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Director of Major Projects
Financial Accounting Standards Board
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Via email

## Invitation to Comment on Exposure Draft Proposed Statement of Financial Accounting Standards "Share-Based Payment"

We appreciate the opportunity to respond to the Exposure Draft of Proposed FASB Statement of Financial Accounting Standards "Share-Based Payment" (ED). We rank among the largest providers of telecommunications services in the United States and the world. We provide communications services and products in the United States and have significant international investments. We are a Fortune 30 company, with approximately 3.3 billion shares outstanding and employing approximately 169,000 people as of December 31, 2003.

We believe that users of financial statements would benefit from consistent application of accounting methodology to the question of share-based payments, but disagree with the definition of fair value included in the ED. It is a long held precept, both economically and in accounting, that the best measure of fair value is market value. This is easily understood by both sophisticated and, especially, common readers of financial statements. Accordingly, we believe that share-based payments that do not have an actual market value at the time they are granted, specifically employee stock options, should be marked to market similar to the treatment given liabilities in the ED.

We adopted the fair value expensing methodology under FASB Statement No. 123, Accounting for Stock-Based Compensation (FAS 123), as amended by FAS 148, Accounting for Stock-Based Compensation – Transition and Disclosure (FAS 148) in December 2002. In adopting it, we elected the retroactive application approach and, therefore have the equivalent experience of applying the fair value method for more than four years of reported financial statements (2000 to the present). This experience leads us to conclude that the practice of using a model to provide a point in time estimate of future value as the basis for accounting for certain types of share based payments, specifically stock options, does not fairly represent the economics of these transactions.

Fair value accounting for stock options under FAS 123, as well as the proposed treatment under the ED, is unique in accounting in that it represents an estimate that is never trued up to actual economics. All other accounting estimates are eventually recorded at their actual economic impact. The truism about the fair value estimate of stock option value is that it is a rare and unusual combination of circumstances that produces an actual economic value to the employee that is the same as the amount recorded in the financial statements. In virtually every case, the actual economic benefit the employee realizes is either greater, maybe significantly greater, or less than the model-generated fair value. The employee may not realize any value at all.

However, fair value accounting under both FAS 123 and the ED does not consider how inaccurate the estimate is compared to actual economics; it is never changed.

For share-based payments such as restricted (i.e., non-vested) stock, this is not the case. For restricted stock, the market value of the stock on the date of grant does have an economic basis to the employee. Although unable to trade the stock, the employee could, at their choice, monetize the stock with a put timed to coincide with the vesting period. Additionally, the physical stock shares, or book-entry notices, have actually been given to the employee. Thus grant date accounting is logical for these types of awards.

Consider that in a situation where a company or individual is considering purchasing most or even 100% of a target company. In their valuation of the company, they want to know what the value of the employee stock options are at the target price. They have no interest in what the original fair value of the options are, nor do they care what an implied repricing of the options would yield in a model. They simply want to know how much in the money the options are and build this into their models as a cost of acquiring the company. On a reduced scale, an individual investor looking to purchase as little as one share of stock is doing the same thing as the larger acquirer—they are buying part of the company. It is only logical that those individual investors really care more about the actual value of the options at a given time rather than an estimate of eventual value dating from when the options were granted.

In the section "Reasons for Issuing This Proposed Statement," the ED lists four areas of concern that it believes are best addressed by use of the fair value approach. We would like to explain our belief that use of a market-based approach, exemplified by a mark-to-market treatment of employee stock options, addresses three of those concerns better than the ED.

The first area of concern in the ED:

"Addressing concerns of users and others. Users of financial statements, including institutional and individual investors, as well as many other parties expressed to the FASB their concerns that using Opinion 25's intrinsic value method results in financial statements that do not faithfully represent the economic transactions affecting the issuer, namely, the receipt and consumption of employee services in exchange for valuable equity instruments. Financial statements that do not faithfully represent the economic transactions affecting an issuer can distort the reported financial condition and operations of that issuer and can lead to the inappropriate allocation of resources. Part of the FASB's mission is to improve standards of financial accounting for the benefit of users of financial information."

