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Letter of Comment No: 5397  
File Reference: 1102-100

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

Re: File Reference No. 1102-100

Dear Ms. Bielstein:

Aetna Inc. ("Aetna" or the "Company") appreciates the opportunity to provide you with our views on the Financial Accounting Standards Board's (the "Board") Exposure Draft, *"Share-Based Payment, an Amendment of FASB Statements No. 123 and 95"* (the "ED") relating to the accounting for share-based payments.

We understand that the Board's has concluded that share-based payments (including stock options) represent compensation cost to a company. Although we have concerns about the ability to reliably measure this cost, we understand that many financial statement users have concluded that this cost should be recognized as an expense in the financial statements. Therefore, in our letter, we will not debate the merits of whether or not Aetna believes that option expensing should be mandated. However, as discussed in the following paragraphs, we respectfully request that the Board reconsider its decisions related to its stated preferability of one valuation model, the accrual of expense associated with awards with graded vesting provisions, the accounting for tax consequences and the proposed effective date. The appendix to this letter provides our views on each of the 18 issues raised for comment in the ED.

#### Preferable Valuation Techniques

We agree with the Board that a binomial lattice-based option pricing model allows a company to reflect the characteristics of a particular employee stock option better than using the Black-Scholes-Merton formula and, therefore, is preferable. However, based on our evaluation, key assumptions used in a binomial lattice-based model include estimating employees' exercise and post-vesting employment termination behaviors and the expected volatility of the company's share price. It is our experience in developing these particular assumptions, that two independent parties,

evaluating the same information, will reach different, yet valid and supportable conclusions. The resulting fair value calculated using either a binomial lattice-based model or the Black-Scholes-Merton formula are both impacted, potentially materially, by a company's selection of these assumptions. For this reason, we believe neither the binomial lattice-based model nor the Black-Scholes-Merton formulas (or any model that relies upon unique, company-derived assumptions) will provide consistent and comparable estimates of fair values between companies and industries. Therefore, the argument for comparable financial information via requirement of a single method is flawed.

Given the current political and economic climate, we understand the view that financial statement users believe they are better informed by expensing the value of share-based payments, despite concerns over the reliability of valuation results. We believe that with the increased attention of financial statement users and management, more precise valuation techniques will continue to evolve, which will allow companies to more accurately estimate the fair value of share-based payments as it relates to their unique business features. Therefore, we request that the Board not prescribe a single, preferable model to be used to estimate fair value, but rather, encourage the development of better option pricing models. Our view is supported by the Board's movement towards principle-based standards.

#### Accrual Method for Awards with Graded Vesting

The ED proposes that each separately vesting portion or tranche of an award with a graded vesting schedule be measured and recognized as a separate award; further, it requires that compensation cost for each tranche be recognized over the requisite service period for that tranche. We fundamentally disagree with the Board's conclusion that the proposed approach better reflects the exchange of employee services for the equity instruments as employees do not perform services in a "graded manner". Rather, we believe that employers and employees view a share-based award with a graded vesting schedule as a single award.

Using the preferable binomial lattice-based model would allow companies to evaluate and incorporate the exercise behavior of its employees. Analyzing this data may indicate that an option holder may exercise options regardless of the graded vesting criteria. Rather than prescribing a specific rule for accrual basis for such a cost, which would greatly increase complexity and require system changes, we believe a principles-based approach to accruing the expense of a graded-vesting award, as prescribed by Statement 123, would be preferable. This approach is supported by the actual employee service period.

#### Accounting for Tax Consequences of Share-Based Payments

We do not support the proposed accounting treatment for the tax consequences of share-based payment. As proposed, the accounting for the tax effects of share-based payments would require tracking and calculations of the tax impacts at the individual employee and grant level, an approach that is contrary to the portfolio approach used to value these awards for compensation recognition and one that is punitive to a company's earnings. We believe that this approach is unnecessarily punitive and will result in both financial statement user confusion and increase compliance cost.

