kpmg

280 Park Avenue
New York, NY 10017

Telephone 212 909 5400
Fax 212 909 5699

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

Dear Ms. Bielstein:

FASB Exposure Draft of a Proposed Statement, *Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123* (File Reference No. 1101-001)

We believe that it is appropriate for the Board to reconsider the fundamental accounting for stock-based compensation. A contributing factor to our view is the International Accounting Standards Board's (IASB's) position on expense recognition in its project on share-based payments.

In the interim, as more companies choose to record compensation expense related to the fair value of the employee stock options that they grant, we support the Board's decision to reconsider the transition and disclosure provisions of Statement 123. While it remains to be seen whether providing additional transition alternatives would encourage more companies to change voluntarily to the fair value method of accounting for stock options, we support the Board's recent initiative. We believe that financial statement users would be well served by transition provisions that would allow companies that change from the intrinsic value method to the fair value method to recognize compensation expense at a more level rate than would result under the current transition approach in Statement 123. We also believe that the proposed amendments to disclosure requirements, particularly those related to enhanced interim reporting, will improve financial reporting.

The remainder of this letter addresses our views on the significant provisions of the proposed Statement. The appendix addresses detailed comments about wording, and a few broader issues that do not relate to the specific issues addressed in the Exposure Draft.

Amendments to Transition Provisions of Statement 123

The proposed amendment to Statement 123 maintains the fundamental choice between the fair value method and the intrinsic value method that exists in that Statement. We believe that it would be inappropriate for the Board to preclude companies that decide currently to apply the fair value method from applying the transition method that exists in Statement 123. Therefore, we believe that the only way in which the Board should permit companies to recognize compensation expense at a more level rate is to offer a choice among transition alternatives. While that choice comes at the cost of comparability among entities, on balance, we find it difficult to object to noncomparability due to a *choice among transition methods* when noncomparability already exists due to the *choice between accounting methods*. We also believe that the proposed amendments to disclosure requirements will mitigate some of that noncomparability.

Furthermore, if the final amendment offers a choice of transition methods, we believe that the three alternative methods (including the transition already in Statement 123) described in the Exposure Draft are the appropriate methods from which to choose. The two newly proposed alternatives (retroactive restatement method or the prospective recognition method for unvested awards and new awards) somewhat mitigate the noncomparability that results from the choices because those two alternatives produce the same current period results (that is, the same results in the period of adoption).

We support the Board's decision to require (in new paragraph 52A) a company that chooses the prospective recognition method for unvested and new awards or the retroactive restatement method to (a) reverse the carrying amount of the accumulated deferred compensation (if any), and related deferred income tax balances that arose under the application of Opinion 25, and (b) recognize the additional paid-in capital, stock-based compensation liabilities, and related deferred tax balances required under Statement 123. We concur with the Board's proposal that the difference between (a) and (b) above should be reported as an adjustment to additional paid-in capital as of the beginning of the period, not as a cumulative effect of a change in accounting principle.

Finally, we agree with the Board's proposal in paragraph 2(c) that for an entity that continued to apply Opinion 25 after the issuance of Statement 123, but ultimately adopted the fair value method in that Statement, only the additional paid-in capital recognized from excess tax deductions for awards accounted for under the fair value method pursuant to the transition provisions of paragraph 52 is available to absorb write-offs of a related deferred tax asset in excess of the benefits of the tax deduction.

Amendments to Disclosure Provisions of Statement 123

We agree with the Board that the proposed Statement would provide greater comparability in reported financial information by requiring disclosure of comparable information for all companies regardless of whether, when, or how an entity chooses to adopt the fair value method of accounting.

We support the Board's proposal in paragraph 2(d) of the Exposure Draft to require certain disclosures in the financial statements of entities for which all or a portion of the cost of stock-based awards was determined under Opinion 25. Effectively, that disclosure requirement exempts only companies that choose the retroactive restatement method.

We agree with the Board's decision not to require disclosure of the pro forma amounts on the face of the income statement because all financial statement disclosures are integral to the financial statements. We support the Board's decision to require the disclosures in paragraph 2(d) to be included in the Summary of Significant Accounting Policies or its equivalent, and to be made in tabular form. However, it is not clear to us whether the phrase "disclose prominently" is operational or necessary. Arguably, the proposed disclosures would be prominent by virtue of being made in the accounting policy note in tabular form. If the Board intended the phrase "disclose prominently" to require additional prominence (for example, bold type or larger font), that is not clear to us. If the Board intended something beyond tabular format in the accounting policy note, we urge the Board to clarify the proposed requirement and to explain in the Basis for Conclusions how the rationale for that requirement is different from the Board's conclusion on the pro forma display issue that all disclosures are integral to the financial statements.

