Letter of Comment No: 5803 File Reference: 1102-100

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Director of Technical Application and Implementation Issues Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

June 30, 2004

Ladies and Gentlemen:

Re: File Reference No. 1102-100

I appreciate the opportunity to express my views on the Board's proposed Statement of Financial Accounting Standards Share-Based Payment – an amendment of FASB Statements No. 123 and 95 (the "Exposure Draft").

It is clear to me from reading the Exposure Draft that the Board and its staff have invested significant time and effort to carefully and thoroughly consider all of the known accounting issues related to employee stock-based compensation arrangements and to develop logical responses to those issues that are generally consistent with the conceptual framework. I commend the Board and its staff for their efforts on this particular project.

In Appendix I to this letter I have included my responses to several of the specific issues the Board raised in the Notice for Recipients to the Exposure Draft. In Appendix II, I address some additional issues related to stock-based compensation arrangements. I would like to summarize here the following general principles that underlie my responses.

- 1. The grant of stock-based compensation for services represents an exchange of value that must be captured in financial statements if they are to be representationally faithful. Nevertheless, I think that certain issues remain with regard to measuring the amount of compensation expense to be recognized. In particular, I have misgivings about using option pricing models that are intended to measure the fair value of options that are freely tradable on an open market to value employee stock options without applying some form of discount to reflect the fact that employee options are nontransferable. In the appendices, I propose a couple of approaches to try to resolve some of the various valuation issues.
- 2. I believe that the fair value measurement objective for equity instruments that are issued as consideration for goods or services should be to measure "the amount of cash that the entity would have had to pay in lieu of issuing the equity instruments in order to effect the transaction." I believe that this definition of fair value properly reflects the facts that (1) financial statements attempt to measure transactions in units of currency (cash) and (2) financial accounting is inherently transaction specific. I also believe that the principles

that govern the measurement of the fair value of equity instruments issued apply equally regardless of the consideration received, whether a service, an asset, or a business.

- 3. I believe that it is important to focus on exactly what it is an entity has bargained for when it grants stock-based compensation awards. I think that a distinction must be made between awards granted in exchange for the specific output of the employee (e.g., a number of sales calls) versus awards granted in exchange for the employee's best efforts toward a performance target, the achievement of which is not in the unilateral control of the employee. In the former case, I believe that compensation expense should be recorded only if the employee generates the specific output. In the latter case, I believe that compensation expense should be recorded if the employee fulfills the service requirement and that the performance condition should affect the measurement of the fair value of the award. This approach would make the accounting for grants with performance conditions consistent with the accounting for grants with market conditions. Considering that there is no substantive difference between these two types of conditions, I think that this approach is preferable to the Board's proposed approach. In Appendix II, I attempt to address the Board's concerns about this approach expressed in the Exposure Draft's Basis for Conclusions.
- 4. I believe that whether an entity is a public or nonpublic entity has no bearing on the substance of the transaction and therefore should not result in a different accounting treatment. However, the fact that an entity granting stock options is a nonpublic entity probably results in the options having a significantly lower fair value than identical options granted by a public entity.
- 5. I believe that, from the point of view of the entity, the economic substance of grants classified as liabilities is different from that of grants classified as equity. Accordingly, I believe that the accounting treatment should be different for those two types of grants.

Although the Exposure Draft addresses only the accounting for stock-based compensation arrangements with employees, I believe that these principles apply equally to grants to non-employees. Accordingly, I generally refer to the recipient of a stock-based award as the "counterparty," rather than the "employee." I also refer to stock-based "compensation" rather than "payment," because the word payment implies consideration in the form of cash, rather than equity instruments.

I believe that this project is important, and I urge the Board to move forward with it and to issue a final standard that requires a fair value approach to accounting for stock options in spite of whatever political pressures may attempt to block it. In my opinion, financial statements above all need to be representationally faithful, and recording compensation expense for employee stock options fulfills that important objective.

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Thank you for taking the time to consider my views. If you have questions or comments, do not hesitate to contact me.

Sincerely yours,

David B. Elsbree, Jr.

Havid B. Elobres, J.