Further, we believe the proposed approach will require companies to build or purchase software capable of tracking the tax and cash flow impacts of share-based awards and exercises at the individual employee and grant level. We currently do not have a reporting system capable of tracking deferred taxes related to stock option activity at an employee level. Before adopting this approach, we respectfully request the Board to perform a cost vs. benefit analysis.

Even if the FASB believes that the grant of share-based awards to employees is a compensation transaction, we view the exercise of an award as a separate equity transaction. As a result, we believe that the income tax benefit recognized for the compensation expense recognized for the award grant should be recognized in the income statement, while the subsequent difference in the realized tax benefits (either higher or lower) should be recognized in equity, consistent with other effects of the award's exercise.

We strongly encourage the Board to reconsider this proposed accounting method to use a portfolio approach to recognize all differences between the tax amounts initially recognized and ultimately realized as additional paid-in capital.

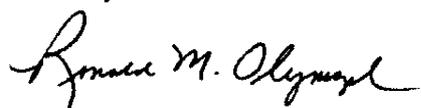
#### Effective Date

We believe the effective date of the new standard should be delayed by one-year. Based on the Board's project timeline, it appears that the final standard will be issued in the fourth quarter of 2004, very close to the beginning of the year of required adoption. We do not believe this effective date will allow companies to properly develop the appropriate accounting and tax systems necessary to comply with the new accounting. Additionally, developing the assumptions for use in a binomial lattice-based option pricing model (as we would want to change to the preferable method) will likely require a considerable amount of time. Finally, companies must educate users (e.g., audit committee, executive compensation committee and board members, external analysts and internal constituents) as well as work with their auditors about company-specific impacts of adopting this new standard. We are concerned that such a short implementation time period will not be sufficient to perform these tasks adequately and, therefore, urge the Board to delay the effective date for one-year.

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We appreciate your consideration of our views on the ED. We would be pleased to discuss our comments further with you or members of your staff. If you have any questions regarding this letter, please feel free to contact me.

Sincerely,



Ronald M. Olejniczak  
Vice President and Controller

**Aetna Inc. Responses to 18 Issues for comment, as set forth in the ED:****Recognition of Compensation Cost**

*Issue 1:* The Board has reaffirmed the conclusion in Statement 123 that employee services received in exchange for equity instruments give rise to recognizable compensation cost as the services are used in the issuing entity's operations (refer to paragraphs C13–C15). Based on that conclusion, this proposed Statement requires that such compensation cost be recognized in the financial statements. Do you agree with the Board's conclusions? If not, please provide your alternative view and the basis for it.

**Aetna Response:**

*For reasons discussed in greater detail below, historically Aetna supported the pro forma disclosure-only approach permitted by Statement 123. Questions concerning the reliability of management's estimate of the fair value of a non-transferable (and non-marketable) equity-based award resulted in our conclusion that investors would be better served with pro forma disclosure of the effect of such an estimate, as the credibility and comparability of financial statements was at risk.*

*Much of the debate regarding the reliability of fair value estimates that took place when Statement 123 was being deliberated still exists, notwithstanding the emergence of a binomial-lattice based option pricing model. However, a greater degree of investor interest in the expensing of employee stock options has placed greater emphasis on reporting such an expense. Therefore, Aetna will not debate the Board's conclusions.*

*Issue 2:* Statement 123 permitted enterprises the option of continuing to use Opinion 25's intrinsic value method of accounting for share-based payments to employees provided those enterprises supplementally disclosed pro forma net income and related pro forma earnings per share information (if earnings per share is presented) as if the fair-value-based method of accounting had been used. For the reasons described in paragraphs C26–C30, the Board concluded that such pro forma disclosures are not an appropriate substitute for recognition of compensation cost in the financial statements. Do you agree with that conclusion? If not, why not?