We agree with the ED that the intrinsic method under Opinion 25 does not faithfully represent the economics of the transaction, but we do not believe model-generated fair values represent them either. There is no question that a mark-to-market approach results in the amount recorded by the company being equal to the amount received by the employee once the option is exercised. The fair value approach, by contrast, fails to capture in the income statement the actual economics received by the employee. Users of financial statements do not dislike traditional Opinion 25 accounting more because it did not reflect actual stock option value than they do because options were recorded at \$0. The zero value placed on options may have been considered egregious, but those users will not be satisfied that an option was valued at \$8 per option when they are exercised at \$40 per option.

The second area of concern of the ED:

"Improving the comparability of reported financial information through the elimination of alternative accounting methods. During the summer of 2002, a number of public companies announced their intention of voluntarily adopting Statement 123's fair-value-based method of accounting for share-based compensation transactions with employees. Since then, approximately 500 public companies have voluntarily adopted or announced their intention to adopt the fair-value-based method. Despite the many public companies that have voluntarily adopted the fair-value-based method of accounting, there remains a large number of companies that continue to use Opinion 25's intrinsic value method. The Board believes that similar economic transactions should be accounted for similarly (that is, share-based compensation transactions with employees should be accounted for using one method). Consistent with the conclusion in Statement 123, the Board believes such transactions should be accounted for using the fair-value-based method."

We agree with the ED that existence of multiple accounting methods is not desirable and hampers comparability between companies. However, any method chosen and required would achieve this goal, not just the fair value method. It is worth noting that the ED allows for different methods between private and public companies for stock options. The ED allows private companies, those with no readily determined market for their stock, to use a mark-to-market approach while requiring public companies, who can easily determine what the actual value to the employee is based on the market, to ignore this actual value. This hampers comparability between these types of companies, while a market value approach would allow for such companies to be compared to each other. Furthermore, the value of stock options to employees is very similar to the value of stock appreciation rights. The incremental value is practically identical. These two types of compensation could easily be considered "similar economic transactions" as noted in the second concern. A mark-to-market approach leaves these similar economic transactions with similar accounting while the ED treats them differently.

The third area of concern of the ED:

"Simplifying U.S. GAAP. This proposed Statement would simplify the accounting for share-based payments. The Board believes that U.S. GAAP should be simplified whenever possible. Requiring the use of a single method of accounting for share-based payment would result in the elimination of Opinion 25's intrinsic value method and the many related detailed and form-driven rules"

We agree that a single method for share-based payments simplifies accounting. However, we again repeat that any single method achieves this goal. Mark-to-market accounting has the advantage of not only simplifying through elimination of alternatives, it is also easy to understand for all readers. Calculating the value is simple to explain: "The value of the option recorded on the balance sheet equals the difference that the quoted market value is above the exercise price of the option times the number of options outstanding. If the market price equals or is less than the strike price, the option is valued at \$0." The ED can neither make a similar claim for brevity and simplicity of explanation of the mechanics of the valuation under a lattice model, nor readily explain why the balance sheet reflects a fair value calculated many years ago when the actual value to the employee at the time of the balance sheet is easily known. Any reader of a financial statement can duplicate a mark-to-market calculation and evaluate sensitivities related to changes in stock price. It is doubtful that more than a handful of such readers can do the same for the lattice model.

The fourth area of concern of the ED:

"International convergence. This proposed Statement would result in greater international comparability in the accounting for share-based payment. In February 2004, the International Accounting Standards Board (IASB), whose standards are followed by enterprises in many countries throughout the world, issued International Financial Reporting Standard (IFRS) 2, Share-based Payment. IFRS 2 requires that all enterprises recognize an expense for all employee services received (and consumed) in exchange for the enterprise's equity instruments. The IASB concluded that share-based compensation transactions should be accounted for using a fair-value-based method that is similar in most respects to the fair-value-based method established in this proposed Statement. Converging to a common set of high-quality financial accounting standards on an international basis for share-based payment transactions with employees improves the comparability of financial information around the world and simplifies the accounting for enterprises that report financial statements under both U.S. GAAP and international accounting standards.

"The Board believes that this proposed Statement addresses users' and other parties' concerns by requiring enterprises to recognize an expense in the income statement for employee services received (and consumed) in exchange for the enterprises' equity instruments, thereby reflecting the consequences of the economic transaction in the financial statements. By requiring the fair-value-based method for all public companies, this proposed Statement would eliminate an alternative accounting method and the accounting guidance associated with that method; consequently, similar economic transactions would be accounted for similarly. Finally, requiring the use of Statement 123's fair-value-based method is convergent with IFRS 2."

