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

Re: Exposure Draft: Accounting for Stock-Based Compensation – Transition and Disclosure (File Reference 1101-001)

Dear MP&T Director,

This response represents the views of the Accounting and Valuation Group of UBS Warburg Equity Research. The Accounting and Valuation Group provides advice on financial accounting and equity valuation methodology to UBS Warburg equities clients and to equity analysts within UBS Warburg Equity Research. The views expressed are provided from an equity analysis perspective and are independent of, and may not necessarily coincide with, the views of UBS Warburg or of UBS. A letter representing the views of UBS has been sent to you separately.

The Accounting and Valuation Group of UBS Warburg Equity Research appreciates the opportunity to comment on the proposed statement "Accounting for Stock-Based Compensation – Transition and Disclosure". We commend the FASB for responding quickly to the wave of companies that have recently decided to voluntarily adopt the fair value method of reporting stock options in their financial statements.

We agree with the FASB that the original transition method in FAS 123 is no longer appropriate. The basis for requiring prospective application of the fair value method was lack of readily available historical information on the fair value of stock options. Today, after 7 years of reporting pro forma data, the basis for that decision no longer exists.

However, we believe the Board's proposal to permit three alternative transition methods is not an improvement over existing practice. In our opinion, it would *further impair* comparability and consistency of reported results. Users of financial reports would not only have to distinguish between companies that have adopted the fair value method and those that continue to use the intrinsic value method, but also have to make an *additional* distinction among those that have adopted the fair value method and determine which of

the three transition methods is used. We believe strongly that multiple transition methods would place a completely unnecessary burden on users of financial statements. Moreover, we fail to see the conceptual basis for allowing different accounting treatments of the same economic event.

We do not think that the factors considered by the Board in deliberating the issue support its conclusions. The ED cites the following main reasons that led to the conclusions: 1) comparability is impaired currently; 2) changing the rules after decisions have been made is inappropriate; 3) disclosure mitigates the lack of comparability in reported results.

We agree with the Board that alternative methods currently exist for accounting for stock options and therefore comparability is already impaired. However, we think new standards should improve current practice rather than continuing the status quo or taking a step back.

While we acknowledge the fact that some companies made the decision to adopt the fair value method based on the existing transition method, we do not think this justifies maintaining the original requirement and permitting multiple transition methods. All business decisions are made in the context of existing regulatory environment. Does this mean changes in regulation are generally inappropriate?

We completely agree with the FASB that disclosure is not a substitute for recognition when the recognition criteria are met. The proposal is inconsistent with this belief in our view. We believe stock options meet the recognition criteria: 1) there is a cost to shareholders when stock options are issued, 2) the cost can be measured with sufficient reliability; 3) the information is both value relevant and reliable. In addition, we believe the size of the cost of stock options is material (Based on our research, earnings for S&P 500 companies would have been lower by about 23% for 2001 under the fair value method), and the benefit of recognition far outweighs the cost. Therefore, the argument that disclosure addresses users' information need does not hold.

We recommend that the Board mandate the fair value method of accounting for stock options. We believe this method better reflects the economic reality. In addition, adopting the fair value method would be consistent with the international effort to bring about convergence of global accounting standards.

Secondly, we recommend adoption of one transition method. We think retroactive restatement is conceptually the best method, as it provides consistent and comparable performance measures. Data for this restatement is fully available due to past FAS 123 disclosures. However, we recognize that restatements could have undesirable practical consequences, and could upset contractual agreements. If the board feels unable to adopt full retroactive restatement then we believe the modified prospective method is a reasonable compromise that improves consistency and comparability of financial information without imposing an unreasonable amount of cost on reporting. We do not believe that the use of the original transition method of FAS 123 is desirable as, in the

transition period, it would force analysts to continue to make adjustments to reported earnings to fully reflect the cost of stock options.

Thirdly, we think breaking down the aggregate stock options expense into appropriate expense categories would add value relevant information to users. Many commonly used performance measures are based on line items above the bottom-line earnings, such as gross margin and operating income.

In summary, we support the FASB in its efforts to modify the existing transition method in FAS 123. But we think only one method, the modified prospective method, should be permitted. If you would like us to clarify our views in this letter, please contact Stephen Cooper at +44 207 568 1962.

Sincerely,

Stephen Cooper
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