

ikon**Letter of Comment No: 5854**
File Reference: 1102-100

From: Gordon Heslop [heslopg@nsula.edu]
Sent: Wednesday, June 30, 2004 5:39 PM
To: Director - FASB
Subject: File Reference No. 1102-100

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My comments on the FASB Exposure Draft on Share –Based Payment are:

Issue 1: I agree with the Board's conclusions, and feel strongly that the Board should resist any pressure coming from politicians and the business community. As a profession it is our responsibility to accurately and truthfully report on financial performance. Corporate ambitions to show higher earnings should not be a consideration especially when it is misleading. When problems arise, accountants could justifiably be blamed if they tailored rules to corporate desires and ignored the true economic impact.

Issue 2: I agree. The observer focuses on the financial statements, not the disclosure, and therefore the desired result is not achieved by using the disclosure in this way.

Issue 3: I agree that fair value is the relevant measure but disagree that it should be done at grant date because I do not think that is accurately possible. To do so requires the use of some model and it is almost never going to be accurate, and sometimes it will be hopelessly inaccurate. Ordinary economic activity a few years in the future is very uncertain, being dependent upon such things as political leadership, overseas economic conditions and consumer and business behavior. This totally ignores any guesses about future terrorist activity or foreign wars. For example, how do you factor in the possibility of a "dirty bomb" released on Wall Street?

I suggest that the measurement date should be the date of exercise. Although this would mean that the compensation expense would only be recognized when the options were exercised, I believe that what the FASB described as the "unique characteristics of employee share options" warrant such a treatment.

Options are not like other estimated expenses such as warranty expenses where the exact amount is unknown but can be estimated based on past experience. This is for 2 reasons, namely:

1. the level of fair value cannot be determined before exercise because the stock price could move anywhere and in some cases could fall so much as to totally wipe out any value and
2. an unknown number of employees could resign or die and therefore not be able to exercise the options.

Determining the fair value at exercise date makes the whole process very simple. The compensation cost is the difference between the current market price and exercise price.

Accounting theorists may disagree with such an approach because it recognizes no cost during the service period, but for reasons stated above, a cost may not exist and if it does, it is undeterminable. Over the long-term, with options being issued and exercised all the time, the recognition of cost will tend to smooth itself out, while still only recognizing actual cost.

Using my suggestion, the company would state in the notes to the annual report the total cost if all remaining valid options were exercised at balance date. This would give the reader an idea of the current situation but would also let them know that things would probably change in the future.

Issue 4(b): I disagree that the lattice model is preferable. As much as possible, the accounting system should be easily understood and transparent. The use of any of these models is just creating a minefield of uncertainty and complication.

Issue 4(c): Estimating expected volatility would be unnecessary if the market price at the date of exercise were used.

Issue 5: If my suggestion of using the exercise date as the measurement date is not accepted, I would support using the intrinsic value method with remeasurement through the settlement date as an alternative. This would guarantee

that over the long-term the full actual cost is recognized. The only problem with this approach is that it would often result in many adjustments, often in different directions, which could confuse the reader.

Issue 6: I agree. I think this is very obviously true.

Issue 7: In theory I agree, but in practice, because of the difficulties in measurement I feel that my suggestion of recognition at exercise date is more practicable and understandable.

Issue 12: Under my suggestion the disclosure would state the current cost if all valid options were exercised at the end of the current period.

I trust this is of some value in your deliberations.

Sincerely,
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