Responses to the Specific Issues Raised in the Exposure Draft

Issue 1: Do you agree with the Board's conclusion that employee services received in exchange for equity instruments give rise to recognizable compensation cost as the services are used in the issuing party's operations? If not, please provide your alternative view and the basis for it.

I agree with the Board's conclusion on this point, and I agree with the Board's reasoning as described in paragraphs C13-C19 of the Exposure Draft. The issuance of equity instruments as compensation for services represents an exchange of value between parties that financial statements must capture if they are to be representationally faithful. The form of the consideration given is not relevant to the determination of whether there should be an accounting consequence.

Issue 2: Do you agree with the conclusion that the pro forma disclosures allowed by Statement 123 are not an appropriate substitute for recognition of compensation cost in the financial statements? If not, why not?

Yes. See my response to Issue 12 regarding the proposed Statement's disclosure objectives.

Issues 3: Do you agree with the view that fair value is the relevant measurement attribute and grant date is the relevant measurement date for equity instruments issued in exchange for employee services? If not, what alternative measurement attribute and measurement date would you suggest and why?

I generally agree that fair value is the relevant measurement attribute and that the grant date is the relevant measurement date for equity instruments. However, my opinions on the precise nature of the "fair value measurement objective" and of what represents the proper measurement date under certain circumstances differ slightly from those of the Board.

First, it should be noted that there appears to be a logical inconsistency between the Board's definition of fair value and the proposed accounting treatment for employee stock options. The Board defines fair value as "[t]he amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale" (paragraph E1). The fact is that almost all employee stock options are nontransferable, and therefore they *cannot* be bought or sold in the current transaction between willing parties. Applying the above definition literally, entities would not recognize any compensation expense for nontransferable stock options issued to employees because their fair value would be zero.

Financial statements inherently measure transactions in units of currency. In other words, financial statements attempt to measure the amount of cash an entity used to effect a transaction (e.g., the historical cost of inventory) or the amount of cash an entity expects to receive as the result of a transaction (e.g., the valuation of accounts receivable). Furthermore, financial accounting is inherently transaction specific. Accordingly, I believe that a more suitable definition of the fair value of equity instruments issued to consummate a transaction (whether with employees or external parties) would be "the amount of cash that the entity would have had to pay in lieu of issuing the equity instruments in order to effect the transaction." I believe that this definition is preferable to the definition in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, and in paragraph E1 of the Exposure Draft for the purpose of valuing equity

instruments issued to acquire services, assets, or businesses. First, it specifically refers to cash. Second, it attempts to capture the cash value of the specific transaction in question, based on the perceived value of the consideration given and received by each of the parties under the specific circumstances.

With regard to the measurement date for stock-based consideration, I believe it should be the date that the parties have entered into a legally binding agreement. Typically, this will be the date the counterparty accepts the offer by the issuer, unless additional authorizations are required. I suggest that this is a slightly more precise definition of the grant date than the definition in either paragraph E1 or paragraph B52, and I suggest it for the Board's consideration. When the counterparty (employee) accepts the offer, he or she has made a definitive assessment that the fair value of the equity instruments to be received is at least equal to the fair value of the consideration given. In my opinion, that date is the most relevant date for the valuation of the award.

I disagree with the service inception date being considered the measurement date in circumstances when it occurs later than the date that the parties enter into a legally binding agreement. The service inception date is not relevant to either party's determination that the fair value of consideration to be received is at least equal to the fair value of the consideration to be given.

Issue 4(b): 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?

I understand that both lattice models and closed-form models are intended to estimate the fair value of options that can be freely traded on an open market. As I discuss further in my response to Issue 4(d), I believe that certain adjustments to the amounts calculated under those models are necessary in order to estimate the fair value of nontransferable options with otherwise identical terms. However, I do believe that the valuation models that exist today provide a reasonably reliable starting point for estimating the fair value of employee stock options to justify their use to measure compensation expense and record that expense in financial statements.

I think it is important to remember that "measurements" of the fair value of stock options are estimates. As a result, I think the Board should avoid requiring spurious accuracy. Although it appears that lattice models may provide more accurate estimates of the fair value of options than closed-form models, I think that there should be no requirement, either implied or explicit, that entities "should" use a lattice model for basic, "plain vanilla" options. An entity could use a closed-form model to estimate their fair value in a more cost-effective manner. However, it is clear than a lattice model will be necessary to value options that have complex characteristics that cannot be captured by a closed-form model.

