



UnitedHealth Group™

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Letter of Comment No: 5475
File Reference: 1102-100

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

Re: Exposure Draft: Proposed FASB Statement, *Share-Based Payment: an amendment of FASB Statements No. 123 and 95* (File Reference No. 1102-100)

Dear Ms. Bielstein:

UnitedHealth Group appreciates the opportunity to comment on the Exposure Draft, "Share-Based Payment" (ED).

UnitedHealth Group believes the adoption of any accounting principle should be based on the fact that it will result in consistent, comparable and reliable financial statements between reporting entities and between years for a reporting entity. Costs that cannot be reliably estimated should not be recorded in the financial statements. Allowing multiple alternative methods to determine amounts to be included in the financial statements does not promote consistent, comparable and reliable financial statements. Differences between the financial statements of reporting entities should not result from alternative accounting principles or application methods, but rather should be explainable by verifiable facts. Also, differences in financial statements between reporting periods should not be caused by the adoption of a new accounting standard.

Keeping in mind these basic principles, we request the FASB consider the following comments:

Expensing stock options "double counts" their impact on diluted earnings per share

UnitedHealth Group has consistently held the position that expensing stock options does not provide financial statement readers with the most appropriate reflection of the economic impact of stock option grants on an entity's financial statements. The granting of stock options represents potential future dilution to the entity's shareholders not an

accounting transaction. The economic cost of a stock option is currently reflected in the financial statements as additional shareholder dilution through the inclusion of stock options in the calculation of diluted earnings pre share. The ED's required expensing of stock options would, in effect, "double count" the impact of stock options on diluted earnings per share.

Existing valuation models are unable to appropriately value stock options.

We have strong concerns regarding the reliability of fair value estimates generated using existing option pricing models. Numerous companies and valuation experts share this concern. The granting of stock options represents an exchange transaction between a company and an employee that is very difficult to reliably value at the date of the exchange (date of grant). Existing models, such as the binomial or Black-Scholes models, rely heavily on estimates and future expectations that are inherently subject to preparer bias and are not based on objective or verifiable third party evidence. Recording an expense in the financial statements based on these unreliable estimates would result in lack of comparability across companies and may result in financial statements that are not representative of a company's financial performance. This will not improve the transparency and usefulness of financial statements.

If one of the existing valuation models must be used to estimate fair value, the standard should require the use of the binomial model.

To enhance comparability across companies, we believe the standard should require the use of a single method of estimating fair value which we believe should be the binomial model. The FASB has stated in the ED that it believes the binomial model is the preferable method for fair valuing stock-based compensation. If the binomial model is superior, it should be required for expense calculations for all companies to enhance comparability across companies. It doesn't make sense to assert that the binomial model is preferable and then not follow through and require the use of this preferable model for all companies. Allowing the use of alternative methods for estimating the same expense does not promote consistent, comparable, reliable and transparent financial reporting.

Companies should be required to restate prior periods on a consistent basis.

We believe that all companies should be required to restate prior period financial statements under a complete retroactive transition approach. This approach would allow valuation methodologies, tax consequences, and recognition patterns to be consistently applied within a company's financial statements. From a comparability standpoint, this adoption method is the only method that will allow users to understand and analyze historical financial trends. The decision regarding a required adoption method should not be driven by the existing accounting theory of changing from one acceptable accounting method to another acceptable method since the FASB is proposing that the previously generally accepted accounting method is no longer acceptable. Rather, the overriding principle should be to provide consistent, comparable, relevant and reliable information that is useful for investors, creditors and others who make capital allocation

decisions. Accordingly, all companies should be required to retroactively apply the provisions of the standard to all periods presented in the financial statements.

Straight-line expensing for graded vesting should be required.

Companies should be required to use the straight-line method of expense recognition when they issue equity awards with graded vesting. The pattern of service provided by the employee is the same whether the arrangement contains graded or cliff vesting provisions. In other words, employees' services are performed uniformly over the vesting period regardless of the vesting provisions. For example, in an arrangement with four-year graded vesting, the attribution approach proposed in the ED would result in recognizing approximately 52 percent of the total compensation cost of the arrangement in the first year, whereas a similar cliff vesting arrangement would result in only 25 percent of the total compensation cost being recognized in the first year. Certainly, neither the employer nor the employee in a graded vesting arrangement believes that the employee has provided over half of the total service in the first year of this four-year arrangement. Given that the pattern of service is the same in both graded and cliff vesting arrangements, we believe that the straight-line expense attribution method should be used for both types of arrangements.

