Johnson & Johnson

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Letter of Comment No: 174
File Reference: 1102-001
Date Received: 1-31-03

January 31, 2003

Ms. Suzanne Bielstein
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401 Merritt 7
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File Reference 1102-001

Johnson & Johnson is pleased to comment on the Board's project "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 discussions and deliberations on stock-based compensation and share-based payments are important. We understand that, based on further discussions, the Board will consider whether it should propose changes to US accounting standards and disclosure requirements for stock-based compensation. The comparison of current US accounting rules and proposed international standards are an important part of that discussion.

The Board has requested that comments be limited to similarities of and differences between SFAS 123 and the proposed IFRS. We believe many constituents hold strong and differing views on issues related to stock-based compensation, not included in this request for comments. If the Board would decide to issue an Exposure Draft of a proposed, new standard, we trust the Board will solicit comments on all issues related to the subject of stock-based compensation.

At a very high level, we believe two important factors need to be considered: international convergence and principles based accounting standards. We are pleased the Board is working towards the accomplishment of those objectives.

International convergence of accounting standards is important and necessary, as it will enhance investor confidence in global capital markets. Stock-based compensation is a high profile example of an area where convergence is desirable.

We strongly support a principles based approach to accounting standards setting. A rules based approach can lead to accounting standards that are too complex, too detailed or too prescriptive and may not allow for sufficient, reasonable judgment. Fair value measurement, in our opinion, is an example of such an area. Stock-based compensation is a topic with very specific and unique complexities. A number of valuation methods have been (and are being) developed to determine the (fair) value of employee stock options. Application of these methods can lead to very different results. We believe SFAS 123 and the Proposed IFRS are similar in that, while rooted in principles, they both represent a rules based standard (although some of the proposed rules are different). We believe both standards need to be challenged from a principles versus rules based standpoint.

The following are comments on five specific similarities or differences.

Employee stock options typically have unique characteristics that differentiate them from other equity instruments: they would typically vest only after a certain period (either via cliff vesting or graded vesting); and they may not vest because of forfeitures. Equity instruments are typically issued when consideration is exchanged. It appears to us that, in the case of employee stock options, consideration is not exchanged prior to vesting. Therefore, we believe employee stock options are issued when vested.

The proposed IFRS uses a units-of-service attribution method to record compensation expense. This method may lead to recognizing expense for options that will not vest. This, in our opinion is flawed.

Another unique aspect of employee stock options is that they cannot be traded. Thus, any valuation method that ignores the difference between instruments (options in this case) that can be traded and those that cannot, is fundamentally flawed. Applying pricing models that do not take into account that difference leads to overstatements of the value of those instruments that are not traded (employee stock options). While SFAS 123 allows for certain adjustments to the option pricing models used, it does not adjust for this particular characteristic.

Also, as pointed out above, we believe very prescriptive guidance in this area (for example: the use of specific options pricing models) is, in our opinion, contrary to the movement towards principles based accounting standards. We believe it would be more appropriate to provide guidance in the factors that may be used to arrive at fair value, rather than prescribing a specific model or method. This can than be coupled with robust disclosures about those factors and assumptions.

We believe that, as a matter of principle, there should be no difference between the accounting of stock options for employees and non-employees. While transactions with non-employees may have certain unique characteristics (i.e. performance conditions), we believe they also have a number of similarities with transactions with employees. Harmonizing the accounting represents an opportunity for simplification.

Finally, and referring to our comment letter of November 4, 2002, we believe that reporting the effect of employee stock options via the calculation of fully diluted EPS is the best reporting method. But the fully diluted EPS calculation is, in our opinion, not compatible with expensing options following an options pricing model. The fair value of stock options, which would be recorded as an expense, is determined or influenced in a significant way by future considerations and by considerations that occur over a period of time. Calculating EPS on a fully diluted basis assumes potential shares exercisable under stock option plans are exercised as of Statement date. The effect will generally be that diluted pro-forma EPS will be understated. In addition, we believe that any method that does not recognize the change in value over time (true-up) is flawed. Therefore, we believe reporting the effect via diluted EPS is the best reporting method.

We thank you for taking our comments into consideration and will be pleased to discuss these with you.

Sincerely,

Stephen Cosgrove

Stephen J. Cosgrove
Vice President, Corporate Controller.