

Letter of Comment No: 5861
File Reference: 1102-100

New York State Bar Association
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Business Law Section
Committee on Securities Regulation

June 30, 2004

By email: director@fasb.org

Director of Major Projects -- File Reference No. 1102-100
Ms. Suzanne Q. Bielstein
Financial Accounting Standards Board of the Financial Accounting Foundation
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Re: File Reference No. 1102-100
Exposure Draft: Proposed Statement of Financial Accounting Standards --
Share-Based Payment, an amendment of FASB Statements No. 123 and 95

Dear Ms. Bielstein:

The Committee on Securities Regulation (the "Committee") of the Business Law Section of the New York State Bar Association appreciates the Board's invitation in the Exposure Draft (the "ED") to comment on the proposed Statement of Financial Accounting Standards, Share-Based Payment, an amendment of FASB Statements No. 123 and 95 (the "Proposal"), which addresses the accounting for transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The Proposal would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method.

The Committee is composed of members of the New York Bar, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and in corporation law departments. A draft of this letter was reviewed by certain members of the Committee, and the views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, are those of the Committee and do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association, or its Business Law Section.

Our comments to certain issues raised in the ED by the Board:

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 believe that the Board should consider permitting, and revise paragraph B193 to expressly authorize, an entity to disclose in its financial statement footnotes for each year for which an income statement is provided the pro forma net income and, if earnings per share is presented, pro forma earnings per share, as if the fair-value-based accounting method in this proposed Statement had not been used to account for stock based compensation cost (i.e., pro forma for APB Opinion No. 25 accounting treatment). The issue of recognizing compensation cost for employee services received in exchange for equity instruments is debated heatedly. We believe that expressly permitting entities to include this supplemental information, if they choose, will be helpful to the entities and the users of their financial statements.

Furthermore, permitting such pro-forma information is different than the issue of disclosure versus recognition for which the Board determined that pro-forma disclosure as if the fair-value-based method of accounting had been used would not be an appropriate substitute for recognition of compensation costs in the financial statements. Here, compensation costs would, of course, be recognized in the financial statements, and the pro-forma information would merely be supplemental information. We are not aware of any valid reason not to permit such pro-forma information and, in fact, believe that users of financial statements would benefit from the additional pro-forma information. At the least the Board should expressly permit entities to include this supplemental information for several years following the adoption of the Proposed Statement so that users of financial statements can better compare periods, particularly if retrospective application is not permitted or impracticable (see Issue 13).

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 the Board should reconsider its conclusion that the modified prospective method should be the only method of transition for public companies. In particular, we believe that entities should be permitted to elect some form of retrospective application upon adoption of the proposed Statement. The Board stated in paragraph C159 that if retrospective application with restatement was practicable, the Board believed it would be the best transition method “because it would provide the maximum amount of comparability between periods and thus enhance the usefulness of comparative financial statements.” We have considered the Board’s rationale for not permitting retrospective application (that is impracticable because it could require an entity to make estimates as of a prior period), but we believe that allowing at least a “modified retroactive” method can overcome some of those concerns. Essentially, this method would permit entities to restate previously issued financial statements, if they so choose, by recording amounts on a basis consistent with the pro forma disclosures previously made in accordance with the requirements of FASB Statement No. 123.

We also believe the Board should reconsider its conclusion to mandate the modified prospective method in light of the fact that a number of companies in the past couple of years have voluntarily adopted the “preferred” fair-value-based method of accounting for options using the prospective method under FASB Statement No. 148. It seems to us that requiring these companies to re-adopt the fair value method using a different transition method (modified prospective) appears unfair, particularly because there appears to have been a reasonable expectation by these companies that the prospective method would not be reversed by the Board. Accordingly, we believe that the Board should consider permitting companies that have voluntarily chosen to expense stock options using the prospective method to continue to do so, if they so choose, rather than re-adopt using the modified prospective method.

Our comment on an issue not raised in the ED by the Board:

Safe Harbor for Forward-Looking Statements

We believe the Board should recommend to the U.S. Securities and Exchange Commission (“SEC”) that the SEC adopt rules extending the safe harbor for forward looking statements to the disclosures made by entities in financial statements and accompanying notes in compliance with proposed FASB Statement No. 123(R). Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 provide a safe harbor to certain public companies for certain forward-looking statements. Excluded from such safe harbor is any forward-looking statement included in a financial statement prepared in accordance with general accepted accounting principles. Although the statutory safe harbor may not extend today to forward-looking statements included in pro forma information disclosed in accordance with FASB Statement No. 123, we believe that it would be appropriate at this time, in connection with 123(R), that the financial statement exclusion be lifted. In general, the ED suggests valuation techniques that are more complicated and require more estimates and assumptions than those generally used today in recording or disclosing compensation costs. These techniques can be expected to require entities to make additional disclosures, including expected dividends and expected volatility (which are supposed to reflect judgments

concerning the future). Entities may also desire to disclose supplemental information permitted by paragraph B193 that may constitute forward-looking statements. The statutes grant the SEC authority to provide exemptions, and we recommend that the Board take this opportunity to request the SEC to provide such exemption. In this regard, we are copying SEC officials on this letter.

Non-GAAP Financial Measures

We believe the Board should recommend to the SEC that the SEC staff provide clarifying guidance to the effect that pro forma disclosures (as we have suggested above in response to Issue 12) made by entities in notes accompanying financial statements in compliance with proposed FASB Statement No. 123(R) not be considered “non-GAAP financial measures” as such term is defined in the SEC’s Regulation G and Item 10(e) of Regulation S-K. Item 10(e) of Regulation S-K prohibits in filings with the SEC the use of non-GAAP financial measures in financial statements or the notes thereto, and Regulation G requires a reconciliation to the most directly comparable financial measure calculated in accordance with GAAP. However, excluded from the definition of non-GAAP financial measures are financial measures required to be disclosed or expressly permitted by GAAP.

Effective Date

We believe that the proposed effective date should be delayed. In general, public companies have been devoting a significant amount of resources reviewing, evaluating, revising and documenting their internal controls towards assuring compliance at the end of this year with Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations implementing such section. We believe that with the expected timing of the issuance of a final FASB Statement No. 123(R) not until late this year, public companies could find its implementation difficult by the Board’s proposed effective date.

We hope the Board and its staff find these comments and suggestions helpful. We would be happy to meet with the staff to discuss these matters further.

Respectfully submitted,

COMMITTEE ON SECURITIES
REGULATION

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