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Letter of Comment No: 5053
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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

File Reference No. 1102-100

Dear Ms. Bielstein:

We would like to take this opportunity to comment on the Proposed Statement of Financial Accounting Standards, "Share-Based Payment: an amendment of FASB Statements No. 123 and 95." Emerson adopted the fair value provisions of FAS 123 on October 1, 2002, and while we fully support expensing awards under FAS 123, we do not believe a complete reexamination of FAS 123 is necessary. Rather the ability to account for awards using APB No. 25 should simply be eliminated. Fundamentally, we do not believe that the other proposed changes improve the transparency or the accuracy of financial reporting. However, if the Board proceeds with the other proposed changes, the following are our key comments:

- Expand definition of performance condition, it is defined too narrowly
- Do not require the lattice model nor consider it preferable
- Attribute compensation cost for all awards on a straight-line basis
- Consistently record excess and shortfall tax benefits in equity
- Consistently report all income tax benefits in operating cash flows
- Reduce existing and proposed disclosures to a handful of items that provide meaningful information, not extraneous data
- Allow companies that previously adopted FAS 123 to continue prospective method transition

Our specific concerns with certain aspects of the proposed amendments are set forth below.

Performance Condition

The Exposure Draft's definition of performance condition too narrowly defines what should be treated as an equity award. We believe that all awards with a performance target based on the operations (or activities) of the company should be treated the same, regardless of what that target is measured against or referenced to.

For example, a company may set a target for earnings per share or a target growth rate that must be achieved over a specified time period, while other companies may require EPS growth to exceed that of another entity or group of entities. Alternatively, a company may set a target that requires achieving an EPS growth that exceeds a certain external measure, such as the growth of the U.S. gross national product. In this last case, the company's board of directors believes that the company's target EPS growth rate should be a factor greater than the growth rate of GNP; thereby, rewarding management only if the company achieves an EPS growth rate that exceeds the growth rate of the general economy. In all of these cases, the condition is tied to the operations of the company. However, the Exposure Draft's current definition of performance condition would require the awards in the first two cases be accounted for as equity awards, while the award in the last case would be treated as a liability. We did not find an explanation in the Exposure Draft, and do not believe there is a theoretical difference, as to why all these awards should not be treated the same.

We disagree with this inconsistency in the proposed standard, and believe the definition of performance condition should be more broadly defined in the final rule so that all awards with performance conditions based on a company's operations (or activities) would be accounted for as equity awards. The definition of performance condition on pages 177 and 178 of the Exposure Draft should be broadened by deleting the word "solely" within item (b), and expanding the examples to include "reference to another entity, group of entities or other factors." The language in this section should also be revised to indicate that a performance condition may be defined by reference to the same or other reasonable factors of another entity, group of entities or other measures so that the examples illustrated above would all have equity classification.

Fair Value Measurement

The Board states in the Exposure Draft that the use of a lattice model, such as the binomial, is preferable to a closed-form model, such as the Black-Scholes formula, which is currently the most widely recognized and accepted model for valuing employee stock awards. We are concerned that paragraphs B10 and B11 require a company to justify why it is not using a lattice model and is instead using a closed-form model, thereby, effectively requiring use of a lattice model. Such a requirement will result in companies incurring significant costs for new systems and to hire consultants to monitor and generate the data for assumptions in the binomial model. Reputable firms offering services in this area for fees in the six-digit range have already approached us. Although each model has its pros and cons, neither is a perfect solution for valuing employee stock options since they cannot take into account the non-transferability of the award. Because of this, and because most inputs for the models are estimates, any fair value calculation will only be able to provide an estimate of an award's value. For most companies, the different models will not result in materially different estimates of fair value for awards.

