statutory authority, has looked to the accounting profession for leadership in establishing and improving accounting principles. Over the years, various accounting standard-setting bodies have been formed to carry out this function. Most of these bodies, however, included part-time members, who remained partners in accounting firms, and thus under the possible influence of clients and other interested parties.

In the late 1960s, the accounting profession recognized that the credibility of its standards was at risk. With encouragement from the SEC, the profession formed a committee, chaired by former SEC Commissioner Francis Wheat, to study and recommend a better process. The final report, published in March 1972, recommended the formation of the FASB as an independent body that would be removed from the influence of active members of the accounting profession and their clients. Moreover, the FASB would be led by a full-time board of experienced professionals who would have the ability to hire a permanent staff of accounting experts. This recommendation was widely endorsed by industry, financial analysts, accounting educators, and practicing accountants, and thus became the FASB we know today.

The SEC issued a policy statement at FASB's formation affirming that the FASB would provide an institutional framework that would permit responsible actions flowing from research and consideration of all points of view. The Commission also noted the collective experiences of the members of the FASB and the commitment by the accounting profession to provide substantial resources to that Board.

Just two years ago, in the Sarbanes-Oxley Act of 2002, Congress reaffirmed and strengthened the Commission's mandate to oversee private sector standard-setting bodies such as the FASB, and to assure

the independence of such bodies. The Act specifically provided a legal framework for the Commission to determine whether a standard-setting body meets critical conditions essential to ensuring the integrity of its processes.² Further, the Act authorized the imposition of a mandatory annual accounting support fee on public companies - thereby removing the dependence of the standard-setting body on voluntary funding from industry and the accounting profession and assuring that it has a steady source of revenue.³ On April 25, 2003, the Commission formally recognized the FASB as a standard-setting body meeting the criteria established by the Sarbanes-Oxley Act. The Commission has twice subsequently determined that the FASB's support fee meets the Act's requirements, most recently on February 20, 2004.

As you know, the House of Representatives recently passed H.R. 3574, The Stock Options Accounting Reform Act. That bill, if enacted, would remove certain decision-making responsibility from the FASB and thereby disrupt the independent, private sector accounting standard-setting process that the Commission historically has endorsed and Congress sought to protect when it passed the Sarbanes-Oxley Act.

The FASB's process for standard setting allows for extensive, thorough, deliberative consideration and open procedures in order to establish standards so that companies can provide relevant and reliable information to the public. Accounting standards that fail to accurately portray events can skew company results, reinforce investor skepticism, and set back efforts by Congress, the Commission, accounting professionals and others who have been engaged in restoring public confidence in the integrity of financial reporting in the United States. The FASB's process includes extensive consultation, public meetings and hearings, written input on proposed standards, and public re-deliberation where appropriate, and includes consideration of the impact on smaller businesses. The process is designed to provide ample and appropriate opportunity for the public to air their views and concerns, while providing the FASB with the opportunity to thoughtfully consider all aspects of those concerns before reaching a final decision.

Moreover, the SEC oversees the work of the FASB to assure that their process operates in a fair and open way and that the results serve the interests of investors. In the event that the Commission believes additional implementation or interpretative guidance, safe harbors, or a delay in an implementation date may be necessary to ensure that any particular standard can be applied consistently and cost-effectively by enterprises registered with the SEC, we typically undertake to assure that the appropriate actions are taken.

The FASB's standard-setting process with respect to the expensing of stock options is in the final stages of what has been a very long and exhaustive process. Because it is critical to the restoration of public confidence in the integrity of financial reporting in the United States that the independence, expertise, and open processes of the FASB be honored and supported, I believe strongly that the FASB's consideration of this proposed standard regarding stock options should be allowed to run its full course.

As always, I appreciate your consideration, and would be happy to discuss this matter with you further should you have any questions or need additional information.

Sincerely,

/s/ William H. **Donaldson**

Chairman

U. S. Securities & Exchange Commission

cc:

The Honorable Tom Daschle

The Honorable Mitch McConnell

The Honorable Harry Reid

The Honorable Rick Santorum

The Honorable Richard C. Shelby

The Honorable Kay Bailey Hutchison

The Honorable Byron Dorgan

The Honorable Jon Kyl

The Honorable Paul S. Sarbanes

The Honorable Ted Stevens

The Honorable Robert C. Byrd
The Honorable Judd Gregg
The Honorable Ernest F. Hollings
The Honorable Mike Enzi
The Honorable Chris Dodd

¹ See Sections 7, 19(a) and items (25), (26), and (27) of Schedule A of the Securities Act of 1933, sections 12, 13(b)(1) and 17(e)(2) of the Securities Exchange Act of 1934, sections 5(b), 14, and 20 of the Public Utility Holding Company Act of 1935, and sections 8, 30(e), 31, and 38(a) of the Investment Company Act of 1940.

² Section 108(a) of the Sarbanes-Oxley Act of 2002 (codified at Section 19(b)(1) of the Securities Act of 1933).

³ Section 109(e) of the Sarbanes-Oxley Act of 2002