

**Karen Salmansohn**

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**From:** Director - FAS  
**Sent:** Monday, Febr  
**To:** Karen Salma  
**Subject:** FW: File Refer

**Letter of Comment No:** 183  
**File Reference:** 1102-001  
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-----Original Message-----

**From:** James Reagan [mailto:james.reagan@ams.com]  
**Sent:** Saturday, February 01, 2003 9:21 PM  
**To:** Director - FASB  
**Subject:** File Reference 1102-001 Response to Invitation to Comment

Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

Re: 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 International Financial Reporting Standard (IFRS), Share-based Payment (File Reference 1102-001)

To the Director, Major Projects and Technical Activities:

American Management Systems, Inc. appreciates the opportunity to provide our views on the differences between certain U.S. accounting standards on stock-based compensation, principally FASB Statement No. 123, "Accounting for Stock-Based Compensation", and its related interpretations and the proposed IFRS. The following represents our responses to the issues outlined in the request for comment:

Issue 1: Statement 123 provides a scope exclusion for ESOPs and certain ESPPs, and the Proposed IFRS does not. Which view do you support and why?

We disagree with the Proposed IFRS and believe that certain ESPPs should be excluded from the scope of the Proposal. This conclusion is based upon our agreement with the three criteria identified by the Board that state that certain ESPPs are not compensatory. Most importantly, we believe that, assuming the purchase plan has no option features, certain small discounts from market price offered to employees are "aimed at encouraging employees to become stakeholders" (SFAS 123 paragraph 235) and are not offered to compensate the employees for services rendered. We agree, however, with the IASB that defining the meaning of small in this context is problematic and believe it would be beneficial for the Board to re-evaluate this definition. We refute the IASB's comment in paragraph BC14 that "it is unnecessary to exempt these plans from the standard" because "the amounts involved are immaterial." We believe the FASB's distinction that the discount is small refers to the value of the rights given to each

individual employee from the entity's perspective in determining whether or not the plan is compensatory; thus, the value to each employee may be small enough so that it is not considered compensation but in aggregate, may be material enough to the entity to justify the need for a specific exclusion in an accounting standard.

Issue 2: In measuring the fair value of stock options granted to employees, both Statement 123 and the Proposed IFRS require use of an option-pricing model that takes into account six specific assumptions. The standards provide supplemental guidance for use in selecting those assumptions.

Issue 2(a): Do you believe that an accounting standard should mandate the use of an option-pricing model for measurement purposes? If not, what other approaches do you believe would provide more consistent and reliable estimates of the fair value of employee stock options granted and why?

No comment

Issue 2(b): If you agree that an accounting standard should mandate the use of an option-pricing model, do you believe that a particular model should be mandated? If so, which model should be required to be used and why?

No comment

Issue 2(c): If you agree that an accounting standard should not mandate the use of a particular option-pricing model, do you believe that additional disclosures should be made to improve the user's ability to compare the reported financial results of different enterprises? If so, what types of additional information should be required to be disclosed?

No comment

Issue 3: Do you believe that employee and nonemployee transactions are distinct and, therefore, warrant different measurement dates for determining the fair value of equity instruments granted? If so, why? If not, why not?

We agree with the IASB conclusion that there is no conceptual difference between employee and nonemployee transactions and that in either case, an entity receives goods or services in exchange for granting equity instruments. Furthermore we believe the nature of the exchange, not the principals to the exchange, should determine the measurement date. If for instance, the issuance is for services, we believe that the transaction measurement date should be consistent regardless as to whether the transaction is with an employee or nonemployee. However, it is feasible that the measurement principle applied should differ when valuing different types of transactions (goods vs. services). In addition, while we generally agree conceptually with the modified vesting date approach established in EITF Issue No. 96-18, we believe that the difficulty in accounting for such an approach, in certain circumstances, far exceeds the benefits. This is especially true when valuing services to be performed over time. In circumstances where the parties to a transaction are not likely to cancel a transaction based upon the changes in value that would

occur using the modified vesting date approach, it would support the conclusion of the IASB that the full value of economic benefits to be received in exchange for the equity instruments granted was contemplated by the entity and the counterparty at the time the contractual arrangements were entered into. As such, we prefer the IASB approach of valuing the transaction on the grant date.