**Aetna Response:**

*We do not agree with the Board's conclusions described in the referenced paragraphs, primarily due to concerns of the reliability of fair value estimates of non-marketable equity-based awards. FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, identifies four fundamental criteria that must be met before an item is recognized, including reliability. We do not believe fair value estimates of employee stock options can be measured with sufficient reliability, due to the significant level of judgment to be applied in current option pricing models (specifically, the future expected volatility of the underlying stock and future employee post-vesting exercise and termination behavior).*

*Additionally, we do not believe the Board has performed an exhaustive user-analysis. We understand that many financial statement users believe that equity instruments awarded to employees for services rendered or to be rendered should give rise to compensation recognition. However, when provided with a comprehensive illustration of the calculation of fair value of an award, we believe many users may disagree*

*that such an estimate is a reliable measure of fair value and hence, may question the value of expensing versus disclosure.*

*With this said, however, if companies are to recognize such costs in earnings, we agree that appropriate caution should be given to financial statement users on the inherent inaccuracies of estimates.*

### **Measurement Attribute and Measurement Date**

**Issue 3:** This proposed Statement would require that public companies measure the compensation cost related to employee services received in exchange for equity instruments issued based on the grant-date fair value of those instruments. Paragraphs C16-C19 and C53 explain why the Board believes fair value is the relevant measurement attribute and grant date is the relevant measurement date. Do you agree with that view? If not, what alternative measurement attribute and measurement date would you suggest and why?

#### **Aetna Response:**

*When issuing equity-based awards to employees, we generally base the amount of the award on estimates of fair value at estimated award/grant date. Therefore, we agree that the grant date is the relevant measurement date. We also agree that fair value is the relevant measurement attribute.*

### **Fair Value Measurement**

**Issue 4(a):** This proposed Statement indicates that observable market prices of identical or similar equity or liability instruments in active markets are the best evidence of fair value and, if available, should be used to measure the fair value of equity and liability instruments awarded in share-based payment arrangements with employees. In the absence of an observable market price, this proposed Statement requires that the fair value of equity share options awarded to employees be estimated using an appropriate valuation technique that takes into consideration various factors, including (at a minimum) the exercise price of the option, the expected term of the option, the current price of the underlying share, the expected volatility of the underlying share price, the expected dividends on the underlying share, and the risk-free interest rate (paragraph 19 of Appendix A). Due to the absence of observable market prices, the fair value of most, if not all, share options issued to employees would be measured using an option-pricing model. Some constituents have expressed concern about the consistency and comparability of fair value estimates developed from such models. This proposed Statement elaborates on and expands the guidance in Statement 123 for developing the assumptions to be used in an option-pricing model (paragraphs B13-B30). Do you believe that this proposed Statement provides sufficient guidance to ensure that the fair value measurement objective is applied with reasonable consistency? If not, what additional guidance is needed and why?

#### **Aetna Response:**

*Paragraphs B13-30 provide for a significant level of judgment to be applied when estimating future employee exercise and post-vesting termination behavior as well as future expected volatility of the underlying stock. This level of judgment is necessary in order to estimate a fair value of an item with an unknown value some time in the future. However, as stated in paragraph B14, there is likely to be a range*

*of reasonable estimates, even pertaining to just one company, so the range of reasonable estimates for an industry will likely be significant.*

*In Appendix B of the ED, the Board provides guidance on estimating expected volatility and expected term, noting however, that it is reasonable that future experience may differ from historical experience. We believe the Board should provide more guidance on the development of such assumptions when utilizing an open-ended option pricing model preferred by the proposed standard. When using a model such as a binomial-lattice based option pricing model, assumptions of volatility and employee exercise behavior must be projected for the life of an option, which in our case has been ten-years. Both our company and industry (Health Care) likely will not have reliable historical experience covering this time span from which to base such assumptions from, as our company and industry have experienced significant changes during that time (e.g., consolidations, divestures, significant product and regulatory changes, etc.). Additionally, companies likely will consider changing certain attributes of equity-based awards as different compensation models are developed. In such cases, historical employee exercise behavior would not be representative of future expected behavior. Therefore, the guidance currently provided in the exposure draft for developing these critical assumptions is not sufficient and should be strengthened. As a result, we anticipate a lack of consistency and reliability of such an estimate within our peer group. However, we do not believe consistency and comparability should be prioritized over relevance and reliability and the rigor in the assumption selection process acceptable to external audit.*