Income tax benefits resulting from share-based payments should be recorded in shareholders' equity and included in operating cash flows.

The ED requirement that excess tax benefits be recognized in equity while any tax benefit shortfall be included in earnings is very confusing and not based on sound logic. We do not understand how an excess tax benefit is, in effect, an equity transaction while a tax benefit shortfall apparently is not. Both the excess tax benefit and the tax benefit shortfall are solely due to share price changes between the option grant date and the option exercise date. We believe any difference between the initial deferred tax asset recognized and the eventual actual tax benefit should be recorded in equity – regardless of whether the difference is excess or a shortfall.

We also disagree with the ED conclusion regarding the classification of cash flows from excess tax benefits in the cash flow statement. If companies are required to expense share-based payments as operating costs, it logically follows that that the tax benefit from that expense generates an operating cash flow. All reductions in income tax payments resulting from stock options should be classified in operating cash flows.

Expense for share-based awards forfeited based on a market condition should be reversed, consistent with the ED's proposed treatment for awards forfeited based on performance or service conditions.

The ED currently does not allow for the reversal of expense recognized for awards forfeited due to not attaining a market condition, while expense may be reversed for awards forfeited due to not attaining a performance or service condition. If the goal is greater consistency and transparency, this distinction between market conditions and

performance and service conditions in terms of determining whether or not to reverse option expense should be eliminated.

One of the best performance-based measures available today is a comparison of a company's Total Shareholder Return (TSR) to the TSR of a peer group. Companies often use such a measure to determine the amount or timing of equity award vesting. Under the ED, the use of such a market condition tied to stock price performance would be discouraged in favor of awards with more arbitrary performance or service conditions. This is moving in the opposite direction from that desired by most shareholders, which is a more direct link between shareholder return and employee stock-based compensation.

Employee stock purchase plans qualifying under IRC 423 should not be expensed.

Employee stock purchase plans (ESPPs) are designed to provide a means for employees to accumulate stock in a company through regular payroll deductions. ESPPs are provided for in Internal Revenue Code (IRC) Section 423. Companies often use these programs as a way to raise capital. These programs generally provide a fixed discount that may approximate the costs of raising capital in the equity markets for certain companies. The discount from the stock price for equity capital raised using an ESPP program is clearly not an expense to the company just as issuance costs to raise equity capital are not an expense. That cost is merely a deduction from the gross equity capital raised. Even if the discount exceeds the expected costs to raise capital, we still do not believe that selling shares at a discount should result in a corporate expense, because no corporate assets have been used up nor has their value diminished as a result.

Under the ED, virtually all ESPPs will be considered compensatory and this will require companies sponsoring such plans to record what may be a significant expense. This requirement will have a significant adverse and unintended consequence in that many companies will terminate their ESPPs. We believe that the FASB should exclude ESPP programs from the ED provided these programs conform to IRC section 423.

The FASB should consider delaying the effective date of the proposed standard.

We are concerned that the anticipated timing for the release of the final standard in the fourth quarter of 2004 will leave insufficient time for calendar year-end public companies to adopt by January 1, 2005. Our proposals to require the binomial model and retroactive adoption, while greatly increasing comparability and consistency between companies and between years, may require additional investment in time and systems for certain companies. Under the ED proposed timeline, companies will have a very limited time to address complex valuation and transition issues. The final standard will provide financial statement users with higher quality information if the implementation period provides adequate time to address these transition issues.

Financial Accounting Standards Board
June 29, 2004

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Thank you for the opportunity to comment on this Exposure Draft. We urge the FASB to consider these comments as it redeliberates share-based payment issues. Please contact Scott Theisen at (952) 936-7141 with any questions on our comments.

Sincerely,

/s/ Patrick J. Erlandson

Patrick J. Erlandson
Chief Financial Officer

Cc: Scott Theisen
Vice President – Corporate Controller