Johnson-Johnson

Stephen J. Cosgrove Vice President Corporate Controller One Johnson & Johnson Plaza New Brunswick, NJ 08933 (732) 524-3737

June 30, 2004

Letter of Comment No: 5540 File Reference: 1102-100

Director of Major Projects Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

File Reference 1102-100
Proposed Statement of Financial Accounting Standards – Share Based Payment an amendment of FASB statements 123 and 95.

Johnson & Johnson is pleased to comment on the Board's proposed statement "Share Based Payment". The accounting for share based payments, including employee stock options, is an important topic and has been subject to considerable debate. We believe many constituents hold strong and differing views on this topic. The following comments specifically relate to employee stock options.

General

The impact of employee stock options should be adequately reflected in the financial statements. As pointed out in previous comment letters, we continue to believe that reporting the effect of employee stock options via the calculation of diluted earnings per share (EPS) is the best reporting method. Calculating EPS on a diluted basis assumes potential shares exercisable under stock options plans are exercised as of Statement date. This method, in our view, fully accounts for the impact of employee stock options on earnings.

The fair value approach, which has some merits, has also serious shortcomings. We do not believe a model should be prescribed, as over time no model (or specific valuation technique) will keep pace with the changes in the types of options plans as well as with evolving valuation techniques. While we believe the lattice model is superior to the Black-Scholes model, it has shortcomings (does not recognize the unique characteristic of non-transferability) and will need to evolve over time. Therefore, we believe that, if employee stock options have to be recorded at fair value, no specific model should be prescribed. This would also make the standard more principles based than rules based, which is in line with one of the Board's general objectives.

We also believe that any method that does not recognize the change in value (true-up) is flawed. It is possible, under the current proposals, that no options would ever be exercised (in case of continuous decreasing stock prices) whereas a registrant would continue to record stock options expense and not be able to true-up that situation.

Income Tax Considerations

We believe the granting of employee stock options and the exercise by the employee are two separate transactions that should be accounted for independently of each other. Thus, the income tax impact of the grant should be measured in relation to the underlying expense and subsequent differences should be accounted for in additional paid-in capital, regardless of whether those differences represent increases or decreases.

The proposed statement requires to account for the tax impacts of employee stock options at the individual employee level. We believe that (1) conceptually, stock options are valued as a portfolio, not individually; and (2) any requirement to keep individual records to calculate the tax impacts by employee would be impractical and not cost beneficial. Note that, in a global corporation, many employees frequently move between different tax jurisdictions and setting up a tracking system to calculate the individual tax impacts is simply not practical.

Presentation

Employee stock options are typically granted to employees in all areas or disciplines within an organization (selling, marketing, R&D, operations, finance, etc...). This would imply that the cost of employee stock options would reside in the various income statement categories, and even on the asset side of the balance sheet, for those activities that are capitalized (example: engineering costs capitalized as part of a building; manufacturing cost included in inventory valuation;...). We believe this is impractical and also does not lead to the desired transparency of information. Therefore, we ask the Board consider a separate line-item display in the income statement.

Transition Methods and Effective Date

When the Board issued SFAS 148 (Accounting for Stock-Based Compensation – Transition and Disclosure), the Board allowed three different transition models.

The current exposure draft only allows the modified prospective method. We believe the same alternatives as per SFAS 148 should now be available to registrants.

Specifically, we believe the retroactive restatement option is a more meaningful method, as it results in the display of comparative trends, which are more useful for users of financial statements. While the retroactive restatement method is more burdensome from a practical point of view, we believe the increased transparency outweighs this disadvantage. We also believe that the information to be used for restatements should be what has been shown for proforma disclosure purposes.

We understand the Board plans to issue a final standard some time in the fourth quarter of 2004, with implementation beginning in 2005. We believe this will not allow registrants sufficient time for implementation. Once the final standard is issued, it needs to be studied and interpreted, valuation models and techniques need to be developed and impacts assessed and understood. While some of that work is ongoing at this time, it is based on an exposure draft which may or may not be amended. Therefore, we believe the effective date of the Standard should be the beginning of 2006.

We thank you for taking our comments into consideration and will be pleased to discuss these with you.

Sincerely,

Stephen Cosgrove

S.J. Cosgrove Vice President, Corporate Controller