We have seen analyses from various valuation experts that the binomial model results in higher values, while other experts have shown that the binomial model results in lower values. A higher value from the Black-Scholes formula is often due to companies using the option's contractual term versus the expected life of the option. Any value from either model is dependant upon the accuracy of the assumption inputs. The binomial model will yield essentially the same value as the Black-Scholes formula if the same 5 assumptions are used for a non-dividend paying stock. While high dividend stocks and high volatility stocks might have larger differences in value, these differences would primarily be due to a lack of rigorous analysis of the assumptions used rather than one model being inherently superior. Since the difference in value between these models is not significant (generally ranging from 0%-10% in the analyses we have seen), the final standard should not state a preference

for, or require the use of, any specific method for calculating the fair value of awards. The time, effort and expense involved to purchase or develop new systems and to hire consultants necessary to implement a binomial model will far outweigh any benefits from its use, especially since its value is not necessarily more precise than that of any other model. We recommend that the Board clarify the language in paragraphs B10 and B11 to make it clear that companies have the choice of which valuation model to use based on the costs and benefits of each given their unique circumstances and materiality of share-based awards.

Attribution of Compensation Cost

We disagree with the Exposure Draft's proposal to require awards with graded vesting features to be valued as separate awards for each vesting tranche such that the compensation expense is heavily weighted towards the earlier periods. For example, an award with graded vesting equally over three years would have 61% of the cost expensed in the first year, 28% of the cost expensed in the second year and 11% expensed in the third year. Conceptually, we believe that the recognition of compensation costs associated with share-based awards should coincide with the weighted-average expected life of the option (for example, five years), regardless of the awards' vesting patterns. Furthermore, a straight-line method for all share-based awards provides the most systematic and rational basis for reflecting the compensation cost and the economic benefit received from the employee. Since the employee's service period and exercise habits are likely to be the same regardless of whether the arrangement contains graded or cliff vesting provisions, the attribution periods should also be the same. We believe the Exposure Draft's requirement to weight the compensation for an award with graded vesting to earlier periods is inappropriate, and recommend that, at a minimum, the compensation should be recognized ratably over the total vesting period (for example, three years) as currently permitted by FAS 123. Further, the time and costs necessary to identify and track separate fair values, as well as tax effects associated with each tranche of an award, will far outweigh any perceived benefits and should not be required.

Income Taxes

The proposed accounting treatment of tax effects is more complicated than the existing accounting under FAS 123 and is inconsistent with the Board's characterization of share-based awards as containing both compensation and equity transaction elements. The Board concluded in paragraph C129 that granting share-based awards is a transaction resulting in compensation expense, while the recipient's holding or exercising of the award is an equity transaction. We agree with the Board's conclusion for recognizing excess tax benefits in equity, and believe that tax benefit shortfalls should be recognized in a consistent manner. Accordingly, all tax benefit differences resulting from changes in the share price, whether an excess or shortfall as compared to the original deferred tax asset, should be treated similarly with recognition in equity.

Furthermore, we do not believe that the benefits of performing a tax accounting "true-up" on an individual award basis can justify the extensive costs that will be incurred in order to comply with these requirements. A significant amount of effort and resources would be required to build and maintain systems capable of tracking the tax and cash flow (see following comment) impacts on an individual award basis. Performing a true-up for the portfolio in its entirety will be significantly more efficient from a cost-benefit perspective, and is more in line with the valuation and grant date tax accounting that is permitted on a portfolio basis under FAS 123.

Cash Flows

We disagree with the Exposure Draft's proposal to require excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid. Classification outside of operating activities is inconsistent with FAS 95, *Statement of Cash Flows*. We do not support an amendment to FAS 95, and believe that classification within operating cash flows is similar to other "inconsistencies" in FAS 95, such as income taxes paid on divestiture gains being reported in operating cash flows while proceeds received from the sale are reported in investing cash flows. We agree with the Board's previous conclusion in FAS 95 that the complexities involved with allocating income taxes between operating, investing and financing cash flows would not justify the costs, and believe that all income tax effects should be classified as operating cash flows. This is particularly true for this proposed standard because the accounting for the awards is so complex. Further, we conceptually do not believe the cash flow statement should be "grossed up" for non-cash items. If the final standard retains the proposed amendment to FAS 95, the Board must also address the other inconsistencies that currently exist in FAS 95.