Issue 4: Do you believe that the fair value of equity awards granted to nonemployees that include performance conditions can be measured with sufficient reliability to justify a grant-date measurement method? If so, why? If not, why not?

We believe that when performance conditions that must be met are established at the time the award is granted, the perceived value of those conditions was determined at the time that both parties to the exchange entered into the arrangement. As such, the value to the parties should be measured on the grant-date.

Issue 5: Do you believe that the notion of issuance is conceptually of importance in the design of a standard on stock-based compensation? If so, why? If not, why not?

We believe that the notion of issuance is conceptually of importance in the design of a standard on stock-based compensation. The Proposed IFRS is focused upon the measurement of the changes in net assets resulting from the receipt of good and services. The IASB continues to treat goods and services received, even when forfeited, as a "contribution" on the part of the employee. We believe this to be contradictory to the way in which other portions of an employee's pay package are treated. For example, if an exempt employee who typically works 40 hours in one work-week then works 60 hours in the following week, that employee is providing additional services to the company. However, the company, assuming they do not have some type of compensatory time plan, records no additional compensation expense in the income statement but instead views the receipt of the employee's services as uncompensated contributed overtime. The fundamental distinction of issuance versus receipt of goods or services becomes important in this example because without the notion of issuance, contributions by an employee may be inconsistently applied depending upon whether the consideration at stake is an equity instrument or cash, for example. The notion of issuance is necessary to distinguish if the equity instrument will even be considered as compensation. We agree with SFAS 123 which states, in footnote 4, that "the equity instrument is not issued until the issuing entity has received the consideration, such as cash, an enforceable right to receive cash, other financial instruments, good, or services, agreed to by the parties to the transaction" when referring to equity instruments subject to service or performance conditions.

Issue 6: Do you believe an equity instrument subject to vesting or other performance conditions is issued, as defined by Statement 123, at the grant date? If so, why? If no, why not?

We do not believe that an equity instrument, which is subject to vesting or other performance conditions, is issued until the point at which those conditions are met. We believe that the criteria of the "receipt of goods and services" as proposed in the IFRS are not fulfilled until the performance conditions for those services have been themselves been fulfilled.

Issue 7: Do you believe that the effect of forfeiture should be incorporated into the estimate of fair value per equity instrument (IASB

approach)? If so, why? If not, why not?

We do not believe that the effect of forfeiture should be incorporated into the estimate of fair value per equity instrument (IASB approach). We believe that all areas of an employees' pay package should be treated consistently, to adhere to Accounting Principles Generally Accepted in the United States. For example, assume a calendar year entity accrues a cash bonus on December 31, 2002 for 100 employees at 10% of their salary, with no performance conditions except employment at the date of payment. The bonus is for services rendered by the employee in the 2002 fiscal year and is intended to be paid on March 15, 2003. It is estimated that 1 employee, who is searching for a new opportunity, is likely to forfeit his bonus and leave prior to March 15, 2003. The fair value of the cash bonus remains 10% of his salary, and only the aggregate value of the bonus is affected if it is deemed probable that the employee will forfeit his compensation. Likewise, if conditions demonstrated that it was unlikely that the employee would resign, the bonus would be accrued in full in 2002, and if circumstances prevailed that the employee left in February 2003, the bonus accrual would be reversed when that information became known, and the adjustment of the estimated bonus payment would be credited to income in 2003.

Including the fair value in the effect of potential forfeitures distorts the concept of fair value. In addition, as demonstrated above, this would be inconsistent with other accounting principles. We believe fair value and potential forfeitures should remain separate and distinguishable criteria.

Issue 8: Should failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the promised benefits affect the amount of compensation expense that should be recognized related to that award? If so, why? If not, why not?

