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Letter of Comment No: 5739
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Sent Via E-Mail: director@fasb.org

June 30, 2004

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

Re: File Reference No. 1102-100

Dear Ms. Bielstein:

We have reviewed the Financial Accounting Standards Board's (FASB) Exposure Draft (ED) of the Proposed Statement of Financial Accounting Standards, *Share-Based Payment - an amendment of FASB Statements No. 123 and 95*, and appreciate the opportunity to present our views.

Recognition of Compensation Cost / Measurement Attribute and Measurement Date

We agree that there is a cost associated with share-based payments, including employee stock options. However, we do not agree with the FASB's position that the cost should be recorded on the income statement because we do not believe that current valuation models produce a cost that is reliable. Valuation at grant date under any valuation model is merely an estimate of what the expense will be. The only thing we know for sure is that the expense produced by these models will ultimately be wrong and the proposed accounting model does not allow any adjustment or true-up to what the actual expense will be.

We believe that the cost associated with employee stock options is already appropriately accounted for under the intrinsic value method of APB Opinion No. 25, *Accounting for Stock Issued to Employees (APB 25)* and by the dilution of earnings per share experienced by shareholders. As a result, we ask that the FASB reconsider the use of the intrinsic value method to measure expense related to employee stock options. We could also accept the following "variations" on the intrinsic value method:

- Over the vesting period, reflect the intrinsic value at the date options vest in the income statement. We believe that an option has two phases; the vesting period where the employer is benefitting from an employee's service and the subsequent equity transaction between the employee and the company that

happens at some point thereafter assuming the option stays in the money. The true expense that accrues while the employee is required to work would be reflected in the income statement.

- Reflect the intrinsic value over the life of the option in comprehensive income.

Fair Value Measurement

We do not support the FASB's view that fair value of employee stock options can be reliably measured. Unlike other assets and liabilities that are measured at fair value, the majority of employee stock options do not have a true or comparable fair value. While models (e.g., the Black-Scholes-Merton formula or lattice/binomial models) may be used to determine the "value" of stock options, such value does not represent fair value from the perspective of a company and employee as counter parties. Further, stock option valuation models such as the lattice model preferred by the FASB are complex requiring significant amounts of data and, given the fact that so few lattice models exist today to value employee stock options, represent subjective evidence of fair value. In this regard, we do not understand how a fair value measurement that does not accurately reflect the actual expense incurred by a company achieves three of the proposed ED's objectives: (1) addressing concerns of users and others that the intrinsic value does not represent the economic transactions of employee stock options, (2) improving the comparability of reported financial information through the elimination of alternative accounting methods, and (3) simplifying U.S. GAAP.

We believe the proposed lattice-based binomial fair value methodology does not meet the FASB's objectives of establishing a stock option accounting model that is reasonable, transparent and understandable and reflecting the real economic values or costs of stock option compensation, which would be fair across industry sectors. The basis for our position follows:

- The lattice or binomial models will produce valuations in excess of the actual value of employee stock options, which have significant restrictions and features not present in freely tradable, short-term options for which the lattice-based binomial model was designed. As such, implementation of the standard could lead to a bias against stock-based compensation programs instead of putting them on a level field with other arrangements.
- Since the binomial model requires companies to make numerous assumptions, the resulting valuations would reflect varying assumptions, even within the same industry, causing a lack of financial comparability of stock option expense among companies. This complexity and subjectivity of assumptions is directly opposed to the FASB's objective of achieving greater transparency and understandability of financial information.
- There is not a broad experience with or testing of the accuracy of the proposed binomial model, which will be significantly more complex and expensive to develop and maintain than current Black-Scholes-Merton pricing models currently used by companies.

Income Taxes

We support the ED's approach whereby a deferred tax asset is recognized based upon the compensation expense recorded for financial reporting purposes and then is not adjusted until the award is settled. However, we do not agree with the FASB's proposal

that upon an option exercise whereby the earnings charge exceeds the amount ultimately deductible, the resulting incremental charge is recorded as expense rather than an adjustment to additional paid-in capital. We believe any excess tax deduction or shortfall resulting from the settlement of share-based payment be recognized as an adjustment to additional paid-in capital. This approach ensures consistent treatment of tax-related effects of the settlement of share-based payment, which we believe is an equity-based transaction between companies and shareholders rather than an expense. Further, for reasons outlined below, this would not require companies to account for the separate deferred tax attributes of share-based payments on an employee-by-employee basis.

We also believe the FASB should adopt a portfolio approach to tracking and accounting for the benefits realized upon exercise or settlement of share-based payments, as opposed to the individual employee approach in the Exposure Draft. We believe the ED's approach of accounting for income taxes by individual employee (and thus exercise date) is inconsistent with how the share-based payment is accounted for at grant date. In addition, in order to record share-based payments by individual employee and related settlement date, companies will need to create an accounting system to track share-based payment data on a grant-by-grant and employee-by-employee basis. In light of complex and continuously changing legislative and regulatory rules impacting individual employees (who may be transferred from one country to another), such accounting systems would require substantial ongoing maintenance and upkeep to track related deferred tax asset attributes of employee share-based payments. Such an individual-based income tax model does not promote improved transparency, reliability and simplification of U.S. GAAP.

