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October 7, 2003

Ms. Suzanne Q. Bielstein
MP&T Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
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Letter of Comment No: 109
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Dear Ms. Bielstein:

My firm, Mercer Human Resource Consulting, has responded to FASB's invitation to comment on its stock-based compensation project on at least two occasions, and I concur with those comprehensive comments. My focus herein is narrower and intended to express a concern as to how performance shares are treated under FAS 123.

For over 30 years I have been an executive compensation consultant. Before our practice was acquired by Mercer in 1998, I was a Principal at KPMG. While not a CPA, it was at KPMG where I learned the critical distinctions between FAS 123 and APB 25. Because of the prevalence of APB 25, most of our design considerations in behalf of clients were in contemplation of the APB 25 accounting principles.

In my opinion, one of the illogical principles of this accounting treatment has been that Restricted Shares are deemed to have met the measurement date test of a known number of shares at a known price and therefore accorded fixed accounting treatment; but Performance Shares are deemed not to have met the measurement date test until the end of the performance period and therefore, variable accounting treatment is required. This accounting distinction in effect penalized companies who felt that recipients of full value stock awards should earn them by delivering performance success in order to vest rather than receiving them by simply remaining an employee for a specified time period.

FAS 123 corrects this anomaly in that performance shares can, in effect, be accorded the same accounting treatment as provided to restricted stock. This leveling of the playing field is an important step in the right direction and should serve as a catalyst to the adoption of more performance-based long-term incentive plans.

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However, and this is why I'm writing this letter, this interpretation is apparently not going to be extended to performance share plans under which performance vesting would be determined by a market measure [i.e., relative or absolute Total Shareholder Return (TSR) or attainment of a pre-established common share FMV]. Rather, it is contemplated that such awards should either 1) be ineligible for a "cost true-up" or 2) be subject to Mark-to-market variable accounting treatment. Both of these approaches result in less favorable accounting treatment than accorded under FAS 123 to performance shares based upon a financial measure.

GE just announced a plan in which some performance share units are contingent upon cash flow results and some performance share units are contingent upon relative TSR results. Based upon my understanding of the contemplated interpretation, GE will have to expense these grants differently with the latter subject to Mark-to-market treatment. I don't think this make sense. The performance share units are identical in every respect except for the performance contingency upon which their vesting will be determined. Also, what if GE had made all of the awarded performance share units dependent upon meeting both the cash flow and TSR performance measures. Which accounting principle would apply? If fixed at grant date because of the cash flow measure, then what's to stop a company from setting a very, very low financial measure and effectively triggering vesting based upon its market measure?

Twice in the 1990's I led research projects in behalf of the then American Compensation Association on how higher performing companies pay their management employees. One of the things we learned about performance share and performance unit plans was that most companies having them really struggled with the setting of their three to five year financial measure(s) for determining whether vesting would occur. Consequently, I prefer the use of relative performance as relates to multi-year plans.

Over the years I also have listened to many discussions about which is the "best" financial measure for indicating company performance success. Whether EVA, ROE, ROCE, cash flow or some other financial measure; the advocate invariably makes his or her case based upon how

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well their preferred measure correlates with Total Shareholder Return. My retort is that nothing correlates better with TSR than – TSR. And if you want to directly link employee pay to the creation of shareholder value, outperforming a composite of selected companies, or an index, on a total shareholder return basis is the criterion that counts.

I think the accounting principles should not discriminate against market measures in favor of financial measures. A company should be able to choose the measurement criteria that it feels best reflects desired performance success. Indeed, 5-year comparative TSR is what every company must plot in the performance graph included in its annual proxy. Why penalize it as a measure for compensation purposes?

However, my personal preferences as to what and how to measure aren't what I'm trying to convey in this writing. Simply stated, treating performance shares like restricted shares for accounting purposes makes imminent sense irrespective of whether the vesting of those performance shares is based upon financial or market price measures or whether those measures are viewed on an absolute or relative basis. Let's get it right for all companies trying to pay their employees in accordance with performance success.

Sincerely,

John D. Bloedorn

cc: Peter Chingos – Mercer Human Resource Consulting
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