We believe that failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the promised benefits should affect the amount of compensation expense that should be recognized related to that award. We believe that the requirement that goods and services must be received as consideration for the equity award granted is not fulfilled unless all conditions are satisfied in full. We assume that an award with, for example, a vesting period of 4 years is granted to an employee because the employer is compensating the employee for providing services to the employer over the next 4 years (i.e. over the period that the employee is earning their related benefit). If the employee does not fulfill the entire obligation of the service period, we assume that the full amount of services has not been received, and therefore, the employer would not pay the full amount of compensation. The treatment for equity awards should be consistent with the accounting treatment that would be applied if cash were exchanged for the services. If an employee had to be with the Company on a certain date to earn a cash bonus, and left just prior to being entitled to receive the bonus, an employer would reverse prior expense recorded and remove the obligation from their balance sheet. Therefore, compensation expense recorded for options earned over time should also be reversed for the amounts forfeited by the employee.

Issue 9: Do you agree that the result of the IASB's approach to calculate the fair value of equity instruments of nonpublic entities would be closer to fair value than minimum value? If so, why? If not, why not?

No comment.

Issue 10: Which of the two attribution methods described by the standards do you believe is more representationally faithful of the economics of stock-based compensation arrangements and why?

We believe the Statement 123 approach is more representationally faithful to the economics of stock-based compensation. Because Statement 123 is a modified grant-date approach, it allows for actual changes in the number of equity instruments issued to be factored into the total compensation expense recorded for each award. This is consistent to the accounting methodology that would be used were we to pay the fair value in cash as opposed to equity.

Issue 11: Statement 123 does not ascribe value to services received in exchange for equity instruments that are later forfeited (that is, recognized compensation expense is reversed upon forfeiture), whereas the Proposed IFRS ascribes value to such services through its units-of-service attribution method (that is, recognized compensation expense is not reversed upon forfeiture). If you support the IFRS's view, do you believe the units-of-service method ascribes an appropriate value to services received prior to forfeiture? If so, why? If not, why not?

We do not support the IFRS's view and believe the Statement 123 methodology is more consistent with other Generally Accepted Accounting Principles.

Issue 12: Do you believe the actual outcome of performance awards should affect the total compensation expense incurred by an enterprise? If so, why? If not, why not?

We believe that the actual outcome of performance awards should affect the total compensation expense incurred by an enterprise. As stated with respect to Issue 8 above, we believe that the requirement that goods and services must be received as consideration for the equity award granted is not fulfilled unless all conditions are satisfied in full. If the company does not receive the required outcome stipulated for providing the equity instrument and therefore does not provide the instrument- we believe that the company should not be required to record expense.

Issue 13: Do you believe this issue is important in considering an attribution model's validity? If so, why? If not, why not?

We believe the issue is important in considering an attribution model's validity. We believe that the FASB 123 model for valuing the option based upon the expected life of the option, but amortizing it over the vesting period is fundamentally flawed as it attempts to attribute expense to the company based upon a decision made by an employee to hold on to the option after the exchange of goods and services has taken place. When the employee chooses to exercise the option should have no impact on the determination of value given by the company to the employee in exchange for their service. The value model should consider the time value of the option only to the extent that the ability to exercise the option is under the Company's control. As such, we believe that the time value of the option should only be based upon the vesting or performance period assigned to the option.

Issue 14: Do you believe that the measurement-date criteria in Issue 96-18 accurately reflects the economics of transactions with nonemployees? If not, why not?

Please refer to our response to Issue 3.

Issue 15: Do you believe that all of the tax benefits derived from stock-based compensation arrangements should be recognized in the income statement? If so, why? If not, why not?

We believe the FASB 123 approach to accounting for the tax benefit associated with stock option is most appropriate. We agree that to the extent that an expense must be recognized in the income statement, the related tax benefit should also be recognized in the income statement.

We appreciate the opportunity to express our views in this letter. If you have any questions regarding our comments, please feel free to contact us.

Very Truly Yours,

James C. Reagan, CPA  
Senior Vice President and Controller