

Harvey L. Wagner
Vice President, Controller
and Chief Accounting Officer330-384-5296
Fax: 330-384-5299

June 24, 2004

Letter of Comment No: 487
File Reference: 1102-100

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

File Reference No: 1102-100

Dear Ms. Bielstein:

FirstEnergy appreciates the opportunity to respond to the Financial Accounting Standards Board's Exposure Draft of a Proposed Statement of Financial Accounting Standards, "Share-Based Payment" (ED).

FirstEnergy is a diversified energy services holding company with \$33 billion of assets and \$12 billion in annual revenues. Our electric utility operating companies comprise the nation's fifth largest electric system, serving 4.3 million electric customers in Ohio, Pennsylvania and New Jersey. We operate 16 power plants that produce more than 13,000 megawatts of electricity. In addition, the Company has some 135,000 miles of transmission and distribution lines, and 103 interconnections with 14 regional electric systems. Annually, FirstEnergy sells approximately 123 billion kilowatt-hours of electricity.

We support the Board's proposals in most respects and comment on the issues below where our conclusions differ from those proposed.

Issue 4(b): Do you agree with the Board's conclusion that the fair value of employee share options can be measured with sufficient reliability? If not, why not? Do you agree with the Board's conclusion that a lattice model is preferable because it offers greater flexibility needed to reflect the unique characteristics of employee share options? If not, why not?

While the FASB believes that it is more appropriate to reflect the fair value of employee stock options as compensation expense in the financial statements, we have had serious reservations regarding the reliability of methods for determining fair value primarily due to the lack of marketability and transferability associated with employee stock options. We agree that, when practicable, a lattice model is preferable because it has the flexibility to incorporate changes in assumptions over the term of the option.

However, there has not been adequate testing of the model to provide any evidence that the resulting fair value estimates are in fact more reliable than those from other models.

While use of the lattice model may not be explicitly required, certain language in the ED suggests that it must be used. We recommend that the FASB clarify that use of the binomial model is not required and allow for a company to select a model that is best suited to its unique circumstances.

Issue 9: For the reasons described in paragraphs C89-C91, the Board concluded that this proposed Statement would require a single method of accruing compensation cost for awards with a graded vesting schedule. This proposed Statement considers an award with a graded vesting schedule to be in substance separate awards, each with a different fair value measurement and requisite service period, and would require that they be accounted for separately. That treatment results in a recognition pattern that attributes more compensation cost to early portions of the combined vesting period of an award and less compensation cost to later portions. Do you agree with that accounting treatment? If not, why not?

We understand the argument for distinguishing between options with graded vesting and those with cliff vesting for purposes of valuing the options. However, we believe that the fair value of stock option grants, whether awarded with cliff vesting or graded vesting, should be recognized ratably over the vesting period since the employees' services are rendered uniformly over that period.

Issue 11: Do you agree with the method of accounting for income taxes established by this proposed Statement? If not, what method (including the method established in IFRS 2) do you prefer, and why?

We agree that a deferred tax asset should be recognized for the income tax effect of the compensation expense recorded for financial reporting purposes. However, we do not support the ED's inconsistent treatment in accounting for excess tax benefits and deficiencies that arise from differences in the cumulative charge to earnings and the amount that is ultimately deductible.

We recognize that employee share-based payment transactions consist of two components - consideration for services rendered and an equity transaction. The tax benefit recognized in the income statement should be based on the compensation expense recognized in the income statement. Any excess tax benefit or deficiency that arises when an option is ultimately exercised should be recognized as an adjustment to paid-in capital since the exercise represents an equity transaction. In addition, the requirement to separately track deferred tax assets associated with each individual grant imposes a significant administrative burden and is inconsistent with the portfolio approach used for the grant date valuation and to record the deferred tax asset.

Issue 12: Because compensation cost would be recognized for share-based compensation transactions, the Board concluded that it was appropriate to reconsider

and modify the information required to be disclosed for such transactions. The Board also decided to frame the disclosure requirements of this proposed Statement in terms of disclosure objectives (paragraph 46 of Appendix A). Those objectives are supplemented by related implementation guidance describing the minimum disclosures required to meet those objectives (paragraphs B191-B193). Do you believe that the disclosure objectives set forth in this proposed Statement are appropriate and complete? If not, what would you change and why? Do you believe that the minimum required disclosures are sufficient to meet those disclosure objectives? If not, what additional disclosures should be required? Please provide an example of any additional disclosure you would suggest.

We do not believe that the disclosure objectives as proposed in paragraph 46 of Appendix A should be supplemented with implementation guidance in the form of Minimum Required Disclosures (paragraph B191 - B193). The extensive disclosure requirements would be overly burdensome and unnecessary for an expense that is recognized in the financial statements.

Issue 13: This proposed Statement would require the modified prospective method of transition for public companies and would not permit retrospective application (paragraphs 20 and 21). The Board's rationale for that decision is discussed in paragraphs C157-C162. Do you agree with the transition provisions of this proposed Statement? If not, why not? Do you believe that entities should be permitted to elect retrospective application upon adoption of this proposed Statement? If so, why?

We believe that companies should be allowed to restate prior period earnings with either a full retroactive transition using the lattice model or with a modified retroactive approach by recording the amounts that they previously disclosed in accordance with the requirements of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Comparability between periods would be enhanced with a retroactive restatement.

Issue 16: For the reasons discussed in paragraphs C139-C143 the Board decided that this proposed Statement would amend FASB Statement No. 95, *Statement of Cash Flows*, to require that excess tax benefits, as defined by this proposed Statement, be reported as a financing cash inflow rather than as a reduction of taxes paid (paragraphs 17-19). Do you agree with reflecting those excess tax benefits as financing cash inflows? If not, why not?

We do not believe that the Board should amend FASB Statement No. 95, *Statement of Cash Flows*, to apply a specific treatment of excess tax benefits related to share-based payments. While we recognize that employee share-based payment transactions consist of two components - compensation expense and an equity transaction - we believe that the associated tax benefits should be reported as operating cash flows consistent with tax benefits associated with other financing or investing activities. The Board should retain and consistently apply to share-based payments their own rationale that "allocation of income taxes paid to operating, investing, and financing

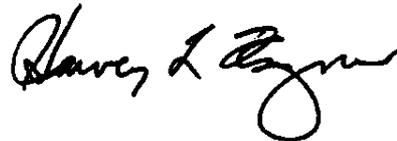
activities would be so complex and arbitrary that the benefits, if any, would not justify the costs involved."

Effective Date

With a proposed release of the final standard in the fourth quarter of 2004 and the proposed effective date of January 1, 2005 for calendar year end public companies, we believe there will not be sufficient time to adequately implement the standard with all the complexities proposed in the ED. We therefore encourage the FASB to either defer the effective date or change the requirements as discussed above to eliminate the need for extensive systems modification.

Thank you for considering our views.

Sincerely,

A handwritten signature in cursive script, appearing to read "Harvey L. Berger".

HLW:cer