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November 4, 2002

Ms. Suzanne Q. Bielstein
MP&T Director–File Reference 1101-001
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Subject: Exposure Draft: Accounting for Stock-Based Compensation–Transition and Disclosure

Dear Ms. Bielstein:

We appreciate the opportunity to submit comments to the Board on the Exposure Draft dated October 4, 2002 that proposes an amendment to FASB Statement No.123 (FAS 123). These comments are made in the context of Mercer Human Resource Consulting's role as compensation consultants, and do not necessarily reflect the views of either our parent company, Marsh & McLennan Companies, or any specific client.

Our comments are limited to the proposals in the Exposure Draft. As many others have observed, however, there are some serious shortcomings in the approach to "fair value" specified in FAS 123.

Paragraph 2a: Transition provisions

The current transition provision of FAS 123, prospective application to new awards only, should remain the only acceptable approach for companies that elect to adopt the fair value recognition provisions of FAS 123. The "retroactive restatement" approach might maximize consistency between periods and comparability among companies if it were the only transition rule (which, we concur with the Board, is unacceptable, as discussed below). But including retroactive restatement as one of three transition choices would undermine the usefulness of the approach and, in fact, impair consistency and comparability. The Exposure Draft amendment would result in *four* different approaches to recognizing stock-based compensation cost: the intrinsic value method of Accounting Principles Board Opinion No. 25 (APB 25) or the fair value method of FAS 123 using one of three transition rules. These choices would exacerbate the potential for confusion among financial statement users.

Recent experience suggests that companies consider the current FAS 123 transition rule acceptable. At Mercer's last count, more than 150 companies had announced their intentions to elect FAS 123 fair value recognition principles, and these companies evidently made their decisions in reliance on the existing transition rules. As the Board has pointed out in paragraph A11, it would be inappropriate to prohibit use of the existing transition rules for these companies. It also would be unreasonable to mandate retroactive restatement as of a specified date, while grandfathering those companies that announced their intention to elect FAS 123 prior to that date. That would result in multiple approaches to recognizing compensation cost, a step backward from the current situation.

Paragraph 3: Disclosure

The additional disclosure recommended in paragraph 3 would represent a useful enhancement to the transparency of financial statements. It would provide users with a prominent display of the Board's preferred approach (i.e., fair value accounting) and would make it easier to compare the financial statements of companies that continue to use the intrinsic value method with those that have adopted the fair value method. In addition, it would mitigate concerns regarding the comparability problems arising from the "ramp-up" effect of the current transition rule.

Paragraph 5: Effective date

It would be difficult for companies to comply with the proposed disclosure requirements as early as the first interim period after December 15, 2002. Since 1996, Mercer has worked with dozens of companies to calculate stock-based compensation costs using the fair value method. In many cases, companies award stock options on numerous dates during a single year but, to facilitate the calculation process, treat the options as if they were granted on a common date. In other cases, the companies value each grant separately. Regardless, a significant effort would be required to recalculate prior years' FAS 123 costs on a quarterly basis. We suggest that the effective date of the interim disclosure requirement be postponed to allow companies more time to comply.

Other: Disclosure of classification of stock-based compensation cost in the income statement

The usefulness of financial statements would be enhanced by requiring disclosure of the classification of stock-based compensation cost *recognized* in the income statement. It would not be useful, however, to require disclosure of the classification of *pro forma* compensation cost. Even worse, a requirement to disclose classification of both recognized and pro forma costs, it would add complexity and confusion to financial statements.

We would be pleased to discuss our comments with the Board or the staff. Please contact me with any questions at 212-345-7648, or susan.eichen@mercer.com.

Sincerely,

Susan Eichen

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