**Issue 4(b):** Some constituents assert that the fair value of employee share options cannot be measured with sufficient reliability for recognition in the financial statements. In making that assertion, they note that the Black-Scholes-Merton formula and similar closed-form models do not produce reasonable estimates of the fair value because they do not adequately take into account the unique characteristics of employee share options. For the reasons described in paragraphs C21–C25, the Board concluded that fair value can be measured with an option-pricing model with sufficient reliability. Board members agree, however, that closed-form models may not necessarily be the best available technique for estimating the fair value of employee share options—they believe that a lattice model (as defined in paragraph E1) is preferable because it offers the greater flexibility needed to reflect the unique characteristics of employee share options and similar instruments. However, for the reasons noted in paragraph C24, the Board decided not to require the use of a lattice model at this time. Do you agree with the Board’s conclusion that the fair value of employee share options can be measured with sufficient reliability? If not, why not? Do you agree with the Board’s conclusion that a lattice model is preferable because it offers greater flexibility needed to reflect the unique characteristics of employee share options. If not, why not?

**Aetna Response:**

*As indicated in our responses above, we do not believe that the fair value of employee stock options can be measured with sufficient reliability even utilizing a binomial lattice-based option pricing model. Measuring the fair value of employee stock options necessitates making assumptions for the future regarding both employee exercise behavior and underlying stock volatility. Actual experience may differ, perhaps materially, from the assumptions made due to factors outside the control or even possible advance knowledge by those individuals developing the assumptions. We therefore, strongly encourage the Board to draft the final standard in such a way to allow new, more reliable measures of fair value yet to be developed to be used to measure the fair value of stock-based payments.*

*However, we do believe an open-form option pricing model such as a binomial lattice-based model is preferable to the Black-Scholes-Merton formula and similar closed-form models for reasons noted in the Board's conclusions.*

**Issue 4(c):** Some respondents to the Invitation to Comment suggested that the FASB prescribe a single method of estimating expected volatility or even a uniform volatility assumption that would be used for all companies. Other respondents to the Invitation to Comment disagreed with such an approach. Additionally, some parties believe that historical volatility, which has been commonly used as the estimate of expected volatility under Statement 123 as originally issued, is often not an appropriate measure to use. The proposed Statement would require enterprises to make their best estimate of expected volatility (as well as other assumptions) by applying the guidance provided in paragraphs B24–B26 to their specific facts and circumstances. In that regard, the proposed Statement provides guidance on information other than historical volatility that should be used in estimating expected volatility, and explicitly notes that defaulting to historical volatility as the estimate of expected volatility without taking into consideration other available information is not appropriate. If you believe the Board should require a specific method of estimating expected volatility, please explain the method you prefer.

*Aetna Response:*

*We do not believe a specific method of estimating expected volatility should be prescribed. Refer to Aetna response to issue 4(a) above.*

**Issue 4(d):** This proposed Statement provides guidance on how the unique characteristics of employee share options would be considered in estimating their grant-date fair value. For example, to take into account the nontransferability of employee share options, this proposed Statement would require that fair value be estimated using the expected term (which is determined by adjusting the option's contractual term for expected early exercise and post-vesting employment termination behaviors) rather than its contractual term. Moreover, the Board decided that compensation cost should be recognized only for those equity instruments that vest to take into account the risk of forfeiture due to vesting conditions. Do you agree that those methods give appropriate recognition to the unique characteristics of employee share options? If not, what alternative method would more accurately reflect the impact of those factors in estimating the option's fair value? Please provide the basis for your position.

