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Ms. Suzanne Bielstein
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Letter of Comment No: 14
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Dear Ms. Bielstein:

On August 12, 2002, Bank of America Corporation announced its intention to begin accounting for all employee stock options as an expense beginning in fiscal 2003. In our August 12 announcement, we commented, "While we believe that expensing employee stock options is the right thing to do, we have been cautious about adopting this approach without a uniform standard to be used by our company as well as competitors." In our opinion, uniform transition and measurement standards are critical because many U.S. companies will be expensing options in the coming year. Without this uniformity, we believe financial statement users will be confused because comparability will be reduced. We applaud the Board for its recent efforts regarding transition and disclosure issues of FAS 123. However, we would like to take this opportunity to encourage the Board to address what we see are the two critical issues, uniform transition and measurement. Because we are quickly approaching the end of the year and many companies will be adopting FAS 123 in 2003, it is imperative that the Board resolve these issues before December 31, 2002.

Transition

The Board recently issued suggested transition guidance containing three alternatives for adopting FAS 123. We do not agree with the Board's approach of allowing three different methods for adopting the standard. We believe that allowing companies to choose from three different alternatives will not result in consistency among preparers as well as making it more complicated for users of the financial statements to assess comparability. Instead, we believe that all companies should follow a uniform method of adoption in order to ensure comparability between financial statements. We recommend that the Board require the fair value requirements apply to all new issuances of employee stock options (ESOs) as well as any unvested ESOs outstanding as of adoption. We believe that this method will appropriately



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reflect the impact of fair valuing ESOs as opposed to the other two methods currently being contemplated by the Board.

Additionally, we are concerned that the Board considers pro forma footnote disclosures the appropriate way to achieve comparability among preparers' financial statements. Specifically, we encourage the Board to require all companies to report the impact of expensing ESOs in their current period earnings based on a single method of application. As discussed above, we believe that method should be fair valuing all unvested options as well as those issued after adoption. The importance of this change warrants more than footnote comparability.

Measurement

Our second concern regards the measurement methodology of FAS 123. Over the past few weeks, some major U.S. companies have expressed concerns similar to ours regarding FAS 123's fair value methodology. We would like to take this opportunity to expand on our concerns and request the Board consider our comments, along with those made by other major U.S. companies, to develop a uniform application of the Black-Scholes model or work to develop a new methodology for purposes of valuing ESOs for expense recognition. As an example of diverse practices, one company recently announced that they would calculate the fair value of their options using quotations from independent financial institutions. While the Board allowed for the use of quoted market prices if those prices became available, it is unclear whether quotations from independent financial institutions are sufficient to meet the Board's standard of "quoted market prices".

To promote comparability and transparency, ESOs should be valued on a uniform and consistent basis across all companies. In the Basis for Conclusions of FAS 123, the Board acknowledges that an ESO is less valuable than an otherwise identical tradable option at any time before the expiration date. The Black Scholes model does not address certain possible valuation adjustments caused by differences between ESOs and publicly traded options. The following describes the more significant differences between ESOs and freely traded options. Additionally, there are basic assumptions in the Black Scholes model that are subject to wide variation in interpretations. Each of these differences may significantly affect the "true" value of an ESO.

- **Transfer restrictions**-The holder of the ESO is not able to sell or transfer the option. This restriction significantly impacts the calculated value because the Black Scholes model assumes that the option can be freely traded. In addition, senior officers of the company are subject to black out restrictions and restrictions on trading while in the

possession of material information that may further reduce the value of the ESO to that employee.

- Hedge and employment restrictions- A significant assumption of the Black Scholes model is that the ESO can be effectively hedged; however, the ESO holder cannot efficiently hedge the option as contemplated primarily due to securities and tax law considerations. This inability typically arises because (1) the ESO holder would be considered an insider or affiliate and subject to short sale rules thereby making the hedging strategy impracticable, and/or (2) the short sale hedge receives capital gains tax treatment while the intrinsic value of the option is taxed as ordinary income. Gains related to the ESO cannot be used to offset the losses because intrinsic value gains are taxed as ordinary income. Thus, the economic benefits of the short sale may not be fully realized. A market maker faced with the same inability to hedge the underlying option would not use a Black Scholes model because the model does not produce a representative value. Instead a market maker would use alternative valuation methodologies that, we contend, would yield a lower value.
- Time value-The holder of the ESO may leave the firm that issued the ESO either voluntarily or involuntarily thereby reducing the option's life. The Black Scholes model assumes a set life for the option and fails to consider forfeitures.
- Vesting-There are many unique vesting features used today to drive desired employee behavior that is intended to increase shareholder value. The Black Scholes model does not consider such features and is not the best representation of the ESOs' value.
- Volatility-Varying assumptions for calculating volatility can significantly impact an ESO's estimated fair value. The Board acknowledged in FAS 123 that expected volatility provides much of the option's value. A major determinant of volatility is price changes in the underlying equity. However, price data can be gathered from differing time intervals – daily, weekly, monthly and so forth. The impact of using differing points in time can be significant. Additionally, FAS 123 contemplates adjustments being made by the financial statement preparer to historical volatility for expected differences from future volatility. These adjustments will result in broad variations in the calculation of fair value.

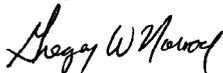
We observe in the Basis of Conclusions to FAS 123 that the Board recognized that transferable options are more valuable than ESOs primarily for the reasons enumerated above. However, the Board's solution of compensating for the overstatement of value through using the expected life of the ESO, as opposed to the contractual life, may have been a reasonable perspective when considering FAS 123 as primarily a disclosure standard but not for income statement

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recognition. We do not believe there is sufficient evidence to support the Board's assumption that adjusting contractual life equals the value impact of issues noted above. The result of the factors noted above is that the fair value calculated using the Black Scholes model is higher than the ESO's fair value and variations in valuation assumptions used by different companies will significantly impact comparability.

As many companies plan to adopt FAS 123 in the coming year, we believe it is important that the issues of transition and measurement be addressed. The Board may wish to convene a working group to address valuation issues and develop solutions to those issues. In our opinion, both transition and measurement issues should be resolved prior to the end of 2002. Without resolution of these issues prior to adoption by many major U.S. companies, we are concerned that the usefulness of the financial statements will be compromised because of inappropriate valuations and differing valuation assumptions making comparability very difficult. We are available to assist the Board in any way it may require and are available to answer any questions the Board may have.

Sincerely,

A handwritten signature in cursive script, appearing to read "Gregory W. Norwood".

Gregory W. Norwood