

Merck & Co., Inc.
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January 31, 2003
Ms. Suzanne Bielstein
Director of Major Projects and
Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Letter of Comment No: 83
File Reference: 1102-001
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Dear Ms. Bielstein:

Merck and Co., Inc. is a New Jersey corporation with its principal place of business at One Merck Drive, P.O. Box 100, Whitehouse Station, NJ, 08889-0100. The Company is a global research-driven pharmaceutical organization that discovers, develops, manufactures and markets products and provides pharmaceutical benefit services. We are pleased to provide you with our comments on the Invitation To Comment, "*Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123, Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-based Payment.*"

We believe it is important for the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to work in concert to achieve the objective of attaining international convergence of the highest-quality accounting standards. We also support the IASB's efforts to develop a standard on the accounting for share-based payments to provide the international financial community with consistent guidance in an area that has increasingly become a part of normal business operations throughout the world.

While both standards' measurement objective is fair value, the philosophical focus of the measurement objective for employee stock options differs significantly between the standards. FASB Statement No. 123, "*Accounting for Stock-Based Compensation,*" (FAS 123) measures and recognizes compensation based on the fair value of the equity instruments issued, whereas the IASB proposed IFRS, "*Share-based Payment,*" (ED) focuses on the fair value of services to be received, for which the fair value of the equity granted is considered a surrogate measure. This fundamental distinction results in substantive differences in the attribution of expense and the treatment of forfeitures. We believe that employee stock options constitute rights to equity that are granted, typically subject to future service requirements, both as a reward for past service and an incentive for future performance. Therefore, we believe that the measurement philosophy for employee stock option expense should focus on the value of the equity instruments issued.

Under FAS 123, the fair value of equity instruments issued is recognized over the period in which the employee provides service to earn the benefit, generally the vesting period, and is adjusted for forfeitures. Consistent with its focus on services received, compensation expense under the ED is recognized based on actual units-of-service rendered at the deemed fair value per unit-of-service, but this fair value factor is not adjusted to reflect actual forfeitures. As a result, this methodology produces anomalous results in certain situations. For example, if all options vest, under the ED an entity will recognize compensation expense in excess of the grant-date fair value adjusted for assumed forfeitures, but less than the grant-date fair value before an assumed forfeiture adjustment. Actual forfeitures in this scenario are equal to zero and, similar to the result derived under FAS 123, the final compensation expense should reflect this. Further, as a consequence of the ED's measurement philosophy, compensation expense recognized related to options that are later forfeited is not reversed because services associated with the options were received. We believe that the focus of employee stock option measurement should be the equity instruments ultimately issued, and therefore, we disagree with ED's attribution methodology and treatment of forfeitures.

We do not believe that the model proposed by the ED offers a better theoretical alternative to FAS 123 and, in fact, it generates anomalous results in certain circumstances. Stock-based compensation accounting was extensively debated in the U.S. for well over ten years through the rigorous due process of the FASB. The FASB addressed the concerns of its constituency in the guidance included in FAS 123, as well as subsequent related guidance in FASB Interpretation No. 44, "*Accounting for Certain Transactions Involving Stock Compensation.*" We recommend that further efforts by the IASB and the FASB should focus on refinement to this existing literature, specifically in such areas as whether enhanced valuation techniques are available which more accurately reflect the non-transferability feature of employee stock options and identification of additional disclosures that would be helpful to financial statement readers.

We look forward to future dialogue with the FASB as the staff considers the IASB's efforts to address the issues of measurement and recognition of employee stock option expense. In particular, at the appropriate time, we would like the opportunity to further discuss the application of option pricing models to estimate compensation expense. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

/s/ Richard C. Henriques

Richard C. Henriques
Vice President, Controller

cc: J.C. Lewent