*Aetna Response:*

*We agree that the fair value of employee share options should consider the expected term of the option rather than its contractual term and compensation cost should take into account the forfeiture of equity instruments due to vesting conditions.*

**Issue 5:** In developing this proposed Statement, the Board acknowledged that there may be circumstances in which it is not possible to reasonably estimate the fair value of an equity instrument. In those cases, the Board decided to require that compensation cost be measured using an intrinsic value method with remeasurement through the settlement date (paragraphs 21 and 22 of Appendix A). Do you agree that the intrinsic value method with remeasurement through the settlement date is the appropriate alternative accounting treatment when it is not possible to

reasonably estimate the fair value? (Refer to paragraphs C66 and C67 for the Board's reasons for selecting that method.) If not, what other alternative do you prefer, and why?

*Aetna Response:*

*We do not agree that using an intrinsic value method with remeasurement through the settlement date is an appropriate alternative when it is not possible to reasonably estimate the fair value of an equity instrument. Furthermore, we do not believe many companies will not be able to estimate fair value.*

### **Employee Stock Purchase Plans**

**Issue 6:** For the reasons described in paragraph C75, this proposed Statement establishes the principle that an employee stock purchase plan transaction is not compensatory if the employee is entitled to purchase shares on terms that are no more favorable than those available to all holders of the same class of the shares. Do you agree with that principle? If not, why not?

*Aetna Response:*

*We do not agree with the principle that an employee stock purchase plan (ESPP) transaction should be compensatory if the ESPP meets the requirements of Section 423 of the Internal Revenue Code. Our reasons for this belief are consistent with those stated in Statement 123's basis for conclusions (paragraph numbers 232-242). The primary purpose of such a plan is not to compensate employees for services rendered; rather such a plan is designed to encourage employees to become stakeholders in an effort to link employee and shareholder interests. We believe that the nominal discount offered is analogous to stock issuance costs avoided by issuing stock to employees rather than the public.*

### **Attribution of Compensation Cost**

**Issue 7:** This proposed Statement would require that compensation cost be recognized in the financial statements over the requisite service period, which is the period over which employee services are provided in exchange for the employer's equity instruments. Do you believe that the requisite service period is the appropriate basis for attribution? If not, what basis should be used?

*Aetna Response:*

*We believe the service period is the appropriate basis for attributing compensation cost.*

**Issue 8:** Determining the requisite service period would require analysis of the terms and conditions of an award, particularly when the award contains more than one service, performance, or market condition. Paragraphs B37-B49 provide guidance on estimating the requisite service period. Do you believe that guidance to be sufficient? If not, how should it be expanded or clarified?

*Aetna Response:*

*We agree the guidance is sufficient. We have typically not offered complex awards with more than one service, performance or market condition.*

**Issue 9:** For the reasons described in paragraphs C89-C91, the Board concluded that this proposed Statement would require a single method of accruing compensation cost for awards with a graded

vesting schedule. This proposed Statement considers an award with a graded vesting schedule to be in substance separate awards, each with a different fair value measurement and requisite service period, and would require that they be accounted for separately. That treatment results in a recognition pattern that attributes more compensation cost to early portions of the combined vesting period of an award and less compensation cost to later portions. Do you agree with that accounting treatment? If not, why not?

Aetna Response:

*We do not agree with the accounting treatment prescribed in the ED. In deliberating this issue in Statement 123, the Board acknowledged that an entity may use an average life for the entire award, ratably allocating compensation cost over the service period would be appropriate. Using the preferable open-form option pricing model would allow companies to evaluate the exercise behavior of its employees. Analyzing this data may indicate that an option holder may exercise options regardless of the graded vesting criteria. As currently drafted, such behavior would not be factored into the attribution model.*

*We do not believe that measuring the transaction using the fair value of the instruments issued should necessarily lead to a required recognition pattern that is inconsistent with the pattern of the value of the services consumed (or the pattern of benefits received) by the company. Consistent with that view, and given the fact that employees' services are rendered "evenly" over the vesting period (regardless of whether vesting terms are cliff or graded), we believe a ratable attribution pattern as allowed under Statement 123, is also a conceptually appropriate approach for a graded vesting schedule alternative.*

*Therefore, we believe that rather than prescribing a specific rule for attribution of cost, a principles-based approach, as prescribed by Statement 123, would be preferable.*

## **Modifications and Settlements**

**Issue 10:** This proposed Statement establishes several principles that guide the accounting for modifications and settlements, including cancellations of awards of equity instruments (paragraph 35 of Appendix A). Paragraphs C96–C115 explain the factors considered by the Board in developing those principles and the related implementation guidance provided in Appendix B. Do you believe those principles are appropriate? If you believe that additional or different principles should apply to modification and settlement transactions, please describe those principles and how they would change the guidance provided in Appendix B.

