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

Subject: File Reference No. 1101-001

Dear Ms. Bielstein:

The Committee on Corporate Reporting (CCR) of Financial Executives International (FEI) wishes to express its views on the Exposure Draft (ED), Accounting for Stock-Based Compensation — Transition and Disclosure. FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of the CCR and not necessarily the views of FEI.

Although members of CCR hold diverse views on the merits of expensing stock options, we concur with the Board's efforts to eliminate obstacles for those who choose to do so voluntarily and we would support finalization of the document if the Board accepts the changes proposed in this letter. We also have identified other issues that are not the subject of this ED but serve as significant disincentives for companies evaluating the merits of adopting the accounting provisions of FAS 123.

Method of Transition

We have all heard the arguments in favor of reducing the number of transition methods. Much of the debate has focused on the lack of comparability that will result from the choice of methods provided for in the ED. Because of the unique circumstances surrounding FAS 123, CCR believes that the issue needs to be evaluated on two levels: (1) comparability across companies choosing to adopt the

accounting in FAS 123 and (2) comparability across all public companies. Under the present circumstances, we believe that the objective of greater comparability through narrowing of transition alternatives is not achievable for reasons discussed below.

We estimate that less than 3% of public companies either have adopted or plan to adopt the accounting provisions of FAS 123. Even if one transition alternative were demonstrably superior, which is not the case, the narrowing of alternatives provides comparability that is largely symbolic given that election by companies to expense stock options will occur over multiple years. Moreover, the elimination of alternatives will likely dissuade at least some of those who are undecided, which hampers progress on the broader comparability issue. We also observe that unlike any other new standard, the existence of pro-forma earnings and earnings per share disclosures provide a basis for users of financial statements to mitigate comparability issues that may arise through the election of different transition methods.

The Committee therefore supports retention of all three of the alternative transition methods. However, we recommend that alternative "b," full prospective expense recognition of unvested options, should be available prospectively to companies who have already elected the expense treatment. Otherwise, that transition method would effectively not be available to companies that adopted expense treatment before December 31, 2002.

Financial Statement Disclosure

We do not object to the requirement to place disclosures of the accounting method used for stock-based compensation and the method of transition to the fair value method in the significant accounting policies footnote. However, we believe that the proposal to require pro-forma disclosure of earnings and earnings per share in that same section is misguided. We believe that most companies report this information in the same footnote where they report other information about stock-based compensation arrangements. We think that this is where most users of financial statements would expect to find it and that the data is more useful in this context. We also disagree with the Board's decision to prescribe a specific tabular form for the disclosures. This is a highly unusual decision that runs counter to the principles-based approach the Board is attempting to follow in other standards and we are concerned that it constrains companies from presenting this information in the most effective way.

We also do not believe the pro forma earnings and earnings per share information should be required to be disclosed in interim financial reports. Such a requirement overstates the importance of this information relative to other data that is presented on an interim basis. In addition, there are many items of information that are considerably more relevant than this pro-forma data that are not required on an interim basis. We understand that at least one company has requested this information on a quarterly basis so that it can incorporate the information in

proprietary earnings measures that it sells to the investing public. It is with great reserve that we withhold comment on whether this proprietary measure enlightens or misleads users of financial statements. Whether it is useful or not, we believe that it would be unfortunate if the primary benefit from the disclosure was the enhancement of the commercial interests of one company. Rather, we believe that, given the burdens that new disclosures impose, the FASB should only require those that have broad appeal and meet the needs of most financial statement users. That is clearly not the case here.

Amendments to FAS 123 Transition Language

The Committee believes that the technical amendments to the transition language described in paragraph 2b are difficult to understand as presently drafted. The complexity of the requirements stems from the arcane deferred tax provisions of FAS 123 that have recently become a significant issue. For reasons discussed further below, we believe that the deferred tax issue needs to be reconsidered by the Board. In the interim, the Board should clarify its intent and provide examples that illustrate how these provisions apply in different fact patterns.

Invitation to Comment

CCR understands that the Board plans to issue an Invitation to Comment that compares the IASB proposal with U.S. GAAP and that it will request comment on whether changes should be made to U.S. standards. We plan to provide the FASB with detailed comments after we have had an opportunity to review the document. However, we would like to ask that the invitation to comment include two important issues:

Valuation of Stock Options under Black-Scholes – Even those members of CCR that have already decided to adopt the accounting provisions of FAS 123 do not believe that the application of the requirements of FAS 123 results in a highly accurate measure of the fair value of employee stock options. We strongly believe that the FASB should reconsider how valuations are required to be performed. Given that nearly a decade has passed since the initial project was on the Board's agenda, we believe that it is time to re-examine whether a better valuation technique is available or could be developed that would better reflect the negative effects on fair value that result from restrictions (e.g., vesting, performance, non-transferability).

Deferred Tax Accounting for Option Grants – FAS 123 prescribes a very unusual approach to deferred tax accounting that, in effect, caps the amount of tax benefit reflected in earnings to the lesser of the tax benefit earned on exercise of the option or the tax benefit accrued based on the fair value of the option grant. While accumulated excess tax benefits in additional paid-in capital may be available to mitigate the effect of this provision, it is likely that the vast majority of companies will

be faced with the following outcome for options issued over the past four years if they choose transition methods b or c: they will record pre-tax compensation expense for options that are likely to expire worthless and they will be prohibited from recording any deferred tax benefits to offset these amounts. It is difficult to explain this result. It appears that we are applying a grant date methodology for the compensation cost and the lower of grant date or exercise date for the deferred tax benefit. We urge the Board to reconsider these provisions.

The Committee looks forward to a continuing, productive discussion with the Board on all aspects of the broader issue of accounting for stock-based compensation. If you have questions regarding this letter, please feel free to contact me at (989) 636-1541.

Sincerely,

A handwritten signature in black ink that reads "Frank H. Brod". The signature is written in a cursive, flowing style.

Frank Brod
Chair, Committee on Corporate Reporting
Financial Executives International