



**Association for  
Financial Professionals**

February 1, 2003

Letter of Comment No: 239  
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Date Received: 2-1-03

Suzanne Q. Bielstein  
Director of Major Projects and Techn  
Financial Accounting Standards Board  
401 Merritt 7  
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Norwalk, CT 06856-5116

Re: File Reference No. 1102-001 Invitation to Comment, *Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123, Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-based Payment*

Dear Ms. Bielstein:

The Association for Financial Professionals (AFP) welcomes the opportunity to respond to the Invitation to Comment (ITC) on accounting for stock options. As corporate finance and treasury professionals, our members will likely be called upon to provide information necessary to formulate the economic assumptions inherent in options-pricing models that are used for estimating employee stock option expense.

AFP continues to oppose any requirement that companies record as an expense the fair value of stock options issued to employees. Employee stock options have value to employees and are a cost borne by shareholders, not the company. The cost of stock options is reflected in fully diluted earnings-per-share, under current accounting rules. However, if the Financial Accounting Standards Board (FASB) decides to require the expensing of the fair value of stock options, it is imperative that FASB address significant issues related to accurately and reliably measuring the estimated cost.

The membership of AFP includes approximately 14,000 financial executives employed by over 5,000 corporations and other organizations. Our members represent a broad spectrum of financial disciplines; their organizations are drawn generally from the Fortune 1000 and middle-market companies in a wide variety of industries, including manufacturing, retail, energy, financial services, and technology. AFP supports members throughout their careers with research, continuing education, career development, professional certifications, publications, representation to key legislators and regulators, and the development of industry standards.

### **Issues Related to Measurement of the Estimated Cost**

There are significant measurement issues associated with the model most widely used for estimating the cost of employee stock option, the Black-Scholes option-pricing model. The Black-Scholes model, which is cited by FAS 123 as an acceptable method, was developed for estimating the costs of marketable stock options. Marketable options have defined expiration dates and are usually held for relatively short time periods. Employee stock options however do not generally share those characteristics. Employee stock options normally cannot be transferred by the employee and usually have long-term vesting periods. For example, an employee may not be entitled to exercise the options for five years and the options may have an indefinite expiration date once the employee is vested. In addition, employee stock options usually are forfeited when an employee leaves the company.

### **AFP's Views on Measurement Issues**

FASB has asked in Issue 2 (b) of the ITC whether a particular option pricing model should be used. AFP does not believe that that FASB should designate one particular model as the only method that can be used to estimate the cost of stock options. One model might not meet the needs of every company and every industry. Companies must have the flexibility to adopt a model that best captures the economic substance of their stock option transactions. AFP also wants to state its opposition to mandating the use of Black-Scholes model.

In Issue 2 (d), FASB has requested comments on whether additional modifications need to be made to options-pricing models other than what is specified in FAS 123 and the proposed International Financial Reporting Standard (IFRS). FASB also requested comments, in Issue 2 (e), on whether additional guidance is needed for selecting the factors used in options-pricing models. AFP believes that additional research must be done to identify modifications that address the shortcomings of the Black-Scholes options-pricing model. Research is also needed to identify additional factors that may be appropriate for estimating the cost. Modifications to existing models and identification of additional factors for estimating cost will create the need for enhanced interpretative and implementation guidance.

Because of the stake that our members have in the outcome of FASB and IASB deliberations on employee stock options, AFP is currently exploring the possibility of performing research on employee stock option pricing methodologies. AFP would be pleased to share with FASB the results of any research performed.

## Recommendations

As the voice of 14,000 corporate finance, treasury, and accounting professionals in all industries, AFP is concerned about accounting for stock options. AFP members have a direct interest in the debate and may be called upon for economic analyses necessary to help implement any new corporate accounting policies related to stock options.

AFP recommends that FASB maintain the option of disclosing, rather than expensing, the cost of employee stock options in financial statements. Employee stock options represent costs to shareholders that are currently reflected in fully diluted earnings-per-share.

If FASB withdraws the disclosure option, then AFP recommends that FASB acknowledge the deficiencies in the Black-Scholes options-pricing model. FASB also should encourage the development of modifications to Black-Scholes and accept a range of alternatives for valuing employee stock options. FASB also should issue interpretative and implement guidance, as necessary, to address modifications to Black-Scholes and/or alternative stock option valuation methodologies.

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On behalf of our 14,000 members, AFP appreciates the opportunity to comment on the FASB proposal. If you have any questions, please contact Gregory Fletcher, AFP's Director of Financial Accounting and Reporting, at (301) 961-8869.

Sincerely,



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