We agree that our proposal does not lead toward convergence with IFRS 2. However, it is of note that IFRS 2 was using FAS 123 as a model. It is safe to say that the IASB had convergence with FAS 123 in mind when it issued IFRS 2. This is demonstrated by their choice of a closed-form model similar to FAS 123. As the IASB is generally more sympathetic to market-based accounting, it is not unreasonable to suggest that the IASB might be willing to evaluate a market-based approach if US GAAP also required such an approach.

The ED asked for comments on 16 specific issues as follows:

Issue 1: The Board has reaffirmed the conclusion in Statement 123 that employee services received in exchange for equity instruments give rise to recognizable compensation cost as the services are used in the issuing entity's operations (refer to paragraphs C13–C15). Based on that conclusion, this proposed Statement requires that such compensation cost be recognized in the financial statements. Do you agree with the Board's conclusions? If not, please provide your alternative view and the basis for it.

We agree that share-based payments do represent compensation, or at least potential compensation, to the employee and should be recognized in the financial statements.

Issue 2: Statement 123 permitted enterprises the option of continuing to use Opinion 25's intrinsic value method of accounting for share-based payments to employees provided those enterprises supplementally disclosed pro forma net income and related pro forma earnings per share information (if earnings per share is presented) as if the fair-value-based method of accounting had been used. For the reasons described in paragraphs C26—C30, the Board concluded that such pro forma disclosures are not an appropriate substitute for recognition of compensation cost in the financial statements. Do you agree with that conclusion? If not, why not?

We agree that for share-based payments disclosure has not served as an acceptable alternative for recognition in the financial statements.

Issue 3: This proposed Statement would require that public companies measure the compensation cost related to employee services received in exchange for equity instruments issued based on the grant-date fair value of those instruments. Paragraphs C16–C19 and C53 explain why the Board believes fair value is the relevant measurement attribute and grant date is the relevant measurement date. Do you agree with that view? If not, what alternative measurement attribute and measurement date would you suggest and why?

We do not agree with the view that fair value represents the relevant value. We believe that market value is the more appropriate measure. If there is a market for the share-based instrument, e.g., restricted stock, then value on the grant date that is recognized over the vesting period is the proper measure. However, for employee stock options, this would only be the case if the options were transferable and readily traded in the public market. Absent that, we believe a mark-to-market approach more readily captures the value of the option to the employee and cost to the company as it captures the value of the share that the company surrenders at the time it is surrendered. Compensation expense would be measured as the percent vested of the option times its intrinsic value at each reporting date. The change in value would continue to be recorded after the vesting period much in the same way that changes in interest rates or plan changes can change the value of pensions or postretirement benefits in periods after those benefits are earned.

Issue 4(a): This proposed Statement indicates that observable market prices of identical or similar equity or liability instruments in active markets are the best evidence of fair value and, if available, should be used to measure the fair value of equity and liability instruments awarded in share-based payment arrangements with employees. In the absence of an observable market price, this proposed Statement requires that the fair value of equity share options awarded to employees be estimated using an appropriate valuation technique that takes into consideration various factors, including (at a minimum) the exercise price of the option, the expected term of the option, the current price of the underlying share, the expected volatility of the underlying share price, the expected dividends on the underlying share, and the risk-free interest rate (paragraph 19 of Appendix A). Due to the absence of observable market prices, the fair value of most, if not all, share options issued to employees would be measured using an option-pricing model. Some constituents have expressed concern about the consistency and comparability of fair value estimates developed from such models. This proposed Statement elaborates on and expands the guidance in Statement 123 for developing the assumptions to be used in an option-pricing model (paragraphs B13-B30). Do you believe that this proposed Statement provides sufficient guidance to ensure that the fair value measurement objective is applied with reasonable consistency? If not, what additional guidance is needed and why?

One of the largest concerns we have with any model-based valuation of options is the difficulty in explaining to readers of our financial statements the relevance of the number to actual economic conditions. While attempting to ensure greater uniformity and comparability among companies, the number of variables and considerations that must go into a lattice model almost guarantees that those variables will be viewed differently by different companies and produce results less comparable than under closed-form models with a narrower range of inputs.

