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VIA E-MAIL AND OVERNIGHT COURIER

Financial Accounting Standards Board
MP&T Director – File Reference 1102-001
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Invitation to Comment on Accounting for Stock Options

Dear Sir or Madam:

Western Digital Corporation appreciates this opportunity to comment on the *Invitation to Comment* on accounting for stock options, dated November 18, 2002 (the "Invitation"). In re-opening the discussion of accounting for stock compensation to employees, the Board has embarked upon a significant and far-reaching project. Considering the potential immense impact of changes in accounting for stock-based compensation on U.S. based companies and their employees, it is absolutely critical that the Board thoroughly consider all points of view as well as the existing accounting conceptual framework.

We realize that the Board has not sought comments on certain issues, including whether stock options granted to employees result in compensation expense to the issuing entity and whether the fair value of such options can be reliably measured. However, we understand and appreciate that comments in these areas are welcome and will be included in the Board's analysis.

The following paragraphs summarize our most important concerns.

The value of an option to an employee is different than the cost to the company and does not represent an expense. Most companies issue stock options to employees to help align their interests with non-employee shareholders. In these cases, employees already receive cash compensation comparable to employees at other companies who do not receive option grants. Thus, if a company were to charge its income statement for the value of options granted to its employees, it could significantly overstate the value of the services being provided. Existing accounting literature recommends that non-monetary transactions be valued using the fair value of the asset received if it is more clearly evident than the fair value of the asset surrendered. Clearly, in the case of transferring stock options to employees for services the value of the services received is much easier to reliably measure than the fair value of an option grant. Given that an option grant does not increase the value of an employee's services and it is a non-monetary equity transaction designed to align employee and shareholder interests, stock option grants to employees should not be treated as an expense.

Option grants do not adversely impact a company's cash position. A complete set of financial statements includes a balance sheet, income statement and statement of cash flows. Because these statements are integrated analyses of a company's financial condition and results of operations, virtually all items that flow through an income statement involve the receipt or the outlay of cash at some point in time. However, an option grant does not involve the outlay of cash. In fact, an option grant involves a cash receipt when the option is exercised. This cash transaction is recorded in equity, as are most transactions involving company stock. Thus, charging the income statement with an expense that never uses cash in effect creates an inconsistency in the basis of presentation within the basic financial statements.

Existing option pricing models are not adequate. There is no market for trading employee options because they are not transferable. Thus, anyone wishing to value an option must use a valuation model. However, such models do not consider the unique characteristics of employee options, such as their non-transferability and vesting provisions. These characteristics significantly impact the value of an employee option and can not be quantified using existing models. In addition, all other things being equal, the valuation of a stock option for a company with a volatile stock price history will be higher than the valuation of an option in a company which has shown slow but consistently steady improvement in its stock price over the same period. However, in reality, most employees would consider the option in the steady performer more valuable than the option in the volatile company.

Existing FAS 123 guidelines permit a wide range of valuation techniques. Setting aside the inadequacies of existing models to value employee options, and assuming the use of one model was mandated (e.g. Black/Scholes), valuations from one company to the next could still vary significantly simply because of the judgment involved in selected inputs to the model. The historical time periods used to predict future stock price volatility or option lives could differ based solely on an individual's judgment of which period might be better in predicting future results. This not only makes valuations subject to honest differences in judgments, but offers a tremendous amount of latitude to those companies whose goal it is to justify the use of inputs that result in the lowest valuation. This weakness in the valuation process will invariably lead to less comparability between financial statements of companies, even within the same industry.

Summary and Conclusion

The investment community relies as much, or possibly more, on the income statement than any other financial statement or analytical model. Therefore, we have tremendous responsibility to continue to improve the accuracy and comparability of the income statement for the benefit of the users of the basic financial statements. An income statement which overvalues the cost of employee services, can be materially changed based on different predictions of stock price volatility or stock option lives, includes material expense transactions that never involve a cash outlay, and which is not comparable between companies in the same industry, is significantly less useful to investors. Stock option grants to employees are not expenses for income statement purposes.

The Board should retain the intrinsic value method currently allowed by FAS 123 for income statement preparation and continue to address fair value considerations in footnote disclosures. This way, the value of the income statement to an investor will not be diminished, and those users who are also interested in the impact of fair-value based accounting for stock options can readily find the information they need.

We thank you for considering our views.

Sincerely,

JOSEPH R. CARRILLO

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