## Deloitte.

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Mr. Lawrence W. Smith Director, TA&I — FSP Financial Accounting and Standards Board 401 Merritt 7

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LETTER OF COMMENT NO. 3

File Reference No. FAS 123(R)-e Re: Proposed FASB Staff Position No. FAS 123(R)-e, "Amendment of FASB Staff Position FAS 123(R)-1"

Dear Mr. Smith:

Deloitte & Touche LLP is pleased to comment on proposed FASB Staff Position No. FAS 123(R)-e, "Amendment of FASB Staff Position FAS 123(R)-1" ("the proposed FSP").

We support the FASB's effort to provide guidance on the proper application of FSP FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services Under FASB Statement No. 123(R)," to equity restructuring and business combination transactions. However, we recommend that the FASB consider the following before issuance of the proposed FSP as a final FSP.

## Changes Made in Contemplation of an Equity Restructuring or a Business Combination

The proposed FSP currently indicates that so long as the conditions in paragraph 4(a) and (b) are met, a change made to an instrument originally issued as employee compensation will not require a reassessment of the recognition and measurement of the instrument under other applicable GAAP in circumstances where the holder is no longer an employee.

Under condition (a) in paragraph 4, any adjustment made as a result of, or in contemplation of, an equity restructuring or business combination must not increase the value to the holders of the instrument. While we agree with this conclusion, we also believe that a reassessment (under other GAAP) should not be required where a change is made to the terms of an award to reflect an equity restructuring or a business combination that occurs when the holders are no longer employees and the change preserves the award's intrinsic value and the ratio of exercise price to stock price.

That is, we do not believe an adjustment should trigger reassessment of the recognition and measurement of an instrument under other applicable GAAP in circumstances where a change is made to the exercise price, the number of shares, or both, of an outstanding fixed award as a result of, or in contemplation of, an equity restructuring or business combination if both of the following criteria are met:

- (a) The aggregate intrinsic value of the award is not increased; and
- (b) The ratio of the exercise price per share to the market value per share is not reduced.

This formula (preservation of intrinsic value and the exercise price ratio) for adjusting options has been applied extensively in practice as a surrogate for a fair value adjustment. In the circumstances described above, we believe that the instrument should remain subject to the recognition and measurement provisions of Statement 123(R) and that a determination of incremental compensation cost should be made pursuant to paragraph 51 of Statement 123(R).

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We appreciate the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact Jim Kroeker at (203) 761-3726.

Yours truly,

Deloitte & Touche LLP

cc: James A. Johnson