



LETTER OF COMMENT NO. /6

citigroup
153 East 53rd Street
New York, NY 10043

December 19, 2006

Mr. John Sarno
Project Manager
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut, 06856-5116

Re: Proposed FASB Staff Position No. EITF 03-06-a, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*

Dear Mr. Sarno:

Thank you for giving us the opportunity to comment on the proposed FASB Staff Position No. EITF 03-06-a, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (the proposed FSP). We have followed the FASB's deliberation on whether unvested instruments granted in share-based payment transactions are participating securities and whether they need to be included in the earnings allocation in computing basic earnings per share (EPS).

Paying dividend equivalents on restricted stock awards is neither a new nor an emerging issue. We are troubled that an area that has been apparently clear for so long – long enough to have specific paragraphs in FASB Statement No. 128, *Earnings Per Share* (FAS 128) dedicated to stock-based compensation – is now being revised. The guidance in FAS 128 was originally found in FASB Interpretation 31, *Treatment of Stock Compensation Plans in EPS Computations*, issued in February 1980. It was reconsidered by the Board and carried forward unchanged into FAS 128, issued in February 1997.

Since these plans and the related guidance for computing EPS have been in existence for an extended period of time, we find it difficult to understand why the Board would choose to modify the EPS computations for them through an FSP at this time and do not believe the Board should do so without more thorough deliberations.

We have the following, more specific, observations.

Amendment of FAS 128

In our view, the proposed FSP is an amendment of FAS 128. Paragraph 61 of FAS 128 states:

The if-converted method shall be used for those securities that are convertible into common stock if the effect is dilutive. For those securities that are not convertible into a class of common stock, the 'two class' method of computing earnings per share shall be used....

The proposed FSP would require the use of the two-class method even if share-based payment awards are convertible into only one class of common stock when restricted stock is distributed or stock options are exercised and, therefore, is an amendment of the above FAS 128 guidance.

We understand that EITF Topic No. D-95, *Effect of Participating Convertible Securities on the Computation of Basic Earnings per Share* (EITF Topic D-95); and Issue 7 of EITF Issue No. 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128* (EITF 03-6), effectively amended FAS 128 to require the use of the two-class method for all participating securities. We struggle to understand how EITF issues can amend the stated guidance in paragraphs 60-61 of FAS 128. To avoid confusion in practice, we believe that the FASB needs to amend paragraphs 60-61 of FAS 128 if the if-converted method is no longer permitted even in the situation where participating securities are convertible to an entity's only class of common stock. The basis for that conclusion should be described in the proposed FSP. In our experience, most share-based payment awards are convertible into the issuing entity's sole class of common stock, and the current guidance in paragraph 61 of FAS 128 seems explicitly to require using the if-converted method.

We recommend that the FASB make amendments to the guidance in FAS 128 only through a formal amendment process to avoid confusion in practice. Since the FASB has an active project on its agenda to revise FAS 128 in convergence with IAS 33, *Earnings Per Share*, we recommend that this issue (and the Board's other ongoing FSP on the two-class method, *Computational Guidance for Computing Diluted EPS Under the Two-Class Method*) be addressed as part of that project, in particular since the decisions in the proposed FSPs would create additional convergence issues.

Basis for Requiring the Two-Class Method for Unvested Stock-Based Compensation Awards

In situations where share-based payment awards are convertible to an entity's only class of common stock, it is not clear to us what the basis is for requiring the two-class

method for the EPS computation or even whether reflecting such amounts in basic EPS at all makes sense.

Also, we feel that the EITF 03-6 requirement of using the two-class method for participating securities should not necessarily apply to share-based payment awards, as share-based payment awards have significantly different characteristics than other participating securities, such as preferred stock issued to independent third parties in a capital raising transaction.

First, the actual amount of dividends paid for awards that are not expected to vest is included in compensation expense. Thus, the dividends being paid on the estimated forfeited stock-based compensation are already being reflected in the numerator of the basic EPS calculation. Wouldn't the two-class method essentially result in double counting? Or should such amounts be added back into the EPS numerator? The Board should explain why it believes this double counting is appropriate.

Second, shares related to unvested share-based payment awards are *not* outstanding and are forfeitable and, as such, do not meet FAS 128's criteria for inclusion in basic EPS either via paragraph 8 or paragraph 10. This is quite unlike instruments addressed in the scope of Issue 03-6, which, while often derivative in nature, are outstanding and are not forfeitable.

Indeed, we believe such differences warrant different accounting treatment and, consistent with the current language in FAS 128, it is more appropriate to include such awards only in diluted EPS computation. However, should the Board disagree, we believe that the Board's basis for conclusions should be described in the final FSP (or preferably as part of the ongoing project to amend FAS 128) so constituents can understand the Board's rationale and apply it in analogous situations.

Treasury Stock Method

We understand that the guidance in the proposed FSP would also change the calculation of diluted EPS. However, this is not explained anywhere in the proposed FSP. One of the proposed changes is that the treasury stock method would only be allowed if it yields a more dilutive EPS than the two-class method. We struggle with reconciling that guidance with the explicit guidance in paragraphs 20-23 of FAS 128, which requires the use of the treasury stock method for share-based payment awards in the diluted EPS calculation. We request that the Board address that inconsistency and amend FAS 128 where applicable.

We believe that using the treasury-stock method in the diluted EPS computation would better reflect the economics of most companies' actual practice of buying treasury stock as part of the management of their share-based payment awards. Note that paragraph A241(k) of FAS 123R requires disclosure of an entity's practice of repurchasing shares.

Implementation Questions

Since the mechanics of the required guidance in the proposed FSP are not explained, we believe the following implementation questions must be addressed in the proposed FSP or constituents will not be able to implement the FSP:

- a. Whether dividend equivalents, including those recorded as compensation expense under FAS 123R, should be added back to the numerator (net income) when calculating basic and diluted EPS.
- b. Whether compensation expense recorded under FAS 123R should be added back to the numerator (net income) when calculating basic and diluted EPS.
- c. How to present the two-class method for entities that only have one class of common stock, and where the share-based payment awards are only convertible into that class of common stock.

Your consideration of our comments would be appreciated. If you would like to discuss any of these points further, please feel free to contact me at (212) 559-7721.

Very truly yours,

Robert Traficanti
Vice President and Deputy Controller
Corporate Accounting Policy