Issue 4(b): Some constituents assert that the fair value of employee share options cannot be measured with sufficient reliability for recognition in the financial statements. In making that

assertion, they note that the Black-Scholes-Merton formula and similar closed-form models do not produce reasonable estimates of the fair value because they do not adequately take into account the unique characteristics of employee share options. For the reasons described in paragraphs C21–C25, the Board concluded that fair value can be measured with an option-pricing model with sufficient reliability. Board members agree, however, that closed-form models may not necessarily be the best available technique for estimating the fair value of employee share options—they believe that a lattice model (as defined in paragraph E1) is preferable because it offers the greater flexibility needed to reflect the unique characteristics of employee share options and similar instruments. However, for the reasons noted in paragraph C24, the Board decided not to require the use of a lattice model at this time. 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?

We do not agree with the Board's conclusion that the fair value of employee share options can be measured with sufficient reliability. Our own experience shows that it would be sheer coincidence if a point-in-time model-driven estimate ended up actually representing true economic value realized by the employees who receive the options. We have seen examples of the model value being both inadequately low and high, and we believe this would have been the case regardless of whether a lattice or closed-form model were used. This inadequacy in projecting actual value is then compounded by the lack of a mechanism to true-up estimates to actual results, a provision unique in accounting.

As to the preference of one model over the other, we believe that models with more inputs and variables provide greater potential for inconsistent results between companies. This potential is then heightened when many of the differences in management's evaluation of variables will not be apparent to financial statement readers. The Black-Scholes model has a large advantage in that its inputs are few and it is possible for a diligent reader to reproduce numbers approximating those used by the company. This allows that reader, if so desired, to assess comparability between companies through assumption sensitivity. It would take an extraordinary reader to attempt to do the same with a lattice model value.

Issue 4(c): Some respondents to the Invitation to Comment suggested that the FASB prescribe a single method of estimating expected volatility or even a uniform volatility assumption that would be used for all companies. Other respondents to the Invitation to Comment disagreed with such an approach. Additionally, some parties believe that historical volatility, which has been commonly used as the estimate of expected volatility under Statement 123 as originally issued, is often not an appropriate measure to use. The proposed Statement would require enterprises to make their best estimate of expected volatility (as well as other assumptions) by applying the guidance provided in paragraphs B24–B26 to their specific facts and circumstances. In that regard, the proposed Statement provides guidance on information other than historical volatility that should be used in estimating expected volatility, and explicitly notes that defaulting to historical volatility as the estimate of expected volatility without taking into consideration other available information is not appropriate. If you believe the Board should require a specific method of estimating expected volatility, please explain the method you prefer.

We believe that the Board should require a specific method of estimating expected volatility if part of the Board's intent is to improve comparability among companies. When addressing historical volatility, there can be notable variations in the measurement based on whether daily, weekly or monthly volatility is measured—and all are currently acceptable under FAS 123. Two

companies with identical volatility patterns could, therefore, use different volatility measures and record different expenses. The requirement in the ED to project volatility only amplifies this problem as point-in-time, subjective evaluations of future events become a basis for recording expense in the financial statements. The absence of any true-up mechanism means that naturally optimistic companies will record higher levels of expense than more conservative and pessimistic companies, without regard to the actual compensation eventually enjoyed by the employee.

Issue 4(d): This proposed Statement provides guidance on how the unique characteristics of employee share options would be considered in estimating their grant-date fair value. For example, to take into account the nontransferability of employee share options, this proposed Statement would require that fair value be estimated using the expected term (which is determined by adjusting the option's contractual term for expected early exercise and postvesting employment termination behaviors) rather than its contractual term. Moreover, the Board decided that compensation cost should be recognized only for those equity instruments that vest to take into account the risk of forfeiture due to vesting conditions. Do you agree that those methods give appropriate recognition to the unique characteristics of employee share options? If not, what alternative method would more accurately reflect the impact of those factors in estimating the option's fair value? Please provide the basis for your position.

If using a model, we do believe it is appropriate to expense only those options that vest. We also concur that expected term should be used rather than grant term when the option is non-transferable.