We also support the proposal to expand the content of the accounting policy note to include the method of accounting for stock-based compensation and the transition method that an entity uses if it adopts the fair value method. Furthermore, we support the proposed requirement to "reconcile" net income (as reported) with pro forma net income by separately identifying stock-based employee compensation expense included in reported net income (net of related tax effects) and total stock-based employee compensation expense determined under the fair value method for all awards (net of related tax effects) granted, modified, or settled in fiscal periods beginning after December 15, 1994. We believe that the proposed disclosures round out the currently required pro forma disclosures and help to address the concerns about comparability that financial statement users have as a result of the choice of accounting methods for stock-based compensation. Finally, we support the Board's implicit decision not to reconsider the placement of the disclosures that continue to be required under paragraphs 46 through 48 of Statement 123.

Amendment to Opinion 28

We believe that financial statement users are better served by disclosures that facilitate timely decision making. Thus, we support the Board's proposal to require the pro forma disclosures and reconciliation to be disclosed prominently in the notes to condensed financial statements for an interim period that includes the effects of stock-based compensation accounted for under the intrinsic value method.

Effective Date

In view of the heightened interest by many companies in adopting the fair value method of accounting for stock compensation, we believe that it is important to make the revised transition provisions of Statement 123 effective as soon as possible. Therefore, we support the Board's proposal in paragraph 4 to amend the transition provisions of Statement 123 effective for fiscal years ending after December 15, 2002, and to permit early adoption if an entity has not issued its financial statements for a fiscal year ended before the issuance of the amendment. We understand that the Board intended to allow early adoption if financial statements for an interim period were not issued before the issuance of the amendment. As entities were required to adopt Statement 123 as of the beginning of a fiscal year, we believe that it is important for the Board to clarify its intent in the final Statement.

We also support the Board's proposal to require companies to provide the expanded disclosures in financial statements for annual periods ending after December 15, 2002 with early adoption encouraged for an entity that has not issued its financial statements for a year ending before December 15, 2002. We also support the proposal to make the amendments in paragraph 2(e) and paragraph 3 effective for quarterly financial statements for the first interim period beginning after December 15, 2002.

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If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449.

Very truly yours,

KPMG LLP

Miscellaneous Comments

Paragraph	Comment
Cover	We believe that the subtitle of the Statement should be "an amendment of FASB Statement No. 123 *and APB Opinion No. 28*" to reflect the amendment proposed in paragraph 3.
2(a)	The last full sentence of the paragraph states, "Awards are considered to be accounted for under Opinion 25 only if they were issued . . . ." We suggest changing the word "issued" to "granted" so as not to limit the Statement to awards that are earned, vested, and nonforfeitable. The same comment applies to the first sentence in paragraph A10.
2(d)(c)	This proposed disclosure would require tabular reconciliation for unvested awards that are outstanding and accounted for under Opinion 25. We believe that the requirement also should apply to vested awards that continue to be accounted for as variable under Opinion 25 until the award is exercised or expires unexercised. Paragraph A13 needs a similar conforming change.
Illustrations 2 and 5	It is not clear to us what benefit financial statement users derive from the tabular reconciliation for Year 2003 in Illustration 2 and for 3 months/9 months 2003 in Illustration 5 when net income as reported is the same as the pro forma amount. Presumably some readers will struggle to identify a difference where none exists. We suggest that the Board consider requiring an explicit qualitative statement if there is no difference between reported and pro forma net income.
Basis for Conclusions (General Comment)	We note that while paragraph A24 addresses cost-benefit issues related to condensed interim financial statements, the Basis for Conclusions does not contain a broader discussion of the benefits and costs of issuing the Statement as has become standard in recent FASB Statements. Similarly, the Basis for Conclusions also lacks a section to address International Accounting Standards. Much of the material in the International Convergence section of the Summary would be better suited to the Basis for Conclusions. The Basis for Conclusions also should identify and discuss the transition provisions that the IASB will include in its forthcoming Exposure Draft on share-based payment transactions.