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Director, TA&I – FSP
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

LETTER OF COMMENT NO. 5

Re: Proposed FASB Staff Position No. EITF 03-6-a “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities”

Dear Director,

We would like to take this opportunity to comment on the Proposed FASB Staff Position No. EITF 03-6-a “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities” (FSP). Emerson is a diversified manufacturer of electrical and electronic products with a market capitalization in excess of \$30 billion.

Summary

In summary, we believe that:

- The FSP is inconsistent with the Basis for Conclusion of FAS 128 which concluded to reduce complexity by replacing Primary earnings per share (EPS) with Basic EPS, a simple calculation that can be compared to Diluted EPS to arrive at a range of possible EPS. Reintroducing needless complexity in the calculation of Basic EPS is not warranted.
- The most common form of share-based payment awards to employees, which are settled in shares of common stock of the company one-for-one and pay dividends during the vesting period at the same rate as common stock, should not be accounted for under the two-class method.
- FAS 128 and FAS 123R already provide for dilution of share-based awards in Diluted EPS and FAS 123R requires that dividends paid are expensed for share-based awards which do not vest. We see no need to further complicate the presentation and communication of EPS with the two-class method which could also lead to redundant dilution in conjunction with the treasury stock method.

Reduce Complexity of Basic Earnings Per Share

FAS 128 developed Basic EPS to reduce the complexity that previously existed for Primary EPS by excluding “common stock equivalents” and restricted stock (unvested shares) from the denominator for Basic EPS. The proposed FSP would effectively put those shares back into the Basic EPS calculation and create confusion about a “second class” of common stock applicable for

share-based awards issued to employees that is difficult to communicate. Nowhere in FAS 128, FAS 123R or other authoritative guidance, nor are we aware in practice, have these type of awards been treated as participating securities. The concept of Basic EPS is simple and understandable – EPS calculated using actual shares outstanding without adjustments for dilution.

Also, during the deliberations of FAS 128, the Board acknowledged that multiple earnings per share amounts might be confusing to users and considered the presentation of only Diluted EPS as it provided the most meaningful information and would have represented a step toward simplification of the earnings per share guidance. We strongly agree with this concept and believe the presentation of Basic EPS is unnecessary, and we are not aware of anyone who uses this measure to gauge performance or otherwise. Since FAS 128 was issued nearly a decade ago, it has become clear that Diluted EPS is the important measure to users of financial statements. The Board should now take the opportunity to reduce complexity by deleting the requirement to disclose Basic EPS or only disclosing Basic EPS in the notes to the financial statements if materially different (e.g. > 3%) from Diluted EPS to provide a range of possible EPS amounts.

Two-Class Method Not Appropriate

We believe that share-based payment awards issued to employees which are subject to vesting, performance or market conditions, settle in shares of common stock of the company one-for-one, and receive dividends at the same rate as common stock are not a “second class” of common stock, and therefore should not be subject to the two-class method. In addition, we believe the two-class method should not be applied to these awards for the following reasons:

First, the guidance provided in the FSP is inconsistent with conclusions in FAS 123R and FAS 128 with regards to the method that should be used for share-based awards. Paragraph 66 of FAS 123R and paragraph 20 of FAS 128 state that the treasury stock method should be used for share-based awards granted to employees in computing Diluted EPS. We do not believe the two-class method was ever intended to be used for share-based awards.

Second, paragraph 61 of FAS 128 states that the if-converted method shall be used for those participating securities that are convertible into common stock. If the Board concludes that share-based awards issued to employees are participating securities and that the treasury stock method is not appropriate for these awards, then the if-converted method is appropriate, and not the two-class method, since unvested/unearned share-based awards are convertible into common stock. The entire basis for using the two-class method is only when the participating securities cannot become shares of common stock.

Third, we believe it is unnecessary to require the two-class method, which will create confusion to the users of financial statements and add complexity to the calculation of EPS. The two-class method with its separate calculations and disclosures of distributed and undistributed earnings is complex and will be difficult for users of financial statements to understand, and complex for preparers to communicate and calculate. The impact of using the two-class method will be immaterial for a vast majority of companies, but will still require reporting (See the “Materiality Considerations” discussion below).

Fourth, we believe the amounts disclosed will be of little or no value when the share-based awards are settled in shares of common stock of the company one-for-one and pay dividends during the vesting period at the same rate as common stock. If the two-class method is applied appropriately, the basic EPS for these awards under the two-class method should be the same as the basic EPS for the outstanding shares of common stock. However, see our comments regarding potential double counting of dilution within the “Diluted Earnings Per Share” discussion below.

