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Director of Major Projects Financial Accounting Standards Board (FASB) 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116 Letter of Comment No: 6394 File Reference: 1102-100

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Re: Exposure Draft - Shared-Based Payment an amendment of FASB Statements No. 123 and 95

#### Members of the FASB:

Medtronic is a world-leading medical technology company, providing lifelong solutions for people with chronic disease. We were founded in 1949 and today serve physicians, clinicians and patients in more than 120 countries. Our fiscal year 2004 net sales were \$9.09 billion and our net earnings were \$1.96 billion. Our market capitalization is approximately \$60 billion.

We appreciate the opportunity to comment on the Share-Based Payment exposure draft. Our comments are organized according to the categories set forth in your invitation to comment (i.e. Recognition of Compensation Cost, Measurement Attribute and Measurement Date, Fair Value Measurement, etc.).

# Fair Value Measurement (Issues 4a - 4d)

We agree that a binomial lattice model is preferable over a closed form model like the Black-Scholes and likely would represent an improvement in determining a "fair value" for share-based awards. However, we still have concerns on whether current option-pricing models can reliably measure fair value. We do not believe current option pricing models can be properly risk adjusted to reflect the illiquid state of non-traded share-based awards. Although the adjustment of the expected term will provide some measure of refinement for the unique characteristics of a shared-based award, we do not believe this is going to bring the fair value of the option in line with what a third party would be willing to pay for such an instrument.

In addition to our concerns over the reliability of the fair value measurement, we also have concerns with prescribing the use of a single model for valuation (binomial lattice) and the complexity of using such a model. We believe there should be some latitude for companies to choose the type of model used, and believe the standard should take into consideration the anticipated evolution of more reliable and less complex models in the future. As noted, we do agree that the binomial lattice model offers an improvement over a closed form model, but we believe the cost of this improvement will be very high as compared to the derived benefit over time. The initial efforts to gather the information necessary to populate the models and have an external valuation expert perform the calculations will be extensive and the burden of the ongoing calculations will likely overshadow the derived benefit to the readers of the financial information.

Therefore, we believe the board should issue the final standard giving companies flexibility in determining the type of valuation model to use.

### Employee Stock Purchase Plans (Issue 6)

We agree that Employee Stock Purchase Plans should be treated similarly to other share-based employee awards and compensation measured at fair value. However, we believe that the provisions for a limited discount, as written in FAS No. 123, are an acceptable alternative to making all discounts considered compensatory. We believe that a nominal 5% discount could be considered equivalent to the costs of otherwise issuing stock to the public and not construed as compensation. In our opinion, the true value of being able to offer a stock purchase plan to employees is to encourage employee ownership and to provide a connection between employee behavior and the overall success of the company. This linkage serves to benefit not only the employee, but also the greater shareholder population. Accordingly, we support the conclusions in FAS No. 123 related to Employee Stock Purchase Plans, and recommend incorporating these provisions into the final Share-Based Payment Standard.

## Attribution of Compensation Cost (Issue 9)

Although we agree that transactions involving the issuance of share-based payments to employees represent an exchange transaction that should be measured at fair value and generally expensed over the employee's service period, we disagree with the proposed treatment of awards with a graded vesting period.

We understand the rationale of the board's decision to treat an award with a graded vesting schedule as distinctly separate awards, however, we believe the costs and complexity of such a requirement will outweigh the benefits of treating an award in this manner. In addition, we believe that recognizing the majority of the compensation cost of an award in the early years of employee service is inconsistent with the pattern of services received by the Company. We believe that recognizing costs evenly over the service period, as the services are being performed, better matches the expense with the benefit received from an award and is better aligned with the intent of offering an award with a graded vesting pattern.

### Income Taxes (Issue 11)

We do not support the Board's conclusions related to the proposed accounting for the income tax effects of share-based payments for two primary reasons. One, we find it hard to understand the asymmetrical treatment of excess tax benefits on share-based awards being recorded as an increase to stockholders' equity and the shortfall in tax benefit being recorded as a reduction in net income. We believe that the amount of the expense associated with a share-based grant should be recognized as compensation expense and subsequent differences in realized tax benefits should be recognized in additional paid-in capital, as the impact of the actual exercise will be recorded. We believe that the grant and the exercise should be treated as two different transactions and not be further segregated to account for the tax impacts at a more disaggregated level.

Two, we believe the exposure draft's proposed treatment of tracking the tax impact of share-based payments down to the employee level is impractical and overly burdensome upon implementation. We believe that the portfolio approach to accounting for the tax impacts of FAS No. 123 is more consistent with how such awards are valued and would simplify what is already a complex standard to implement.

### Transition (Issue 13)

Although, from an administrative prospective, the modified prospective method of implementation is a good compromise between restatement and prospective treatment, we do not agree that a

single method of implementation should be prescribed for all companies. A more appropriate option would be to give companies a choice in the method of adoption similar to FAS No. 148, where the board allowed three different alternatives for transition.

From the perspective of the financial statement user, we believe the retroactive restatement of the information prescribed by the standard would provide the most useful information to the reader of the financial statements; however we acknowledge that a full revaluation of each option granted for each of the affected years in the financial statements is impractical, and believe that this issue could be resolved in a similar fashion to the modified prospective method proposed by the Board. Just as the exposure draft prescribes that the modified prospective method would utilize the previous option pricing valuations, we would suggest using these same valuations in the restated figures for the prior years. We also believe that the prospective method of adoption should be an available transition alternative due to the fact that many companies have already adopted FAS No. 148, in attempt to provide transparent financial information, and would now be penalized by having to re-adopt the proposed standard under a new transition method.

Effective Date

Although the proposed standard is a step forward, we believe the standard as written will be a much larger burden to implement than initially perceived by the Board. Given the complexity of the proposed option valuation methodology, the graded vesting provisions and the tax ramifications of the proposed standard, we believe that delaying implementation by one year would be necessary to effectively comply with the changes. The complexity of the valuation methodology alone will require companies to gather a significant amount of additional data that either does not exist today or is not effectively tracked, and partner with a limited number of third party valuation experts to derive the option valuations. In addition to the complexity of the pricing model, companies that offer options with graded vesting provisions will be faced with finding a way to effectively track an exponential number of option grants and the related expense and tax impact associated with each grant.

Therefore, we believe it is necessary to provide companies an additional year to implement the standard given the complexities and lack of available data required to be incorporated into the fair value model suggested by the new standard. An additional year for implementation will lead to more accurate fair value data and better disclosure when implemented.

Again, we appreciate the opportunity to comment. If you have any questions regarding this letter or would like to discuss any of our views further, please feel free to contact me at (763) 505-2770.

Sincerely,

Gary L. Ellis

Vice President, Corporate Controller and Treasurer

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