Issue 4(d): The Board decided that fair value be estimated using the expected term rather than its contractual term to take into account the nontransferability of employee share options. The Board also 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.

I disagree that using the expected term of the option rather than its contractual term adequately captures the effect of the nontransferability of employee stock options on the fair value of those options.

First, let us be clear that the fair value of a nontransferable option is less than the fair value of an otherwise identical option that may be traded on an open market. If the holder of a tradable option believes that the fair value of the underlying stock (and therefore also of the stock option) is likely to decrease in the future, he or she can protect himself or herself from bearing those anticipated future losses in value by selling the option on the open market and receiving cash immediately. The holder of an otherwise identical nontransferable option does not have the same possibility available. The additional risk of loss inherent in the nontransferable option must lead to a lower fair value than for an otherwise identical freely tradable option.

I do not believe that using the expected term of the option rather than the contractual term of the option adequately captures this difference in fair value. It seems to me that the fair value of a freely tradable option that has similar terms to those common for employee options (i.e., the option may be exercised after a period of one to two years, it expires after five to ten years, and it is forfeitable under certain conditions) would be similarly affected. That is to say, I believe that it is necessary to use the expected term to estimate the fair value of a freely tradable option with otherwise similar terms to an employee option. As a result, an additional discount is necessary to give proper effect to the nontransferability of the employee option.

I believe that the fair value of a nontransferable option moves in tandem with the fair value of a freely tradable option that has otherwise identical terms. It seems to me that there should be some fixed discount percentage that could be applied to all lattice or closed-form model estimates of the fair value of stock options to estimate the fair value of nontransferable employee stock options. Whether than discount should be 10%, 25%, 50% or more needs to be assessed based on all available evidence. Once that assessment has been made, I recommend writing that fixed discount percentage into the final Statement so that it is applied consistently across all entities.

If the Board does not feel that a fixed nontransferability discount approach is appropriate, perhaps an alternative approach would be to use a risk-adjusted discount rate in valuation models, rather than the risk-free rate. Such an approach may be able to capture the additional uncertainty that holders of nontransferable options have about the realizability of future cash flows associated with such options. Some may feel that this approach would "double count" the uncertainty associated with the future cash flows arising from the option. I would note that nontransferable options inherently have a higher level of uncertainty than do freely tradable options. Holders of the latter type of option at least have the comfort of knowing that that the alternative of selling the option is available to them to remove the uncertainty. Perhaps this approach is worth additional consideration by the Board.

Issue 5: 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? If not, what other alternative do you prefer, and why?

I believe that the intrinsic value method no longer should be considered an appropriate approach to accounting for stock options under any circumstances (see also my responses to

Issues 14(a), 14(b), and 15). I believe that an entity's best estimate of fair value should be the basis for recording compensation cost.

Issue 9: 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. Do you agree with this accounting treatment? If not, why not?

Although I tend to agree with the Board that the theoretically correct answer is to treat each option in a graded vesting stock option award as a separate award, I also have great sympathy for preparers' arguments that compensation expense for such awards should be recorded on a straight-line basis. I expect that preparers will make these arguments in their comment letters, so I will not present them here.

Whatever the Board decides on this point, it should require the same treatment for all grants with graded vesting schedules to ensure the greatest comparability across entities.

Issue 11: Do you agree with the method of accounting for income taxes established by this proposed Statement? If not, what method do you prefer, and why?

The issue of accounting for the income tax effects of stock options grants is both complicated and perplexing. Congress would do accountants a big favor by amending the tax law such that stock options do not affect an entity's income tax return under any circumstances. However, I am not holding out any hope that that will happen.

Non-qualified options create a tax deduction for entities only if they are exercised by the employee. Disqualified options create a tax deduction only if an employee sells the stock he or she obtained by exercising a qualified option within one year of exercise. Both of these kinds of events are contingent events whose occurrence is completely outside the control of the entity. Accordingly, the resulting tax benefit appears to have the characteristics of a gain contingency. Under Statement 5, Accounting for Contingencies, practice has been to recognize contingent gains only when realization of the gain is certain. My recommendation is that the tax benefits arising from both non-qualified and disqualified options be treated in this manner. Under this approach, entities would not record deferred tax assets associated with stock option grants and would instead treat the tax benefit in a manner similar to a permanent difference.