Other Comment Areas and Recommendations

Should the FASB continue to support the fair value method for share-based compensation, we offer the following additional comments and recommendations:

1. **Reloads** - We are concerned with the ED's proposed accounting for "reload" options. Although we agree that a reload provision in an option increases its value, we believe that the reload provision should be included in the initial fair value estimate of the host instrument. We believe this feature can be built into an open-ended valuation model, with the likely triggering behavior of the reload provision based in part on the company's past experience. Our position is based primarily on the fact that, unlike other modification events in which a company uses its discretion to contemporaneously effect a change, a reload provision is a contractual provision built into the option itself. Further, the exercise of a reload relates to an action taken by the employee and not the exchange of a new instrument by the employer for additional services. Thus, it should not trigger additional compensation expense at the date of exercise.

We also believe that the FASB's proposal on reloads adds significant complexity and cost. First, systems must be developed to track each single reload option. Second, due to the frequency and wide dispersion of grant dates of reload options, valuation experts have told us that companies with reload options will be required to do valuations as frequently as weekly, adding undue cost and complexity. Finally, the expense of reload options will add undue volatility to stock option expense.

2. **Reporting Share-Based Compensation Expense** - We recommend that the FASB require companies to record share-based compensation expense as such as a

single component in the income statement. Given the unique nature of share-based compensation (i.e., how such cost is measured, the fact that it is noncash, and it may never result in the use of a company's resources or assets if stock options are not exercised), a one-line item presentation outside of operating margin would promote transparency and address concerns regarding the benefits of users of financial information.

3. Expiration of Worthless Options - The standard is based on the premise that the awarding of stock options to employees in exchange for services is compensation to the employee. Paragraph C13 of the Exposure Draft states "that compensation cost should be recognized for employee services received in exchange for valuable equity instruments." We agree with the premise behind this statement for equity instruments which transfer value to the employee at the vesting date, and agree that after vesting, the risk and benefit, as per paragraph C20, belong to the employee. Paragraph C20 also states that "after an employee share option vests, the employer has benefited from the services received." The contract, however, is between two parties - both the employer and the employee. If the option is underwater at vesting, and stays underwater until the end of the contractual life, the employee has not benefited from the services he/she rendered, and thus, compensation has not been provided to the employee. In this situation, the employee does not receive anything of value (as per paragraph C13) for services rendered. In this case, we feel strongly that compensation expense recorded for these options should be reversed at the end of the contractual life of the option. Just as the expense is reversed when the employee does not fulfill his part of the contract (the service period), we feel the expense should be reversed should the company not fulfill its part of the contract (providing valuable equity instruments, or compensation to the employee).

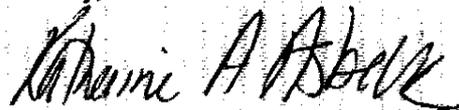
4. Effective Date - We believe the proposed effective date should be delayed by one year. The proposed standard is complex and will be difficult to implement. Companies are already spending significant resources in 2004 focused on the implementation of Sarbanes-Oxley Act provisions and the Securities and Exchange Commission's accelerated filing requirements. In addition, the share-based payments standard would also require company resources beyond the accounting function. Examples of additional steps required as a result of the issuance of the standard follow:
 - Considerations relative to changes in overall plan designs, including reviewing impacts through compensation committees of Boards of Directors,
 - Designing and educating management on choices that must be made relative to how the impacts of share-based payments will be budgeted, reflected in internal management reporting and allocated to business units,
 - Developing or hiring an outside consultant to perform the binomial valuation. This is a very intensive exercise, including reviewing and understanding significant amounts of employee exercise history and stock volatility assumptions. We believe that a number of firms are "scrambling" to get valuation models in place and we believe there will be limited resources to help companies with valuation as year end approaches.
 - The need to educate companies' investors on the impacts of expensing the awards, including providing updated earnings guidance. Most companies give guidance for the first quarter at or near year end, requiring CFO's to have a very clear picture of what this means to each company before year end, and
 - The need to address Sarbanes Oxley Section 404 impacts for the execution and accounting for share-based payments.

Given the above issues and the expected timing of the issuance of a final standard late this year, we believe a required implementation date beginning in January 2005 will be very difficult operationally for companies to achieve. Further, as we have seen from other recently issued standards with short implementation periods (e.g., FASB Interpretation No. 46 and SFAS No. 150), significant implementation issues will arise after the issuance of a final standard as companies begin to fully engage on adoption plans. Given the other priorities companies currently are faced with, it is not realistic to assume they will begin full scale implementation based on proposed rules that are at risk of changing. We do not believe the short implementation period provided for in the ED will provide a sufficient amount of time for such issues to be adequately surfaced and resolved.

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Thank you for the opportunity to comment on this ED. If you would like to discuss any of these comments further, please call me at (607) 974-8242.

Sincerely,



Katherine A. Asbeck
Senior Vice President and Controller