Nevertheless, if the Board strongly believes that these shares should be included in Basic and/or Diluted EPS, rather than requiring the two-class method, the FSP should simply require including 100 percent of the unvested/unearned share-based awards in the Basic and Diluted EPS calculations. This alternative would achieve similar dilution of EPS available for common stockholders as compared with the two-class method but would be a less complex approach for users to understand and for companies to apply in practice. However, we believe that the current guidance under FAS 123R and FAS 128 already adequately accounts for the dilution of share-based awards.

Diluted Earnings Per Share

The draft FSP only discusses how the share-based awards that are deemed to be participating securities should be included for Basic EPS and does not address Diluted EPS. We believe the FSP should clarify whether it applies to Diluted EPS, particularly since paragraph 20 of FAS 128 already requires the treasury stock method in computing Diluted EPS, but not the two-class method. By not addressing the calculation of Diluted EPS, the proposal could lead to applying the guidance only to Basic EPS resulting in two different dilution calculations, the two-class method for Basic EPS and the treasury stock method for Diluted EPS. It is noteworthy that such a conclusion could potentially result in more dilution for Basic EPS compared with Diluted EPS.

If applicable to Diluted EPS, the proposal could lead to double counting for the impact of share-based awards. The two-class method may lead to double counting since the shares would already be included (partially or fully) in the denominator in the Diluted EPS calculation through the treasury stock method and 100 percent of the shares would effectively be included again through the two-class method allocation. The combined impact is that each share-based award could effectively be counted up to two times in the Diluted EPS calculation. The Board should consider withdrawing the proposed FSP, or as discussed above, replacing it with a requirement to simply include 100 percent of the share-based awards in computing Basic and Diluted EPS (but then exclude these shares altogether from the treasury stock method dilution calculation) to reduce the complexity and eliminate any double counting of the impact.

In addition, FAS 123R requires that dividends paid on share-based awards be expensed if the awards do not vest or are not earned. However, up until the time that it is known whether or not the shares will vest or be earned, FAS 128 would require those shares, through the weighted average shares calculation, be included in the calculation of Diluted EPS, thus resulting in the possibility that the impact could be accounted for twice (i.e. in the shares and as an earnings reduction). As an alternative to the two-class method in the proposed FSP, a much simpler approach, with a similar net impact on EPS, would be to immediately expense all dividends paid on unvested/unearned share-based awards as compensation expense (consistent with IRS tax treatment) and continue to apply the treasury stock method for share-based awards.

Materiality Considerations

If the Board moves forward with this proposal, we believe that a “materiality threshold” should be considered. In today’s environment, materiality appears to be moving to a lower and lower threshold and preparers are challenged to disclose even the most immaterial of impacts. Auditors and regulators are reluctant to permit preparers to rely on the statement at the end of standards that “the provisions of this Statement need not be applied to immaterial items.” We believe that the Board should consider reintroducing a quantitative materiality threshold (e.g. 3% difference), rather than a subjective threshold, when applying the two-class method with respect to the

presentation of Basic and Diluted EPS in an effort to limit unnecessary confusion when the amounts are not materially different.

Prospective Application

The proposal states that the requirements shall be applied retrospectively for all prior-period earnings per share. We do not agree that the changes suggested in the proposal should require restatement, and therefore, we encourage that if a final FSP is issued, that it be applied prospectively, along with appropriate disclosures.

Investment analysts and institutional investors have indicated to us that restatements to the financial statements complicate their analyses. They prefer to begin their forecast of the future from a static set of historical financial results and then analyze any changes. Restatements of even a small magnitude require them to adjust their data for consistency. In addition, retrospective application requires the Company to restate for all prior periods presented in the annual report, including two prior years of EPS by quarter and 10 prior years of summary EPS data.

Conclusion

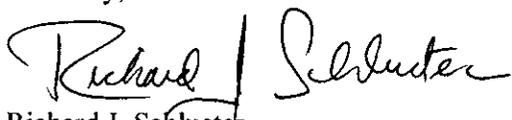
We believe that FAS 128 sufficiently addresses dilution for share-based awards to employees that are convertible into common stock on a one-to-one basis and pay a dividend at the same rate as common stock, and that the two-class method should not be used.

If the Board decides to proceed with this FSP, we hope that our various suggestions for reducing the complexity of the proposed Basic and Diluted EPS calculations will be considered:

- Do not modify the computation of Basic EPS,
- Eliminate Basic EPS or only require disclosure in the notes if materially (e.g. > 3%) different from Diluted EPS,
- Include 100 percent of the unvested/unearned share-based awards in both Basic and Diluted EPS calculations, or
- Expense all dividends paid on unvested/unearned share-based awards.

We appreciate the opportunity to respond to the working draft and trust that our comments will be seriously considered in future Board deliberations on this issue.

Sincerely,


Richard J. Schlueter
Vice President & Chief Accounting Officer

cc: Robert Herz
Chairman, Financial Accounting Standards Board

Walter J. Galvin
Senior Executive Vice President & Chief Financial Officer