I understand the Board's logic in suggesting that "excess" tax benefits result from an equity transaction and therefore should be treated as a contribution of capital. Nevertheless, I prefer treating the entire tax benefit that results from stock option grants as a component of income tax expense or benefit rather than as an equity item. The income statement is intended to measure the performance of management based on its operating decisions, and ultimately this tax benefit arises as a result of management's operating decision about how to compensate the entity's employees.

Additionally, the Board's proposed approach in the Exposure Draft would lead to dissimilar treatment for excess tax benefits and tax deficiencies, even though both arise from the equity transaction described in paragraph C129(b). Accounting for the entire tax benefit associated with employee stock compensation in the income statement would resolve this disparity and result in a simpler accounting model than the Board's proposed approach.

Similarly, I prefer treating the reduction in taxes paid as a component of net operating cash flows in the statement of cash flows.

Issue 12: Do you believe that the disclosure objectives set forth in the 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 requirements you would suggest.

I recently had the opportunity to read my new client's December 31, 1970 consolidated financial statements. It struck me that the notes to those financial statements were only three pages long, whereas the notes to the same client's 2003 consolidated financial statements are twenty-five pages long. I believe that the set of three page notes actually conveys more information to the investing public than the twenty-five page set, because investors are far more likely to actually *read* a set of three page notes to financial statements than a set of twenty-five page notes!

The fact that so few investors actually take the time to read the notes to financial statements is the reason it is so important that we as a profession make sure that the accounting is right in the actual financial statements. No amount of additional disclosure requirements can compensate for bad accounting principles. Accordingly, I believe that the pro forma disclosures allowed by Statement 123 are not an appropriate substitute for recognition of compensation cost in the financial statements.

I also believe that "less is more" when it comes to financial statement disclosures and that we as a profession should strive to eliminate disclosures that are not absolutely necessary to the investing public's understanding of an entity. For example, it is not clear to me how the average grant date fair value of options granted during the year could be decision useful information to users of financial statements. It is certainly not information that I use as an investor.

As an investor, I want to know (1) how much non-cash stock compensation expense is included in the income statements presented and (2) what is the potential for future dilution of my ownership interest. The former disclosure already is indirectly required under Statement 95, Statement of Cash Flows, because that Statement requires a reconciliation of net income to net cash flow from operating activities. I believe the latter disclosure would be sufficiently addressed by a description of an entity's stock-based compensation arrangements and a tabular summary of the options or other awards that are outstanding and exercisable as of the current balance sheet date (similar to the tables that many entities presently disclose under the requirements of Statement 123).

See also the discussion of Accounting for Grants That Represent Liabilities vs. Grants That Represent Equity in Appendix II for an additional disclosure recommendation for awards classified as liabilities.

Issue 13: Do you agree with the transition provisions of this proposed Statement? If not, why not?

I believe that the transition provisions in recent accounting pronouncements that allow for different effective dates for public and nonpublic entities negatively affect the comparability of financial results across entities and therefore are not in investors' interests. I recommend

that effective date requirements be the same for all entities for all new accounting pronouncements.

Issue 14(a): Do you agree with the Board's conclusion to allow an intrinsic value method for nonpublic entities? If not, why not?

I disagree with allowing nonpublic entities the alternative of using the intrinsic value method of accounting for stock options. I think the Board will agree with me that two transactions that have the same substance should be accounted for the same way by different entities. This principle is essential to ensuring the comparability of financial statements. Whether an entity is a public or private entity does not change the substance of a stock-based employee compensation arrangement. In both cases, the entity receives services in exchange for equity instruments. Accordingly, the accounting for such transactions should be the same for both public and private entities. However, all other things being equal, options on stock that is not publicly traded likely have a lower fair value than options on stock that is publicly traded, and this fact should be reflected in the valuation of the options.

