

June 7, 2004

Director of Major Projects-  
File Reference No. 1102-100  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

RE: Share-Based Payment

The issue of the accounting treatment for payments made with the use of company equity has, and will continue to be, contentious for many entities. I am glad that the board is again addressing the issue and coming to closure on this topic. From my personal perspective, this issue should have been resolved with the issuance of Statement 123, without the bowing to congressional threats. In fact, as we look back, had the board gone forward as this exposure draft is now doing, it is possible that some of the accounting and audit failures may not have occurred as the costs would have been reflected.

First of all, it is important that the opinions and viewpoints expressed here are those of my self and are not to be construed to represent the viewpoint or position of the company.

Overall, I am in agreement with this proposed statement. There are some areas for which I think an alternative or intermediate approach maybe preferable. My comments below shall refer to the issues as noted.

Issue 1: I am in full agreement that the issuance of options and bargain basement purchase options to employees is a form of compensation. In the early deliberations regarding Statement 123, many companies argued that stock options were not compensation, but rather to align interests with that of owners. Then when the stock market dropped, these same people argued that options need to be re-priced because it affected the compensation package. Well, options and such ARE part of the compensation package just as vacation, health, salaries and bonuses.

The issuance of options to employees should be treated as a salary expense. Broad based stock purchase plans should be treated as a benefit cost. Granted these are both components of total compensation, but I do think the differentiation is worthy of note.

Issue 2: This proposed statement is only in effect doing what the initial intent of statement 123 hoped to do. Not only should this be recorded as an expense in the financial statements, the amounts that have been recorded through the proforma notes as permitted by Statement 123 should be now reflected in the financials as a cumulative adjustment.

One area for which I think the accounting should be different is to record the option cost as a liability until such time as exercise occurs. One of the reasons I advocate this approach is so that there is more visibility of the value of options outstanding. I say this because I feel that the immediate reflection in equity on the financials will be lost on most investors. Investors look at the financials and unfortunately do not devote the time and attention to the notes which are a part of the financials. A second reason for the recording of a liability is that the exercise of the options can require the entity to use financial resources. For instance, the entity may have to purchase, for cash, the shares of stock on the open market, at what is most likely a premium above the receipt of funds for the exercise of the options.

Issue 3: The value of the options at the grant date is an appropriate point in time. First, while options typically vest into the future, they are granted for that which has been performed by an employee. The date upon which the Board grants the options is that point in time when the Board has assigned a value. Further, most companies grant options on an annual basis and having a single point in time would allow for a greater cost benefit in terms of administration.

Issue 4(a): There is, and will probably always be differences of opinion on the valuation of, and the methods used, including various criteria. We use various estimates in financial reporting today applying various assumptions. This is no different. The use of an option pricing model, while not perfect, does try to reflect the cost associated with the options. I believe that the most critics are those who advocate no recognition of a cost.

Issue 4(b): Because the lattice models encompass more variables in the equation, we can make a reasonable conclusion that such models will provide better information. Yet, the issue is not the model itself, but the assumptions and reasoning used in the application of the models. That is an audit issue for which the entity should be required to document its assertions and conclusions on the application. Notes to the financials should disclose these conclusions and the reason so that users can then evaluate and make an informed decision.

Issue 4(c): See comments in 4(b).

Issue 5: I would see this issue being applicable to companies that are not publicly traded only. Even those thinly traded would have some basis for valuation, including using those such as brokerage houses for information. Yet, even in the former situation, an entity granted options has made certain "assumptions" as to their value to the option holder. Therefore, those assumptions used in the modeling of such a plan or program should be used in the applicable model and the accounting applied consistent with that prescribed for all others.

Item 6: Refer back to my comments on Issue 1. While an entity may not treat the program as "salary", it should reflect such as a benefit cost. The cost should be the difference between the exercise price and the price at the time granted or purchased as the case could be. For instance, an employee can purchase a share for \$10. The price is \$11. The

company has to purchase the share on the open market. It should record an expense of \$1. A company may provide meals to employees at a reduced cost and in fact subsidize the meals. The company currently recognizes this subsidy in the financials. I do not see a difference in purchasing shares at a discount with the company subsidizing.

Issue 7: Agree.

Issue 8: Agree.

Issue 9: Agree.

Issue 10: Agree except that any modification that extends terms with the concurrent increase in options be treated as original terms for original options and valuation only on the incremental portion.

Issue 11: In this case, I agree with IFRS 2 that no recognition be made for the tax effect until such event has actually transpired. My reasons are: (i) to have better harmonization with IASB, (ii) tax laws are subject to dramatic change and this area is shall we say "high risk" for such, (iii) complexity of accounting for such, (iv) the unknown of actual usage and the timing thereof, (v) the actual tax implication is more than likely not significant to the organization. The tax implication for broad based shares as discussed in Issue 6, if within current tax parameters under section 423 of the code, would be treated as a permanent difference under FASB 109.

Issue 12: Agree except that disclosure of rates used, etc should also require the basis for the assumptions and conclusions arrived at. The basis used, while disclosed, in and of itself will not add value to a user without the user understanding the reason for using such rates.

Issue 13: I disagree with the prospective method. For all outstanding options a cumulative adjustment should be made. Companies have already made proforma disclosure. This only needs to be incorporated. There is very little cost or effort involved and will immediately bring the accounting for options onto the face of the financial statements.

Issue 14(a): Refer to Issue 5 where I said that non-public companies should use the analysis of value to an option holder as the basis for valuation. No entity will issue such to employees without having made certain valuation assumptions internally. Therefore, without a ready market for the valuation, the entity should apply those assumptions used in determining the program to the options actually granted.

Issue 14(b): The accounting and disclosures should be the same for all entities. Applying Issue 14(a) as I have suggested will provide information to users, most likely creditors of a private entity. They need such information to determine costs and risks to their organization.

Issue 15: No separate accounting or disclosure should be applied to small business issuers.

Issue 16: I agree. In fact, applying IFRS 2 makes it readily identifiable to segregate the tax benefit and record such.

Issue 17: Comments on the accounting have been expressed in earlier issues.

Issue 18: I agree.

Respectively Submitted,

Louis W. Sanford, CPA  
VP Finance  
Dow Hotel Company, LLC  
16400 Southcenter Parkway  
Suite 305  
Seattle, WA 98188  
Office: 206-575-3600  
Fax: 206-575-0600  
E-mail: [Lsanford@dowhotelco.com](mailto:Lsanford@dowhotelco.com)