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FASB PUBLIC COMMENT SESSION ON SHARE-BASED PAYMENT EXPOSURE DRAFT

June 29, 2004

Summary of Comments by Frederic W. Cook & Co.

OPINION PRICING MODELS – A MAJOR ISSUE

Our firm believes that option-pricing models, developed for short-lived traded options, overstate the value of long-lived employee options because they do not adequately discount for the unique characteristics of such options, which include the recipient's inability to sell or transfer the option, hedge the option position, or exercise the option until vesting or during blackout periods. Also, once exercised, the option expires losing remaining time value.

Consequently, we urge the FASB to:

1. **Conduct a market test** of whether the option-pricing models proposed by the FASB measure the amount which investors and traders would be willing to pay for options with such characteristics, and

2. **Delay the implementation** of the new accounting standard until the results of the test have shown the accuracy, reliability and consistency of the measurement method proposed by the FASB.

OTHER COMMENT AREAS AND RECOMMENDATIONS

1. Restatement – Companies should be allowed to restate prior period earnings in a manner consistent with the new requirements, using the same pro forma net income and EPS as disclosed in footnote disclosure under current FAS 123 for the prior periods. This will permit comparability of operating income from one period to the next, without the arbitrary effect of a major change in GAAP accounting.

2. Graded vesting – Companies should be allowed to continue to choose between straight-line accruals or front-loaded accruals when they issue equity grants with graded vesting. To mandate front-loaded accruals for all new grants introduces a tremendous amount of complexity and calculations, particularly for companies with monthly or daily vesting.

3. Reload options – There is no reason for an exception to the general principle of modified grant date accounting that states that the value of a grant should be measured at its grant date if it can be so valued. No reason is given for forcing this one exception on reload grants. Option valuation experts have testified that the value of a reload feature can be built into the estimate of fair value at grant. Companies that wish to include a reload feature should be allowed to do so without the requirement to value each reload grant separately, which is punitive.

4. Equity restructurings – Companies that undergo equity restructurings should be allowed to adjust their outstanding stock option/SAR grants using as a safe harbor the formulas and principles embodied in EITF 90-9. This would be much simpler than forcing a comparative fair value calculation which might have unforeseen consequences on the grants and which will be quite difficult to explain or understand to participants and to shareholders.

— Examples would include the spin-off of a more volatile unit from a less volatile parent, or the acquisition of a less volatile unit by a more volatile parent

5. Pro forma disclosure – Paragraph B193 should be reworded so that companies are expressly permitted to make pro forma disclosures in their financial statement footnotes as to what net income and EPS would have been had there not been a fair value earnings charge for employee stock options. This would facilitate the interests of sophisticated investors who wish to assess the operating performance of companies without the estimated grant date value of stock options.

— More information is better than less information in the interests of transparency

6. Income taxes – It seems grossly unfair and asymmetrical to require that, in situations where the earnings charge for options exceeds the amount ultimately deductible, the incremental deficit flows through the income statement, but in the reverse situation the incremental positive bypasses the income statement and is a direct credit to capital surplus. The same treatment should be accorded either way. The same comment and suggestion of symmetrical treatment should apply also to statement of cash flows.

7. Footnote Disclosure – The footnote disclosures specified in paragraph B191b should be required for each year an income statement is required (as it is under current rules), not just the most recent fiscal year.

Respectfully submitted,

Frederic W. Cook