Additionally, under the Exposure Draft, an entity that has gone through an initial public offering ("IPO") and had elected to use the intrinsic value method prior to the IPO would apply two different accounting methods to its stock option grants in the same set of financial statements. It would continue to account for options granted prior to the IPO under the intrinsic value method, and it would account for options granted after the IPO under the fair value method. In my opinion, this result is highly undesirable and not justified by cost-benefit considerations.

Issue 14(b): The Board made several decisions to mitigate the incremental costs nonpublic entities would incur in complying with the provisions of the proposed Statement. 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?

I do not believe that cost-benefit considerations justify different accounting treatment for transactions that have the same substance just because the entity is or is not a public entity. If cost-benefit considerations justify a certain accounting treatment for some entities, such considerations justify that treatment for all entities, as all entities have an interest in saving money.

Nevertheless, I would observe that many times the target audience of public entities' financial statements is different from that of nonpublic entities' financial statements. Accordingly, I think that different disclosure requirements for public and nonpublic entities may be justified. Cost-benefit considerations may be one factor to consider in drafting those requirements.

Issue 15: Do you believe that some or all of the alternatives allowed nonpublic entities should be extended to small business issuers, as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934?

No. See my responses to Issues 14(a) and 14(b).

Issue 16: Do you agree with reflecting excess tax benefits, as defined by the proposed Statement, as financing cash inflows in the statement of cash flows? If not, why not?

No. See my response to Issue 11.

Additional Thoughts on Stock-Based Consideration

Market, Performance, and Service Conditions

In the Exposure Draft, the Board proposes to account for stock options that have performance conditions differently from those that have market conditions. A market condition would affect the valuation of an option, and compensation expense would be recorded without regard to whether the market condition is achieved or not. A performance condition, on the other hand, would not affect the valuation of an option; instead, compensation expense ultimately would be recorded only if the performance condition is achieved. During the service period, compensation expense is recorded only if achievement of the performance condition is considered probable and is reversed if the performance condition ultimately is not achieved.

The proposed guidance in the Exposure Draft for both market and performance conditions described in the previous paragraph is consistent with the existing guidance in Statement 123. In paragraphs C94 and C95, the Board describes the two primary reasons for maintaining separate treatments for market and performance conditions. First, "some Board members... were concerned about the potential inconsistency if the effects of performance conditions were taken into account in measuring fair value at the grant date if the effects of service conditions were not treated similarly." Second, the Board has concerns about the ability of entities to develop probability distributions reflecting the likelihood that an entity will achieve a specific performance condition. I believe that performance conditions should be accounted for in the same manner as market conditions, and I will address the Board's concerns in the following paragraphs.

First, with regard to the interaction of performance and service conditions, I believe that a distinction needs to be made between two different kinds of performance conditions. The distinction is based on an analysis of what exactly the entity has contracted to receive in exchange for the stock-based compensation. The first type of condition involves situations where the entity is bargaining for the specific output of the counterparty (employee) that is within his or her unilateral control. For example, the employee may be required to perform a minimum number of sales calls in order to exercise the options. I will refer to such conditions as "specific output conditions." I believe that these types of conditions typically are more common in stock-based compensation arrangements with independent contractors than with employees.

The second type of condition involves situations where the entity is bargaining for the counterparty's (employee's) best efforts towards the achievement of a performance objective. In these situations, the counterparty does not have unilateral control over the achievement of the objective; he or she must work in concert with the other employees in the organization in order to achieve the objective. An example would be a condition that requires the entity's net sales to increase by 20% from one fiscal year to the next in order for the employee to be able to exercise the option. I will refer to these conditions as "best efforts performance conditions."

In the case of specific output conditions, I believe that the bargained-for exchange between the parties is an exchange of options for the specific output of the counterparty. If the counterparty does not deliver the specific output, no exchange has taken place, and therefore no compensation cost should be recorded. Accordingly, I propose to account for such options the way the Board proposes to account for options with performance conditions in the Exposure Draft.