Aetna Response:

*We have no comment on the principles and related implementation guidance for modifications and settlements.*

## **Income Taxes**

**Issue 11:** This proposed Statement changes the method of accounting for income tax effects established in Statement 123 as originally issued. Paragraphs 41–44 of Appendix A describe the proposed method of accounting for income tax effects and paragraphs C128–C138 describe the Board's rationale. That method also differs from the one required in International Financial Reporting Standard (IFRS) 2, Share-based Payment. Do you agree with the method of accounting

for income taxes established by this proposed Statement? If not, what method (including the method established in IFRS 2) do you prefer, and why?

Aetna Response:

*We do not agree with the proposed method of accounting for income taxes discussed in the ED. We believe the tax benefit recognized in earnings for share-based payments should be reflective of the amount of compensation expense recognized, with any differences between that amount and the amount ultimately realized flowing to equity. We also believe the Board should adopt a portfolio approach to tracking and accounting for the benefits realized upon exercise or settlement of share-based payments, as opposed to the individual employee approach in the ED.*

*We believe that when a company grants share-based awards to employees, that transaction represents a compensation transaction. We view the exercise of the award by the employee represents a separate equity transaction. Consistent with this view, we believe 1) the amount of income tax benefit recognized for the option grant should be reflective of the amount of the underlying compensation expense recognized in the income statement, and 2) any subsequent differences in realized tax benefits, both higher and lower, should be recognized in additional paid-in capital along with the impacts of underlying option exercise.*

*The approach proposed in the ED appears to be punitive and we believe will result in both financial statement user confusion and increased compliance cost. The proposed method of accounting for taxes will require companies to calculate the tax impacts at the individual employee level. However, the valuation of the share-based award is calculated for the entire portfolio. We believe this requirement to account for taxes at an individual level will require significant operational efforts to build and maintain systems that are capable of tracking data at such a level. We currently do not have such a reporting system capable of tracking deferred taxes at an individual level. Before adopting this approach, we respectfully request the Board to perform a cost vs. benefit analysis. We encourage the Board to reconsider this accounting method to use a portfolio approach to recognize all differences between the tax amounts initially recognized and ultimately realized as additional paid-in capital.*

*We would appreciate additional guidance relative to the transition rules and the impact on deferred taxes. For example, the method of accounting for tax benefits realized from the exercise of options for which no compensation expense was recognized under existing rules is unclear. Based on our interpretation of the ED's transition guidance in paragraph 21, we would calculate the deferred tax true-up based upon a comparison of the tax deduction received versus the actual amount recognized in the financial statements. Therefore, for a company that had been applying the disclosure-only approach under APB Opinion No. 25, the entire tax benefit for any award that was fully vested at adoption of the proposed Standard would be recorded to equity. Please clarify if this result is the intended result. It is also unclear as to whether the individual or portfolio approach would be utilized for purposes of determining the appropriate tax treatment upon exercise for options outstanding but not fully vested as of the date of adoption. We believe it would be impractical to require companies to go back and calculate the information needed to apply the individual approach for these previously issued options. Thus, should the individual approach survive the final standard, we believe the portfolio approach should be grandfathered for all options outstanding, both vested and unvested, as of the date of adoption.*

## Disclosures

**Issue 12:** Because compensation cost would be recognized for share-based compensation transactions, the Board concluded that it was appropriate to reconsider and modify the information required to be disclosed for such transactions. The Board also decided to frame the disclosure requirements of this proposed Statement in terms of disclosure objectives (paragraph 46 of Appendix A). Those objectives are supplemented by related implementation guidance describing the minimum disclosures required to meet those objectives (paragraphs B191–B193). Do you believe that the disclosure objectives set forth in this proposed Statement are appropriate and complete? If not, what would you change and why? Do you believe that the minimum required disclosures are sufficient to meet those disclosure objectives? If not, what additional disclosures should be required? Please provide an example of any additional disclosure you would suggest.