Issue 5: In developing this proposed Statement, the Board acknowledged that there may be circumstances in which it is not possible to reasonably estimate the fair value of an equity instrument. In those cases, the Board decided to require that compensation cost be measured using an intrinsic value method with remeasurement through the settlement date (paragraphs 21 and 22 of Appendix A). Do you agree that the intrinsic value method with remeasurement through the settlement date is the appropriate alternative accounting treatment when it is not possible to reasonably estimate the fair value? (Refer to paragraphs C66 and C67 for the Board's reasons for selecting that method.) If not, what other alternative do you prefer, and why?

We concur with the Board that this is the proper way to account for those equity instruments.

Issue 6: For the reasons described in paragraph C75, this proposed Statement establishes the principle that an employee stock purchase plan transaction is not compensatory if the employee is entitled to purchase shares on terms that are no more favorable than those available to all holders of the same class of the shares. Do you agree with that principle? If not, why not?

We concur that purchases at terms no more favorable than those available to other holders are not compensation.

Issue 7: This proposed Statement would require that compensation cost be recognized in the financial statements over the requisite service period, which is the period over which employee services are provided in exchange for the employer's equity instruments. Do you believe that the requisite service period is the appropriate basis for attribution? If not, what basis should be used?

We concur that the vesting period is the appropriate period over which to initially recognize expense. As previously stated, we believe that actual economic impact of employee stock options should continue to be recognized over their entire life by using a mark-to-market approach.

Issue 8: Determining the requisite service period would require analysis of the terms and conditions of an award, particularly when the award contains more than one service, performance, or market condition. Paragraphs B37–B49 provide guidance on estimating the requisite service period. Do you believe that guidance to be sufficient? If not, how should it be expanded or clarified?

While we believe the guidance to be relatively adequate, there is an apparent contradiction in the treatment of changes in implicit service periods. If subsequent to a grant, the estimate of initial service period changes, the proposed accounting is inconsistent between changes that lengthen the implicit period and those that shorten it. Under the proposal, if the implicit period shortens, the period over which expense is recognized also shortens. However, if it lengthens, no change is made. We do not agree that the accounting for two similar economic events should be different based upon whether the change increases or decreases current expense. It is illogical, even dangerous, to design different accounting for similar items based on results rather than the fundamental transaction. Extending the example in B40 may illustrate this. In this case, an award was issued with an assumed service life of four years. After one year, it became probable that it would be achieved in two years and the service period was shortened. However, if during year two, it became probable that the service period needed to be moved to three years or even back to four years, no change is allowed. Such disparity in treatment is not designed to encourage conservative evaluation of transactions.

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 concur with this treatment. It is similar to our current approach to expensing employee stock options.

Issue 10: This proposed Statement establishes several principles that guide the accounting for modifications and settlements, including cancellations of awards of equity instruments (paragraph 35 of Appendix A). Paragraphs C96–C115 explain the factors considered by the Board in developing those principles and the related implementation guidance provided in Appendix B. Do you believe those principles are appropriate? If you believe that additional or different principles should apply to modification and settlement transactions, please describe those principles and how they would change the guidance provided in Appendix B.

We find the approach to modifications inconsistent with the fundamental premise of the ED that the initial grant had a fixed determinable value. If an award has a fixed fair value, then additional compensation should be measured based on the excess of the modified award over the original value, not the value immediately before modification. The ED holds that changes in the fair value of the award are of no economic importance to the company because the company has truly incurred a permanent transfer of that fixed value to the employee. Extending this logic, there should be no additional economic consequence to the company as long as anything the company gives the employee for that instrument does not differ from that value.

We admit that this conclusion does not seem consistent with the actual economics of the modification; more than likely it is readily apparent that the modified award is worth more than the award prior to modification. However, we believe this more clearly emphasizes that the original award did not have a fixed value that should never change. Instead, we believe it helps demonstrate that marking the awards to market more clearly captures the actual economics involved in the transaction.

As an example, assume a 10-year option is granted with an original fair value of \$10. The company's stock declines precipitously and the option remains unexercised after six years, at which time it is modified. The option has a fair value of \$2 prior to modification, and after modification, the fair value is \$6. The employee exercises that option at the end of 10 years and receives \$5. Viewed from the point of view of the employee, the Internal Revenue Service and the employee's statement of net worth, the employee has received \$5 from the company. Under the accounting of the ED, the company has recorded \$14 of expense in order to give the employee that \$5. Under mark to market accounting, the company would have recorded \$5.

