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Financial Accounting Standards Board  
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Dear Ms. Bielstein:

Citigroup Inc. appreciates the opportunity to comment 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"* (the ITC). As you may be aware, Citigroup is one of a growing number of companies that has recently adopted FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) for recognizing compensation expense. Accordingly, we support using a fair value method to recognize stock-based compensation expense, and believe that it provides greater transparency to financial statement users regarding a company's use of stock-based awards.

Notwithstanding our decision to adopt FAS 123 for recognition purposes, we share the concern voiced by many companies that FAS 123's valuation approach overvalues stock-based compensation. We believe this shortcoming is a major impediment that is preventing more companies from adopting fair value accounting for stock-based compensation. While we have accepted the argument that "zero cannot be the right answer," we are concerned that the FAS 123 fair value methodology may foster behavior among companies that is contrary to its intention. Proponents of fair value accounting for stock options frequently state that recognizing compensation expense will help companies better manage and allocate their equity-based compensation awards. However, we are concerned that it may instead force companies to curtail the use of a highly motivational compensation tool, based on a measure that companies themselves believe to be overstated. While, as explained in more detail below, we do not agree with all aspects of the IASB's proposal, we do support its more general approach to option

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valuation as opposed to FAS 123's more prescriptive approach. Further, we believe the IASB's recent proposal provides the Board with an excellent opportunity to revisit the issue of option valuation, nearly eight years after the issuance of FAS 123.

Our views on the major issues addressed in the ITC are summarized below.

#### Units-of-service/Forfeitures

We believe that compensation expense should be recognized only for awards that ultimately vest. This principle is consistent with both FAS 123 for all awards, and the treatment under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, for awards that result in compensation expense. We strongly disagree with the IASB's treatment of forfeitures whereby the expense already recognized for equity instruments ultimately forfeited is not reversed. Although we acknowledge that services have been received prior to the forfeiture, the fact that the employee forfeited the awards indicates that the services were not provided as consideration for the awards.

Additionally, the fair value per option will often be over- or understated under the IASB's methodology because forfeitures estimated at the grant date are not subsequently adjusted to actual experience. The differences between estimated and actual results accumulate over time, resulting in recognition of expense that is not truly reflective of actual experience. We do not understand how this result is any improvement over the FAS 123 approach.

We also note that if a cash bonus is being accrued for an employee and that employee terminates his employment prior to receiving his bonus, that accrued amount is reversed to income. While we acknowledge that a cash bonus is a liability rather than equity—and that some may argue that a different accounting treatment is therefore necessary—we believe that a forfeited employee option is so similar to an unearned cash bonus that a similar accounting result should be expected. In our view, justifying a different treatment based on a technical accounting argument produces the kind of counterintuitive accounting result that perplexes financial statement users.

#### Nontransferability

Both FAS 123 and the IFRS require that the option-pricing models use expected life, rather than contractual life, to reflect the nontransferability of the option. In fact, this is the only prescriptive discount required by the IFRS. We question why this particular discount is the only one that the IFRS has chosen to specifically mandate. In our view, companies should be given the latitude to determine whether the use of expected life is, in fact, the most appropriate way to adjust the fair value per option to reflect nontransferability. While use of expected life as opposed to contractual term does reduce the value of an option, and therefore is directionally correct, we are not aware of any

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empirical studies that would suggest the resulting discount is adequate, nor that it is the only way to value nontransferability.

In general, we find it troubling that the FASB has found it necessary to be so prescriptive in valuing employee stock options, while providing little or no guidance in valuing other subjective items such as derivatives, financial guarantees, and intangible assets. We believe that companies should be afforded the same judgment in valuing employee stock options as they are in valuing other material accounting items. We would not object to general guidelines, however, of parameters or variables that companies would be required to consider in the valuation.

### Income Taxes

Under the IFRS, all tax effects related to equity instruments are recognized in the income statement. This differs from FAS 123, which requires a more complex approach that may result in either an income statement or equity effect, or both. We believe that the FAS 123 requirements are overly complex. The IFRS approach is much more practical and in our view reflects—through income—the effect of real cash flows realized through the income tax benefits associated with employee stock options.

### Nonemployees

We support the IASB's proposal that employee and nonemployee stock-based compensation transactions should be accounted for similarly. Many companies find that EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18), has been extremely difficult to apply in practice. We understand that even public accounting firms who specialize in such accounting issues view EITF 96-18 as a beguiling array of rules that is impossible to apply consistently. The IASB presents a much more practicable methodology by using the grant date as the measurement date for nonemployee transactions where the fair value of goods or services is not readily determinable. Further, we do not believe that the EITF adequately justified its rationale for using a different model for nonemployees. In our view, a consistent methodology will increase comparability and transparency in the financial statements, and eliminate an approach that has frustrated many preparers and auditors since it was first issued as an EITF consensus.

### Nonpublic entities

We believe that nonpublic companies should be allowed to use the minimum value method to measure the value of equity instruments granted to employees. As noted in FAS 123, it is clearly not feasible to estimate volatility for a stock that does not publicly trade. We do not agree with the IFRS position that a nonpublic company's use of a very subjective estimate of volatility yields a more appropriate expense amount than does the minimum value method. In addition, we would expect much less comparability between

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financial statements of nonpublic companies if they are required to make such subjective estimates.

Reloads

We support the IASB view that the fair value of options with reload features should be measured at grant date, as opposed to the FAS 123 approach where each reload is valued as a separate grant. We understand that option pricing techniques have sufficiently evolved since the issuance of FAS 123, such that reload features may be measured as part of the original option valuation. This results in an expense amount that truly reflects the premium value of an original option grant with a reload feature, which we believe is consistent with the grant date valuation objectives of FAS 123.

In summary, we believe the IASB proposal provides the FASB with an opportunity to improve the shortcomings of one of the Board's most controversial standards. By focusing on improved methods of valuation, we believe the Board can move closer to a stock-based compensation standard that gains far greater general acceptance.

If you have any questions or require more information, we would be pleased to discuss our comments with you in more detail.

Sincerely,

William P. Hannon  
Controller & Chief Accounting Officer