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Director of Major Projects
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856
Via email

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The members of the Accounting and Reporting Standards Committee of the Connecticut Society of Certified Public Accountants are pleased to submit their comments on the exposure draft Proposed Statement of Financial Accounting Standards – *Share-Based Payment—an amendment of Statements No. 123 and 95*.

The views expressed in this letter are those of the Accounting and Reporting Standards Committee. Those views are not necessarily the view of the membership of the Connecticut Society of Certified Public Accountants.

We appreciate the opportunity to present our comments. Should there be any questions, please feel free to contact Michael Novosel, Chair of the Accounting and Reporting Standards Committee at 860-678-6000.

Very truly yours,

Michael T. Novosel, CPA
Accounting and Reporting Standards Committee Chair



We applaud the FASB for its efforts to maintain the integrity of the accounting and reporting standard setting function in the private arena. In addition, we appreciate both the FASB's work at improving the accounting and reporting for equity-based compensation, as published in its Share-Based Payment exposure draft, and the opportunity to comment on it. While we realize and understand the political and market pressures the FASB is facing in its work on Share-Based Payment, we encourage the Board to stick to fundamental accounting theory and concepts and not be influenced by those forces, which prevented the Board from resolving this accounting matter with SFAS 123.

We respectfully ask the Board to consider our following comments and suggestions regarding its exposure draft on Share-Based Payment, An Amendment of FASB Statements No. 123 and 95. Our response is related to several "Issues" outlined in the exposure draft.

Measurement Date, Valuation and Expense Recognition

Problem

We agree that compensation cost related to employee services received in exchange for equity instruments issued should be based on the fair value of those instruments and we understand the need to determine fair value at grant-date. However, we do not believe the exposure draft adequately addresses the following inherent problems and defects with valuation and recognition as originally prescribed by SFAS 123:

- Inflexibility in the failure to recognize incorrect valuation assumptions; and
- Disassociation between measurement date and value recognition and the longevity of the disassociation.

Under the proposed accounting, compensation cost, based on grant-date fair value of instruments granted, would be accrued over the service period, which is usually the instrument's vesting period. The event that triggers the recording of the transaction by the issuer, is the receipt of services, not the granting of the instruments. Consequently, herein lies the problem; several years could elapse between the times of valuation and recognition. This is a problem because fair value is an estimate, which is inherently subject to not being representative of actual value.

Establishing an estimated fair value at grant-date and requiring the application of that estimate throughout an equity instrument's vesting period could result in accounting which does not faithfully represent the economic transaction. Regardless of the valuation model used to estimate fair value, the assumptions used to determine the estimate could prove to be significantly inaccurate with the passage of time. Furthermore, the longer an instrument's vesting period, the more susceptible the valuation is to being unrepresentative of the economic transaction.

Proposed Solution

It appears as though the Board has recognized valuation as a problem, and has attempted to address the problem with a better valuation model, the lattice model. We believe this solution is not adequate as it fails to resolve the aforementioned defects. We believe the following solution will result in a more faithful representation of equity compensation transactions.

Measurement Date and Valuation. Fair value should be determined at grant-date for the first vesting period, or tranche. Fair value should be re-measured at the last day of the first tranche for the second tranche and at the last day of each tranche for the subsequent tranche.

Re-measuring fair value will shorten the estimation period and result in a value that is more faithfully representative of the transaction. Re-measuring fair value at the end of each tranche will provide the opportunity to improve valuation assumptions and benefit from actual experience. Re-measuring fair value at the end of each tranche will significantly mitigate the disassociation between measurement date and value recognition. In addition, periodically re-measuring fair value would alleviate the burden of producing the best possible valuation only at grant-date under valuation models that may not be cost beneficial.

In paragraph C22 of the exposure draft, the Board defended the use of an estimated fair value for recognition in financial statements and stated:

Uncertainties inherent in estimates of the fair value of share based payment arrangements are generally no more significant than the uncertainties inherent in measurements of, for example, loan loss reserves, valuation allowances for deferred tax assets, and pensions and other postretirement benefit obligations.

We agree with the Board's point that fair value estimation is much like other estimates recognized for reserves and other financial statement items. However, estimates for reserves and other items are periodically analyzed and re-measured, based on actual experience and current information. We believe similar treatment should be made available to estimates for equity compensation.

Recognition. Compensation expense should be recognized over the service period, or vesting tranche, based on the tranche's fair value. At the end of each tranche, the expense should be adjusted to properly reflect actual volatility and stock price and instruments that were terminated and forfeited. Compensation expense should not be recognized nor adjusted after the adjustment is recorded at the end of the last tranche.

Periodically adjusting estimated compensation expense for actual experience would result in expense that is more faithfully representative of the transaction. The ability to adjust the expense would alleviate the burden of producing the best possible valuation under valuation models that may not be cost beneficial.

Thank you for the opportunity to share our comments with you.