

# BELLSOUTH

June 30, 2004

Letter of Comment No: 5842  
File Reference: 1102-100

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

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Dear Ms. Bielstein:

BellSouth Corporation is a Fortune 100 communications company headquartered in Atlanta, Georgia, and a parent company of Cingular Wireless, the nation's second largest voice and data provider. As an early adopter of the expense provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, we support the Financial Accounting Standards Board's proposal to require expense recognition for employee stock options. However, we believe certain provisions cause sufficient concern to warrant further deliberation before the Proposed Statement of Financial Accounting Standards, *Share-Based Payment*, is finalized for issuance, and we appreciate the opportunity to express our views in this letter.

## **Measurement Date and Measurement Basis**

It seems that much of the resistance to required expense recognition for share-based payments arises from the potential irrational result that expense is recognized based on grant date circumstances and valuation assumptions for options or shares that may be worth much less than the expense recognized, or may even be worthless, on the exercise or vesting date. We suggest that the Board revisit the alternative to measure expense at the vesting date, not because this measurement date is theoretically preferred (although it does have merit), but because it might represent a compromise that is more acceptable to the constituent body as a whole. We also suggest that the Board concurrently revisit the use of intrinsic value as the measurement basis for expense recognition. Expense recognition based on intrinsic value at the vesting date would be consistent with the actual value provided by the company for the award, and would also represent a significantly simplified and practical approach to the accounting model for share-based payments, thereby costing less to implement and administer. Additionally, this approach would improve consistency in the accounting results for share-based payments classified as equity and those classified as liabilities.

## **Preference for use of lattice model to value employee stock options (paragraphs B11 and B12)**

We believe the verbiage in paragraphs B11 and B12 of the Exposure Draft is ambiguous regarding whether the Board simply prefers use of the lattice model to value employee stock options or actually requires it in those circumstances where the information is available and the related expense is substantial. We encourage the Board to clarify these provisions in the final standard. Further, while we agree with the Board that the lattice model represents superior theoretical valuation methodology, we believe that the practicality of widespread implementation of this model by the effective date of the Exposure Draft provisions is doubtful, as indicated by our comments below regarding the effective date provisions. We also share other constituents' concerns that it may be inherently easier to manipulate assumptions and valuation output when using the lattice model, and such manipulation may be easier to mask (e.g., investors and analysts could not easily reproduce the results as is possible when using the Black-Scholes formula). We have no recommendation to address this concern, but agree with others that this important issue deserves further consideration before finalizing the exposure draft provisions.

**Awards Classified as Liabilities (paragraphs 25, 25A, 33A)**

The Exposure Draft methodology to fair value awards with market conditions, in particular those with market conditions that include reference to peer group results, is extremely complex and burdensome. Furthermore, for awards with market conditions that are classified as liabilities, this complex and burdensome calculation must be performed at each reporting date. Those companies with outstanding liability-classified awards containing market conditions on the effective date of January 1, 2005 will be required to record the cumulative effect of the change in valuation methodologies as of January 1, 2005, and to revalue these liabilities quarterly thereafter.

While we agree with the theoretical superiority of the recommended methodologies, we do not believe sufficient consideration has been given to the significant burden imposed by, and the practical implementation of, these requirements for liability-classified awards. Consider, for example, Illustration 8 in the Exposure Draft (Appendix B, beginning at paragraph B92), but assume that the awards in this illustration are classified as liabilities. The awards in the illustration are stock units with both performance and market conditions, and footnote 42 of paragraph B94 references the use of Monte Carlo simulation to value the awards. The requirement to value awards using this methodology on the grant date is a significant burden (for equity-classified awards), but the burden imposed by requiring revaluation of such awards using this methodology on a quarterly basis would be considerable. We do not believe the benefits of the theoretically superior valuation methodology justify the cost of practical application of the methodology to liability-classified awards. **Ultimately, the expense recognized for liability-classified awards is equal to the cash paid to the employee at exercise or vesting of the award.** We believe a simpler and more practical valuation approach is warranted for liability-classified awards, and would be consistent with the Board's objective to simplify accounting standards whenever possible.