However, we do concur that the method proposed in the exposure draft is superior to that used in FAS 123. By comparing the fair value of the modified award to the fair value of the unmodified award immediately before modification, there is at least a measure of the change determined on a consistent basis. This at least allows both the modified and unmodified award to be measured using similar assumptions, providing a much sounder basis for determining the effect of the modification.

Issue 11: This proposed Statement changes the method of accounting for income tax effects established in Statement 123 as originally issued. Paragraphs 41–44 of Appendix A describe the proposed method of accounting for income tax effects and paragraphs C128–C138 describe the Board's rationale. That method also differs from the one required in International Financial Reporting Standard (IFRS) 2, Share-based Payment. 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 do not agree with the method of accounting for income taxes as proposed by the ED. We find two difficulties with the approach. First, it treats similar transactions differently based on the final accounting, not economic result. The ED requires deductions in excess of those initially recognized to be treated as part of equity, while those less than originally recognized when granted are treated as additional expense. For example, assume an employee exercises two blocks of options at the same time. Both were recorded under accounting required by the ED at an initial fair value of \$100 with a deferred tax benefit of \$40. At exercise date, one block was worth \$110 while the other was worth \$90, and the company still had an effective tax rate of 40%. Thus, the employee received \$200 and the company received a tax deduction of \$80, amounts identical to those recorded by the company. However, the accounting proposed by the ED would have the company record an additional \$4 of tax expense and place a \$4 benefit in paid-in-capital, not because of the economics of the transactions to the company, but rather because of the accounting answer produced. This lack of consistency for similar transactions is not readily explainable to a reader of financial statements. The best that can be said to the reader is that the accounting rules require this result.

The second difficulty we find with the approach to income taxes is that it is inconsistent with the treatment of the underlying option by the ED. Under the accounting proposed by the ED, the option value is never trued up to actual economics received. The assumption is that there has been some permanent transfer of value to the employee. However, when it turns to income taxes,

the ED decides that the value transfer was not permanent, there is not some value memorialized on the balance sheet for which a deferred tax should remain. Rather, the ED proposes the pragmatic approach that income taxes need to be trued up once actual economics are known. While laudable, it is inconsistent with the approach the ED takes to the corresponding option.

The approach to income taxes under IFRS 2, as described in paragraph C134 takes more of a mark-to-market approach to income taxes. This approach does seem more in line with the actual economics of the transaction.

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 agree with most of the proposed disclosures as described in B191. However, we do not see any value in specifically identifying the amount of compensation cost capitalized for share-based payments. We also observe that many of the disclosures are centered on providing the reader with information about the intrinsic value of the options and actual economics of the options. As we stated in regard to Issue 2, above, we believe that for share-based payments disclosure has not served as an acceptable alternative for recognition in the financial statements, and the need to explain the actual economics of the share-based payments in the footnote disclosures raises the question as to why they are not reflected in the actual 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 agree that the prospective only method should not be allowed. When we adopted the fair value provisions of FAS 123, we elected the retrospective method as allowed under FAS 148 because we felt that it provided the most complete comparable information for the readers of the financial statements. While we agree that the modified prospective method should provide readers with adequately comparable information on companies that have already elected the fair value approach, we do not understand the Board's reluctance to require a modified retrospective method for those who currently elect the disclosure method. In describing the modified prospective approach, C160 notes that unvested awards fair value is to be based on original estimates used in the pro forma disclosures, it would appear more consistent to provide that information in the actual statements.

Should the Board consider using a mark-to-market approach that would be significantly different than the fair value method of FAS 123, we believe that a cumulative effect would be the most appropriate accounting to bring outstanding share-based payments to their market value.

Issue 14(a): This proposed Statement would permit nonpublic entities to elect to use an intrinsic value method of accounting (with final measurement of compensation cost at the settlement date) rather than the fair-value-based method, which is preferable. Do you agree with the Board's conclusion to allow an intrinsic value method for nonpublic entities? If not, why not?

