Johnson & Johnson

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Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

To: Director, Major Projects and Technical Activities

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

Johnson & Johnson is pleased to comment on the above mentioned Exposure Draft.

We believe the discussions and deliberations on stock-based compensation and share-based payments are important and understand the Board will issue additional material in the near future for comments.

This comment letter specifically focuses on the proposed amendments to disclosure provisions. The objective of the proposed disclosure requirements is to provide greater comparability in reported financial information for all companies regardless of whether, when, or how an entity adopts the fair value method of accounting.

1. The proposed statement indicates that all entities shall disclose prominently, in the Summary of Significant Accounting Policies or its equivalent, certain information related to stock-based employee compensation. We agree that prominently displaying information related to this subject, in tabular format, will enhance comparability of financial information.
   However, we believe using an option pricing model (such as Black-Scholes) has serious limitations, such as: the assumption of the existence of a trading strategy, significant dependence on the expected volatility of return of the stock and the expectation of a dividend stream in correlation with future stock prices, among others.

2. The proposed statement requires disclosure of Diluted – Pro Forma Earnings per share. The objective of this indicator is to reflect Earnings per share on a diluted basis based on net income determined after applying the fair value method of accounting to stock-based employee compensation (after tax).

   We believe there is a conceptual conflict between applying fair value accounting to stock compensation and calculating earnings per share on a fully diluted basis.
   The fair value of a stock option (per SFAS 123) shall be estimated by an option pricing model (e.g. Black-Scholes) that takes into consideration, as of the grant date the following factors:

- Exercise price of the option
- Expected life of the option
- Current price of the underlying stock
- Expected volatility of the underlying stock
- Expected dividends on the stock
- The risk free interest rate for the expected term of the stock.

Thus the fair value of stock options, and hence current compensation expense, is determined or influenced in a significant way by future considerations and by considerations that occur over a period of time.
Calculating EPS on a fully diluted basis assumes potential shares exercisable under stock option plans are exercised as of the Statement date. This, in our opinion, is in conflict with the assumptions used in the options pricing model. The effect will generally be that Diluted Pro-Forma EPS will be understated.

Also, as the (present) value of stock options upon issuance is included in the numerator of the EPS calculations, and since the Diluted Pro Forma EPS calculation will include in its denominator options issued in prior years, in our opinion, a double counting occurs at the level of Diluted Pro forma EPS.

We therefore suggest the Board reconsider the requirement to disclose Diluted Pro-Forma EPS.

If Diluted Pro Forma EPS would require disclosure, then we believe the accounting method to value stock options should not include assumptions that are determined or influenced by future considerations.

We thank you for taking our comments into consideration and will be pleased to discuss these with you if that would be helpful.

Sincerely,

Stephen Cosgrove

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Vice President, Corporate Controller