**Expense Adjustment for Forfeitures (paragraph 26)**

The Board decided early in its deliberations to eliminate the alternative provided in FAS 123 that allows companies to adjust expense for forfeitures as they occur. This decision was based on the fact that companies should now have enough information to calculate estimated forfeitures; however, the Board did not consider the mechanics and systems modifications involved in changing from the actual forfeiture method to the estimated forfeiture method. We agree that the information to estimate forfeitures is in fact available, and we also believe that this method serves as a more theoretically correct basis for expense recognition. However, we also believe the cost of implementing this provision outweighs the benefit of the more theoretically pure expense recognition during the requisite service period. Ultimately, the expense must be trued-up to the amount based on actual forfeitures during the requisite service period; therefore, we believe the Board should reconsider retention of the alternative to adjust expense for actual forfeitures as they occur.

**Cashless Exercises and Minimum Statutory Withholding Requirements (paragraph 25C)**

We believe the verbiage in this paragraph should be clarified with respect to the types of awards to which the provisions apply. A purely literal reading of this paragraph in isolation could result in the conclusion that the provisions apply only to stock options; however, the original intent of the provisions contained in this paragraph was to specify situations in which fixed awards (under APB Opinion No. 25) did or did not become variable due to form of exercise and shares "withheld" or repurchased by the issuer for optionee withholding taxes. We believe, based on our understanding of the origin of the provisions, that the intent of amending this provision to FAS 123 is to apply the guidance to **all** awards settled in shares and the determination of whether these awards should be classified as equity or liabilities (and thereby be subject to expense fixed at the grant date vs. expense fixed at the exercise date). If our understanding is correct, this intent is not clearly communicated in the actual verbiage of paragraph 25C. Also, in the case of an award that is classified as a liability solely because the minimum statutory withholding provisions are not met, please clarify whether the entire award should be classified as a liability or whether just the shares represented by the excess tax withholding should be classified as a liability.

**Tax Provisions**

We recommend that the recognition of tax benefits in the income statement be based on the corresponding stock compensation expense recognized in the income statement, and that any excess tax benefits or deficiencies resulting from the vesting or exercise of the awards be recognized as adjustments to additional paid-in capital. The Exposure Draft requires recognition of tax deficiencies in the income statement and excess tax benefits in the balance sheet, which seems contradictory. We recommend using the same approach to recognize both tax deficiencies and tax benefits at vesting or exercise to create a symmetrical recognition method. Providing a similar approach more accurately reflects the effects of stock-based compensation on the financial statements, is more consistent with FAS 109 requirements, and greatly reduces implementation and ongoing administration costs by eliminating the need to track deferred taxes for each individual option.

**Effective date of Exposure Draft**

As stated previously, we support the proposal to require expense recognition for all share-based payments. However, many constituents have expressed valid concerns related to provisions included in the proposed Statement, including the preferred valuation methodology and the practical application thereof. We therefore request that the Board consider delaying the finalization of the exposure draft provisions to allow time to thoroughly address these issues prior to issuance of the final standard. We do not perceive the benefit of issuing a standard that then requires immediate attention to, and resolution of, the implementation issues contained therein.

If issuance of a final standard is not delayed, we request that the Board consider delaying the effective date of the provisions by one year to allow all affected parties sufficient time to properly plan for the implementation. We are concerned that the Board has taken a somewhat simplistic view of the substantial investment in research and systems and process changes that will be required to implement the standard as currently written. Due to the complexity of and burden imposed by certain provisions (e.g., development of appropriate assumptions to be used in a lattice model, the valuation and revaluation requirements related to liability-classified awards that have market and/or performance conditions, and the requirement to track expense by individual for the tax benefit calculation at exercise), significant resources will be expended to fully understand the provisions and to determine how to most effectively and efficiently comply with the provisions. Furthermore, a reasonable possibility exists that the Board may reconsider some provisions, resulting in the potential for changes to the final standard. We believe it is unreasonable to expect companies to be in a position of full compliance on January 1, 2005, considering that the redeliberation process will take place in the last half of 2004 and the final standard may not be issued until late 2004.

Thank you again for the opportunity to participate in the standard setting process by expressing our views. Please do not hesitate to contact me at (404) 249-3035 if you wish to discuss any of our comments.

Sincerely,

/s/ Raymond E. Winborne, Jr.

Raymond E. Winborne, Jr.  
Assistant Vice President - Controller