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

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Dear Director:

The American Gas Association (AGA) is pleased to submit its comments concerning the Financial Accounting Standards Board's (FASB) Exposure Draft of an Amendment of Statement No. 123, "Accounting for Stock-Based Compensation - Transition and Disclosure."). The AGA represents 189 local natural gas utilities that deliver natural gas to almost 60 million homes and businesses in all 50 states. Additionally, the AGA provides services to member natural gas pipelines, marketers, gatherers, international gas companies and a variety of industry associates.

AGA supports the FASB's efforts to reevaluate, improve and clarify the accounting and disclosures for the accounting for stock-based compensation (employee stock options). The issue of fair value vs. intrinsic value accounting for employee stock options has recently received heightened awareness by investors, as well as preparers, users and readers of company financial statements as a result of the need for more transparency in financial statements. Prior to July 2002, only three companies (Boeing, Level-3 and Winn-Dixie) had adopted the fair value method of accounting for employee stock options. However, since July 2002, approximately 179 companies have adopted the fair value method of accounting, including such companies as Coca-Cola Co., General Motors and General Electric.

While the AGA agrees that transparency in financial statements is essential, the AGA also believes that transparency can not be achieved without consistency and comparability in accounting and financial reporting between all companies and for all reporting periods. The Exposure Draft greatly improves disclosure provisions of SFAS 123, which will provide more financial information to the readers and users of financial statements to understand the financial impact of employee stock options. Additionally, this Exposure Draft does provide guidance and alternatives for companies to transition to SFAS 123; however, the AGA believes that the following issues need to be addressed and resolved in order achieve transparency, comparability and consistency:

- Valuation of employee stock options;
- Number of transition alternatives; and
- International Accounting Standards Board's (IASB) project on shared-based payment.

Valuation of Employee Stock Options

The economic value of employee stock options granted and recorded as compensation expense is determined on the date of grant utilizing option-pricing models, such as Black-Scholes and Binomial Pricing models. These models take into account such factors as stock price on date of grant, exercise price, expected option life, volatility of the underlying stock, expected dividends and risk-free interest rate. These factors are based on certain assumptions, which change over time and may differ between companies.

Currently, the only adjustment to the initial amount of compensation expense recorded for employee stock options granted is for forfeitures of unvested employee stock options, and not for true-ups or changes in the underlying option-pricing model factors, as well as for the expiration of vested employee stock options. Additionally, since companies may make different assumptions with respect to the option-pricing model factors, the resulting economic value and amount of compensation expense calculated and recorded may differ between companies. Consequently, the compensation expense recorded and reported in each company's financial statements may result in improved transparency, but the amount of compensation expense included in the financial statements may not be comparable and consistent. Therefore, the AGA believes that option expense recognition should not become mandatory until a consistent and comparable approach to the valuation of options can be determined.

Number of Transition Alternatives

The Exposure Draft does not require companies to recognize and record compensation expense in their financial statements for employee stock options granted, but continues to allow companies to use the intrinsic value method of accounting under APB Opinion No. 25, "Accounting for Employee Stock Issued to Employees." However, for those companies wanting to adopt the fair value method of recognizing stock-based compensation expense, the Exposure Draft provides for the following transition options:

- **Prospective Application of New Awards** - Compensation expense recognized for all new awards granted after the year of adoption. This option results in a "ramp-up" effect.
- **Prospective Recognition for Unvested Awards and New Awards** - Compensation expense recognized for the unvested portion of previously issued awards as well as new awards in the year of adoption. Under this approach, the compensation expense recognized in the year of adoption is the same as the retroactive restatement method, except prior periods are not restated.
- **Retroactive Restatement** - Prior periods' reported net income is restated for the effect of the change to the fair value method of accounting for fiscal years after December 15, 1994. The net income in the year of adoption will be the same as the net income under the prospective method for unvested awards and new awards.

The AGA does agree that the above do provide alternatives to companies adopting the fair value method of recognizing stock-based compensation expense. However, when the above three alternatives are coupled with the fact that the intrinsic value method of accounting can continue to be followed, the comparability of financial statements is impaired, which the Board has acknowledged. Additionally, the Board acknowledges, and the AGA agrees, that comparability is impaired under current guidance since both intrinsic value and fair value methods of accounting are allowed.

The Board has addressed this lack of comparability by amending the required disclosures, which apply to all companies other than those companies that adopt retroactive restatement, to require the presentation of comparable information for all periods included in the presentation. The AGA agrees with the Board's belief that "disclosure is not a substitute for recognition in the financial statements," but the amended disclosures tend to clarify and mitigate the comparability issues. However, the AGA believes that the existence of four different methods of accounting for employee stock options in and of itself will cause confusion to the readers and users of company financial statements and tend to offset any benefits derived from the increased and amended disclosures.

International Accounting Standards Board's (IASB) Project

The FASB and IASB have publicly stated and are working together on the convergence of accounting standards across international markets. Currently, the IASB is working on a share-based payments project, which includes employee stock options. The Board acknowledges that the IASB's proposal to recognize expense for the fair value of employee stock options at the date of grant is similar to SFAS 123, but important differences still exist between the IASB's proposal and SFAS 123. Additionally, the Board acknowledges that United States standards, including the requirements of this Exposure Draft, if adopted, could change once the IASB completes its project in order to have a consistent standard across all international markets. Therefore, the AGA believes that it is premature and detrimental to the criteria of comparability and consistency to propose changes to United States accounting standards related to employee stock options when such standards may again change within the next two years or by 2004.

Disclosure

The AGA agrees with the FASB's proposed amendments to SFAS 123 disclosure requirements and believes that such requirements improve transparency in the financial statements and provide more financial information to understand the financial impact of employee stock options. However, the AGA believes there is insufficient benefit to the proposed interim period reporting requirement to justify the effort and cost of preparing such disclosures. Secondly, the interim period reporting requirements are not consistent with those for other employee benefits related statements, SFAS 87, SFAS 132 and SFAS 106, which only require annual disclosure:

Conclusion

While the AGA agrees the Exposure Draft greatly improves disclosure provisions of SFAS 123, the AGA believes that the Exposure Draft does not resolve the issues of transparency, comparability and consistency with respect to employee stock options. The FASB must address the issues of consistency in valuing employee stock options and lack of comparability resulting from the four different accounting methods. Additionally, companies may again need to make changes to their employee stock option accounting methods if the FASB proposes changes to SFAS 123 and this Exposure Draft based on the outcome of the IASB's project further impacting comparability and consistency. Finally, the AGA believes that interim reporting should not be required since it is not consistent with requirements of other employee benefit related accounting standards and until at least the FASB and the IASB converge on an internationally accepted standard.

AGA appreciates this opportunity to contribute to the standard-setting process and hopes that our views will be helpful to you in your deliberations.

Very truly yours,

[s] *Teri Balog*

Teri Balog
Chairman, American Gas Association Accounting Advisory Council