*Aetna Response:*

*We believe the disclosure objectives set forth in the proposed statement and minimum required disclosures appear to be excessive and disproportionate relative to the amount of compensation cost and other expense categories included in an income statement. Rather, we suggest that companies be permitted to utilize the principles-based disclosure objectives per paragraph 46, Appendix A rather than the prescriptive disclosures in paragraphs B191-B193*

## Transition

**Issue 13:** This proposed Statement would require the modified prospective method of transition for public companies and would not permit retrospective application (paragraphs 20 and 21). The Board's rationale for that decision is discussed in paragraphs C157–C162. Do you agree with the transition provisions of this proposed Statement? If not, why not? Do you believe that entities should be permitted to elect retrospective application upon adoption of this proposed Statement? If so, why?

*Aetna Response:*

*We agree with the transition provisions of the proposed statement. Should the Board consider retrospective treatment, we would only support this treatment as a permitted exception to the modified prospective method proposed.*

## Nonpublic Entities

**Issue 14(a):** This proposed Statement would permit nonpublic entities to elect to use an intrinsic value method of accounting (with final measurement of compensation cost at the settlement date) rather than the fair-value-based method, which is preferable. Do you agree with the Board's conclusion to allow an intrinsic value method for nonpublic entities? If not, why not?

*Aetna Response:*

*We do not agree with the Board's conclusion to allow different accounting for nonpublic and small business issuers. We believe consistency and comparability require all companies complying with US GAAP should be subject to the same accounting guidance.*

**Issue 14(b):** Consistent with its mission, when the Board developed this proposed Statement it evaluated whether it would fill a significant need and whether the costs imposed to apply this proposed Statement, as compared to other alternatives, would be justified in relation to the overall benefits of the resulting information. As part of that evaluation, the Board carefully considered the impact of this proposed Statement on nonpublic entities and made several decisions to mitigate the incremental costs those entities would incur in complying with its provisions. For example, the Board decided to permit those entities to elect to use either the fair-value-based method or the intrinsic value method (with final measurement of compensation cost at settlement date) of accounting for share-based compensation arrangements. Additionally, the Board selected transition provisions that it believes will minimize costs of transition (most nonpublic entities would use a prospective method of transition rather than the modified prospective method required for public entities). Moreover, the Board decided to extend the effective date of this proposed Statement for nonpublic entities to provide them additional time to study its requirements and plan for transition. Do you believe those decisions are appropriate? If not, why not? Should other modifications of this proposed Statement's provisions be made for those entities?

*Aetna Response:*

*We do not agree with the Board's conclusion to allow different accounting for nonpublic and small business issuers. We believe consistency and comparability require all companies complying with US GAAP should be subject to the same accounting guidance.*

**Small Business Issuers**

**Issue 15:** Some argue that the cost-benefit considerations that led the Board to propose certain accounting alternatives for nonpublic entities should apply equally to small business issuers, as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. Do you believe that some or all of those alternatives should be extended to those public entities?

*Aetna Response:*

*We do not agree with the Board's conclusion to allow different accounting for nonpublic and small business issuers. We believe consistency and comparability require all companies complying with US GAAP should be subject to the same accounting guidance.*

**Cash Flows**

**Issue 16:** For the reasons discussed in paragraphs C139–C143, the Board decided that this proposed Statement would amend FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined by this proposed Statement, be reported as a financing cash inflow rather than as a reduction of taxes paid (paragraphs 17–19). Do you agree with reflecting those excess tax benefits as financing cash inflows? If not, why not?