We agree these companies should be allowed this accounting. We do find it interesting and inconsistent that the intrinsic method is allowed for entities without a public market based intrinsic value but not allowed for those that have one. This places an unusual burden on the reader in that the entities for which independent value information is readily available may not use this information in their accounting while those for which this information is not readily available, will.

Issue 14(b): Consistent with its mission, when the Board developed this proposed Statement it evaluated whether it would fill a significant need and whether the costs imposed to apply this proposed Statement, as compared to other alternatives, would be justified in relation to the overall benefits of the resulting information. As part of that evaluation, the Board carefully considered the impact of this proposed Statement on nonpublic entities and made several decisions to mitigate the incremental costs those entities would incur in complying with its provisions. For example, the Board decided to permit those entities to elect to use either the fairvalue-based method or the intrinsic value method (with final measurement of compensation cost at settlement date) of accounting for share-based compensation arrangements. Additionally, the Board selected transition provisions that it believes will minimize costs of transition (most nonpublic entities would use a prospective method of transition rather than the modified prospective method required for public entities). Moreover, the Board decided to extend the effective date of this proposed Statement for nonpublic entities to provide them additional time to study its requirements and plan for transition. Do you believe those decisions are appropriate? If not, why not? Should other modifications of this proposed Statement's provisions be made for those entities?

We concur with the Board's decisions because the lack of readily available market information does place an added burden on those companies.

Issue 15: Some argue that the cost-benefit considerations that led the Board to propose certain accounting alternatives for nonpublic entities should apply equally to small business issuers, as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. Do you believe that some or all of those alternatives should be extended to those public entities?

We do not believe that accounting should vary based on the size of the company involved. We believe accounting should try to capture the economics of transactions and present them in as understandable a fashion as possible to the readers of financial statements.

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 agree that out of the vast number of items that give rise to income taxes, this one type of transaction should be singled out and removed from operations. Many much more significant transactions related to investing or financing have their tax effects reflected in cash from

operations on the cash flows statement. While we understand the Board's view that under the exposure draft this is an equity transaction, the tax benefits or consequences of other transactions in the financing section of the cash flows statements are reflected in operations. It is contrary to normal materiality considerations to single out this one transaction for special treatment.

Issue 17: Certain accounting treatments for share-based payment transactions with employees in this proposed Statement differ from those in IFRS 2, including the accounting for nonpublic enterprises, income tax effects, and certain modifications. Those differences are described more fully in Appendix C. If you prefer the accounting treatment accorded by IFRS 2, please identify the difference and provide the basis for your preference. If you prefer the accounting treatment in the proposed Statement, do you believe the Board nonetheless should consider adopting the accounting treatment prescribed in IFRS 2 in the interest of achieving convergence?

Except as noted, we do not have a strong preference for either method.

Issue 18: The Board's objective is to issue financial accounting standards that can be read and understood by those possessing a reasonable level of accounting knowledge, a reasonable understanding of the business and economic activities covered by the accounting standard, and a willingness to study the standard with reasonable diligence. Do you believe that this proposed Statement, taken as a whole, achieves that objective?

While the ED can be read and understood by a knowledgeable audience, it probably is not readily understandable by most readers of financial statements. It is difficult to say whether only a "reasonable" level of knowledge and understanding would be necessary to understand any superiority of model-based accounting over market value accounting. Additionally, a public company has a responsibility to the readers of its financial statements to attempt to make its financial statements as understandable as possible to a wide audience. It is difficult to explain to those readers why a fixed, model-driven expense is more relevant to them than the intrinsic value of the share-based payment which possibly may either far exceed the model amount or show the share-based payment to be worthless to the holder. While it can be explained to readers that the model provides a fair value estimate at the time of issuance, it is at best difficult to explain why that point-in-time estimate should never be altered to reflect economic reality when every other accounting estimate is required to be trued up to actual results.

We appreciate the opportunity to comment on projects undertaken by the Financial Accounting Standards Board. If you would like to further discuss any of our comments, please do not hesitate to contact either Andrew Libera, Executive Director – External Reporting and Accounting Policy at (210) 351-3043 (al7444@txmail.sbc.com) or myself at (210) 351-3900 (js0093@txmail.sbc.com).

Yours very truly,

John J. Stephens
Vice President and Controller