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Sent:

Wednesday, June 02, 2004 11:09 AM

To: Director - FASB

Subject:

File Reference 1102-100





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Suzanne, attached is a pdf of my comment letter on stock-based

Letter of Comment No: 2964 File Reference: 1102-100

compensation.

-- Jack Ciesielski

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June 2, 2004

Ms. Susan Bielstein
Director, Major Projects & Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Ms. Bielstein,

I am writing to comment upon the FASB exposure draft, "Share-Based Payment." First, I would like to congratulate the Board for its fortitude in taking on this project in the face of so much well-organized opposition and with the full knowledge of the unfortunate outcome the last time the FASB attempted to reform accounting for stock-based compensation. By adding the project to the Board's agenda, the FASB is fulfilling the mission of being a true standard-setter. To address only the issues that its constituents will find agreeable is to pay attention to only the trivial. The issue of stock-based compensation has been anything but trivial, and especially so in the last ten years since Statement No. 123 was introduced to the world in its half-finished form.

I believe that for a stock-based compensation standard to be effective, there are two criteria that must be achieved:

Universality. The standard must produce the same results for instruments that are of the same substance, and not provide reporting exemptions for certain stock based instruments that are equity instruments. I speak of the situation with fixed price stock options granted to employees, for which the related compensation has gone unrecorded by the vast majority of firms. An effective standard would require that these instruments be valued at the grant date and their expense be recorded as the employees earn the rights to the instruments. Instruments given to non-employees deserve the same treatment.

Usefulness to users. Those who use financial statements have a certain burden upon them to be sophisticated enough in finance to understand just what it is that they're reading. While there are times that I would prefer to be a brain surgeon instead of a financial analyst, I know that brain surgery is a difficult subject that cannot be "dumbed down" to a level that I might be able to grasp. So it is with stock-based compensation: by nature the compensation packages awarded are complex structures, and valuing them and recording them in the financial statements will not be as simple a transaction to report and discuss as would be, for instance, the purchase of goods for cash consideration.

Valuing and recording the financial instruments given as compensation entails much estimation and disclosure; the presentation of unwieldy transactions will not be simple or pretty. Yet we can't simply avoid recording them because they're complex and unwieldy; to do otherwise would be to present financial statements that are not representationally faithful to the events being recorded. While the accounting and disclosures required by the exposure draft are complex, they are understandable - and bring knowledge - to the reader who is willing to spend the time required to educate himself or herself on the subject. In short, the accounting and disclosures will be understandable to someone who wants to understand them.

I believe the FASB has fulfilled these criteria in its exposure draft. For the first time, companies will be universally required to account for employee stock options like the equity instruments that they are - and will merit the same kind of expense recognition as other equity instruments like restricted stock. This standard should go far toward improving the consistency and representational faithfulness of financial statements.

There are two suggested improvements that I offer: one related to nonpublic entities, the other relating to disclosures.

With regard to nonpublic entities, I recommend the "intrinsic value" method be abandoned and the fair value approach be the only one permitted for both public and nonpublic firms. I know the Board was aiming for flexibility and ease of adoption by all parties when it allowed this treatment, but I don't believe it improves the accounting for the nonpublic firms. The intrinsic value method has not provided useful information in the past and expediency is a poor reason to keep it around. Furthermore, I am not even sure that it is all that necessary of a concession. I don't believe that small businesses like the florist on the corner are handing stock options to employees; I don't think that the firms that would benefit from such an exemption are the ones issuing options in the first place. I believe that the nonpublic companies that are handing out stock options would be financially sophisticated enough to employ the more rigorous fair value methodology.

With regard to disclosures, I recommend that firms be required to explicitly state the service period over which the fair value of each grant will be expensed. I see that vesting requirements and service periods are listed as examples of general disclosures required in the exposure draft - but examples of general disclosures are generally disclosed poorly by firms. Analysts want to be able to project future option compensation expense to the extent they are able to do so, but they are hampered by the lack of concise information about the service/expense period. It may be a small thing, but I would prefer to see the service period for grants removed as an example of the general description disclosures and listed as a specifically-required disclosure on its own.

Those are my only comments. Best wishes for bringing this project to a long-overdue conclusion.

Sincerely,

Jack Ciesielski