*Aetna Response:*

*We do not agree with the Board's decision to amend Statement 95 to reflect excess tax benefits as financing cash inflows and believe this issue was appropriately addressed by the FASB's Emerging Issues Task Force in Issue No. 00-15, Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a*

*Company upon Exercise of a Nonqualified Employee Stock Option. We believe the current accounting for such tax deductions is appropriate and should not be changed.*

## **Differences between This Proposed Statement and IFRS 2**

**Issue 17:** Certain accounting treatments for share-based payment transactions with employees in this proposed Statement differ from those in IFRS 2, including the accounting for nonpublic enterprises, income tax effects, and certain modifications. Those differences are described more fully in Appendix C. If you prefer the accounting treatment accorded by IFRS 2, please identify the difference and provide the basis for your preference. If you prefer the accounting treatment in the proposed Statement, do you believe the Board nonetheless should consider adopting the accounting treatment prescribed in IFRS 2 in the interest of achieving convergence?

### *Aetna Response:*

*For accounting treatments proposed in the ED that differ from those in IFRS 2, Aetna does not prefer the accounting treatment accorded by IFRS 2. While we support convergence in concept, we believe that the objective of any accounting standard should be the highest quality standard rather than convergence at any cost/impact.*

## **Understandability of This Proposed Statement**

**Issue 18:** The Board's objective is to issue financial accounting standards that can be read and understood by those possessing a reasonable level of accounting knowledge, a reasonable understanding of the business and economic activities covered by the accounting standard, and a willingness to study the standard with reasonable diligence. Do you believe that this proposed Statement, taken as a whole, achieves that objective?

### *Aetna Response:*

*The proposed statement achieves the stated objective. However, we do not believe most financial statement users will "study the standard with reasonable diligence" to understand the risks associated with the proposed accounting (most notably, the significant assumptions used to measure the fair value of an employee stock option). Ultimately, the user's lack of understanding of this accounting risks the credibility and comparability of financial statements that may further erode investor confidence in our financial reporting model. The proposed standard may be read and understood by a person possessing a reasonable level of accounting knowledge, such as the financial management of companies and certain analysts, but we do not believe it will be understood by many other users of financial statements. Given the technical nature of such accounting and the length of the exposure draft, it is unlikely that such users will attempt to study and understand the proposed accounting. Thus, it is reasonable to assume that at some point in the future, preparers will be asked to provide for additional disclosure to respond, which is not a cost beneficial alternative.*

**Other:*****Effective Date:***

*Further, we believe the effective date of the new standard should be delayed by one-year. Based on the Board's project timeline, it appears that the final standard will be issued in the fourth quarter of 2004, very close to the beginning of the year of required adoption. We do not believe this effective date will allow companies to properly develop the appropriate accounting and tax systems necessary to comply with the new accounting. Additionally, developing the assumptions for use in a binomial lattice-based option pricing model will likely require a considerable amount of time, including coordination with outside experts, if determined necessary. Finally, companies must educate users about company-specific impacts of adopting this new standard. We are concerned that such a short implementation time period will not be sufficient to perform these tasks adequately and, therefore, urge the Board to delay the effective date for one-year.*

*It is also important to consider other pressing changes to which companies are currently devoting significant resources (e.g., Sarbanes-Oxley Act – Section 404 and the SEC's accelerated filings). Management is heavily involved in ensuring such initiatives are executed in a timely and accurately manner.*

***Earnings per share calculations:***

*We respectfully request the Board provide additional background on its decision to require the average unrecognized compensation cost be included in the assumed proceeds when calculating the dilutive effect of in-the-money options. The basis for this conclusion is consistent with prior guidance, but the historical rationale for this conclusion has been lost in the various interpretations and new FASB statements. Additionally, guidance is necessary for appropriate and consistent application of this calculation (i.e., implementation questions regarding use of weighted average or simple average unrecognized compensation cost). We request that the Board provide illustrative examples of the calculation of the diluted weighted average share calculation.*