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MP&T Director
Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, P.O. Box 5116
Norwalk Connecticut 06856-5116 USA
Via e-mail: director@fasb.org

Dear Sir/Madam:

Re: File Reference 1102-001

The Forest Products Association of Canada (FPAC) is pleased to submit comments in response to the Invitation to Comment on 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*.

Introduction

FPAC was established in February 2001, and builds on almost 100 years of experience as the former Canadian Pulp and Paper Association. Representing 30 of the country's largest producers of pulp, paper and wood products, FPAC speaks nationally and internationally on public policy issues. Its members have responsibility for over 75 percent of the working forests in Canada.

Canada and the US share a common interest in the success of the North American forest products industry. Our national industries make significant contributions to our economies. The Canadian industry represents 3% of the country's gross domestic product. The US industry accounts for more than 8% of total US manufacturing output.

Moreover, our national industries have a close interrelationship and rely on each other for prosperity. Many firms in the industry have operations on both sides of our border – Canadian firms with US subsidiaries and US firms with Canadian subsidiaries.

In addition, many Canadian firms are listed on American securities exchanges or have US dollar-denominated debt and are required to reconcile between Canadian GAAP and US GAAP in annual financial reports. As such, FPAC is interested in potential amendments to American standards.

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Valuation Methodologies

FPAC concurs with the objective of achieving a high level of transparency in corporate financial reporting and accounting practices. However, it is critical that as new standards are considered transparency does not jeopardize accuracy. Investors, analysts and others in the financial community would not be well served by measures that decrease the level of accuracy in corporate reporting.

The valuation of stock-based compensation is not known to have a high degree of accuracy. The major shortcoming is the reliance on option-pricing models to determine the fair-value measurement. Even the Black-Scholes model calculations are of questionable accuracy, often overestimating the true cost of the compensation. The sensitivity of valuations to assumptions is significant, as the use of alternative assumptions may produce greatly varying results. The level of interaction between assumptions also contributes to varying results.

Many enterprises may find it difficult to select assumptions because they have incomplete information on historical exercise patterns or do not track annual exercises by individual option grants. Including expenses based on these estimated valuations will reduce the accuracy of financial statements. As security markets fluctuate these expenses, re-measured at each reporting period¹, will fluctuate. Stakeholders reviewing such statements may be misled about the true financial position of corporations.

There could be a significant effect on retained earnings and future income measurement. In some cases, awards would be reported as liabilities, negatively impacting on a corporation's equity. The negative impact on earnings could have a negative impact on debt covenants and regulatory requirements. Given the inaccuracies of valuation methodologies, such impacts are inappropriate.

The Board notes the shortcomings of the option-pricing models in the Invitation to Comment (ITC). The ITC also highlights several items on which additional disclosures could be considered. Consideration of greater note disclosure based on option-pricing model results is concerning to FPAC members. Since these disclosures relate to inaccurate estimations, additional disclosures will not inform the user, but more likely create greater confusion and uncertainty. In fact, the additional disclosures mandated under Statement 148 are of marginal benefit as they are based on unsatisfactory option-pricing model valuations.

.../3

¹ As mandated under Statement 148, adopted December 31, 2002.

Recommendations

FPAC suggests that work be undertaken to develop more accurate valuation methodology. Accordingly, mandating the expensing of stock-based compensation should be deferred until such time that more accurate valuations are possible. In the interim, the option of pro forma impact note disclosure under Opinion 25 should be maintained.

Although international convergence of accounting standards is a positive objective, the results will only be positive if convergence is based on best practices. Due to the unsatisfactory nature of the option-pricing valuations, FPAC urges the FASB to defer convergence with the IASB proposed IFRS, *Share-based Payment*, until more accurate methodologies are developed. Such an initiative should include international experts so that an international consensus is reached. This would lead to more accurate valuations, better reporting and consistent treatment across jurisdictions.

Summary

Expensing stock-based compensation costs at often inaccurate theoretical valuations will decrease the credibility of financial results being reported and create uncertainty in capital markets to the detriment of investors and the forest products sector. FPAC believes that until more accurate valuation methodologies are developed, the required note disclosures provide an investor the necessary information to assess the impact of stock options without clouding the financial performance of a firm's operations.

Yours truly,

Paul Lansbergen
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