Disclosures

Despite requiring compensation costs associated with share-based payment awards to be recognized within the income statement, the proposed standard's disclosure requirements are unnecessarily lengthy and more extensive than the current requirements of FAS 123. The proposed standard requires over 40 additional data points be disclosed beyond the existing disclosure requirements including: 1) the number and weighted average grant-date fair value for nonvested shares as of the beginning and end of the most recent year, granted during the year, vested during the year and forfeited during the year; 2) the total intrinsic value of options exercised and the total intrinsic value of shares vested during each year an income statement is presented; 3) the aggregate intrinsic value of options fully vested, options expected to vest and options currently exercisable as of the latest balance sheet date; 4) the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized as of the latest balance sheet date; 5) the amount of cash received from the exercise of options and similar instruments, 6) the amount of excess tax benefits recognized in equity; 7) the amount of cash used to settle equity instruments granted; 8) a description of the company's policy, if any, for issuing shares upon option exercise, including the source of those shares; and 9) if the company expects to repurchase shares in the following year as a result of its policy, the expected amount of shares to be repurchased. The purpose of financial statements and disclosures are not, and should not be, to provide the user with the details to replicate and "prove out" that the accounting was done correctly. No other area of accounting requires such detailed disclosures.

We believe that the proposed standard itself is overly complex, and that if all the proposed disclosures are necessary for a full understanding of option accounting, then the rules need to be simplified. Moreover, we do not believe that the proposed Minimum Required Disclosures are necessary, and most go beyond the Board's objectives stated in paragraphs 46 and 47 of Appendix A. Most of these disclosures will not be useful to financial statement users once all companies are required to recognize compensation costs in the income statement. The volume and complexity of the proposed disclosures will only clutter the financial statements and make it difficult for readers to identify the important information. The Board should determine what information is truly necessary, rather than convenient for users, and eliminate the remainder of the proposed disclosures. In addition, if the requirements i. and j. of paragraph B191 of the Exposure Draft are retained, the final standard should clarify for which period or periods of time these disclosures are required.

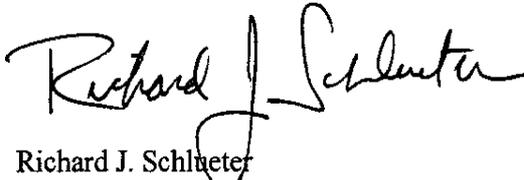
Transition

We strongly believe companies that have previously voluntarily adopted the provisions of FAS 123 using the prospective method should be allowed to continue to apply that approach, for all awards granted and outstanding prior to issuance of the revised standard, under the existing FAS 123 accounting including measurement of fair value, attribution of compensation expense, and classification as equity or a liability. The burden to companies already following the accounting requirements of FAS 123 to "readopt" under the revised standard will be onerous and complex, at the very least. Further, no accounting inconsistencies would exist between awards expensed under the current FAS 123 and awards expensed under a revised FAS 123 if the final standard merely eliminated the ability to account for awards using APB 25 without the other proposed changes.

If the Board retains the proposed transition rules in the final standard, paragraph 23 should be amended to have symmetrical accounting for cases where an instrument that was classified as equity but is now classified as a liability had previously recognized compensation cost that exceeds the estimated fair value of the liability. This excess amount should be reversed through the income statement, net of tax effects, consistent with the Exposure Draft's treatment when the fair value of the liability exceeds previously recognized compensation cost.

In conclusion, we believe the Board should keep it simple and merely require all companies to adopt the existing fair value provisions of FAS 123. We appreciate the opportunity to respond to the Board's Proposed Statement and trust that our comments will be seriously considered in future Board deliberations on this issue.

Sincerely,



Richard J. Schluter
Vice President & Chief Accounting Officer

Cc: Walter J. Galvin
Executive Vice President & Chief Financial Officer