In the case of best efforts performance conditions, I believe that the bargained-for exchange between the parties is the exchange of options for the counterparty's (employee's) best efforts towards the achievement of the performance condition. I think employers generally expect their employees to make their best efforts towards the objective of improving the performance of the employer as an essential part of their service to the employer, regardless of whether he or she has been granted options. Therefore, "best efforts" really just equates to service to the entity. Accordingly, I believe that if the employee has performed services over the vesting period, the bargained-for exchange of value has taken place between the parties, and therefore compensation cost should be recorded whether or not the performance condition ultimately is achieved.

I believe that this distinction between specific output conditions and best efforts performance conditions resolves the concerns of those Board members who noted a potential inconsistency by treating performance conditions differently than service conditions.

It seems to me that the fair value of an option that includes a best efforts performance condition will vary in direct proportion to the perceived likelihood that the performance condition will be achieved. For example, if the likelihood of the performance condition being achieved is perceived to be 50%, the fair value of that option likely will be about 50% of the fair value without the performance condition that has otherwise identical terms. Accordingly, I propose that a probability percentage be applied to the fair value of an otherwise identical option to estimate the fair value of an option with a best efforts performance condition.

The use of such probabilities to value stock options appears to be entirely consistent with the use of probabilities in the "expected cash flow approach" to estimating fair value described in Concepts Statement 7. Additionally, under Interpretation 46(R), Consolidation of Variable Interest Entities – an interpretation of ARB No. 51 (revised), entities are already required to make difficult estimates of the probabilities of future events and the related cash flows in order to determine whether they are required to consolidate variable interest entities. Notably, Board members expressed no such concerns about the ability of entities to develop such probability distributions in the Basis for Conclusions in Interpretation 46(R). In my opinion, the judgments about the probability of events related to a variable interest entity are generally much more difficult to make than judgments about the probability of stock option best efforts performance conditions being met.

Accounting for Grants That Represent Liabilities vs. Grants That Represent Equity

In the Exposure Draft, the Board proposes to measure awards that are classified for as liabilities the same way as those as equity, i.e., at fair value (except that awards classified as liabilities are remeasured at fair value at each balance sheet date). In my opinion, awards classified as liabilities should be measured at intrinsic value.

I believe that an analogy is appropriate to better understand the distinction between liability awards and equity awards and to understand the accounting for stock-based compensation in general. Both types of awards can be compared to lottery tickets. Awards classified as liabilities are like lottery tickets where the entity will pay the employee for any winnings on the ticket if the required conditions have been met ("entity-paid lottery tickets"). In contrast, awards classified as equity are like lottery tickets where the state lottery commission will pay the employee the winnings on the ticket ("state-paid lottery tickets").

An employer who grants state-paid lottery tickets has no further obligation to the employee once the tickets have been issued. The existence of performance or market conditions does not change this fact. The only question is whether the employee will perform the service required for the option to vest. Looked at in this way, it is clear that a grant of state-paid lottery tickets represents a nonmonetary transaction that should be accounted for in a manner consistent with the guidance in Opinion 29, Accounting for Nonmonetary Transactions. Paragraph 18 of Opinion 29 indicates that such transactions should be accounted for at fair value. I believe the guidance in the Exposure Draft for accounting for awards classified as equity is generally consistent with this approach.

With entity-paid lottery tickets, however, the entity has a contingent obligation to make payments to employees who hold winning tickets. The entity's obligation also may be affected significantly by the existence of performance or market conditions in the terms of the award. Such obligations, it seems to me, should be accounted for in a manner consistent with the guidance in Statement 5 for contingent liabilities. Under that guidance, contingent liabilities should be recognized if a loss is both probable and reasonably estimable. Generally speaking, stock-based compensation arrangements that are classified as liabilities call for the entity to make a payment that is equal to the intrinsic value of the award on the exercise date. Accordingly, I believe that the intrinsic value of an award on a given balance sheet date represents the best estimate of the amount to be paid and therefore should serve as the basis for measuring compensation expense related to such awards.

Additionally, in light of the fact that the liability will be expensed ratably over the service period, I recommend that entities be required to disclose, either on the face of the balance sheet or in the footnotes, the full amount of the liability, the amount of the liability that has not yet been recognized as expense, and the net amount recognized. This disclosure would be similar in appearance to the disclosures entities make of historical cost, accumulated depreciation, and net book value associated with their property, plant and equipment accounts.