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FSPFAS128A

LETTER OF COMMENT NO. 9

March 12, 2007

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed FASB Staff Position No. FAS 128-a "Computational Guidance for Computing Diluted EPS under the Two-Class Method"

Dear Mr. Smith,

We would like to take this opportunity to comment on the Proposed FASB Staff Position No. FAS 128-a "Computational Guidance for Computing Diluted EPS under the Two-Class Method (FSP)." We appreciate the proposed guidance on the application of the two-class method for computing diluted EPS, since the existing literature does not specifically address or illustrate this method. However, we do not support the proposed FSP for the following reasons.

In summary, we believe that:

- The proposed FSP is amending GAAP rather than interpreting the existing accounting guidance.
- Based on existing accounting pronouncements, the two-class method is not appropriate for securities that are convertible into common stock.
- The FSP is inconsistent with the Basis for Conclusion of FAS 128 which concluded to reduce complexity.
- If the Board determines that the treasury stock method is no longer the appropriate approach for share-based awards that pay dividends, then a less complex approach should be used. Rather than apply the two-class method, simply amend FAS 128 to expense the dividends paid on share-based awards, or include 100 percent of the shares associated with these awards in the denominator of the basic and diluted EPS computation.

Amending, Rather Than Interpreting GAAP

We are concerned that the Board is allowing EITF Abstracts and FASB Staff Positions to amend existing GAAP literature without sufficient due process. EITF Topic D-95 allowed the preparers of financial statements to elect how participating convertible securities should be included in the computation of basic EPS by using either the if-converted method or the two-class method, pursuant to the guidance included in FAS 128. However, EITF No. 03-6 rescinded Topic D-95 and required that convertible, as well as all other participating securities, be included using the two-class method. We believe that by issuing EITF 03-6, the Task Force overreached its intended purpose by effectively changing the guidance included in paragraphs 60-61 of FAS 128 without a formal amendment. Further, we believe the proposed FSP EITF 03-6-a is going one step further (and again beyond its intended purpose) by extending the requirement to use the two-class method to share-based payment awards. The consensus in Issue 2(a) of EITF 03-6 states that share-based payment awards, including options and unvested stock that contain a right to receive dividends, are not subject to the guidance in EITF 03-6 until those awards are fully vested. The accounting for share-based payment awards is already addressed in both FAS 128 and FAS 123R. Therefore, we believe that this proposed FSP is extending faulty conclusions even further to the calculation of diluted EPS for share-based payment awards. We urge the Board to consider these comments as it deliberates on the proposed FSPs as well as the comprehensive project on EPS. At a minimum, the reasoning behind these changes should be explained in a "basis for conclusion."

We question the rationale behind issuing proposed FSP Nos. EITF 03-6-a and FAS 128-a. The accounting for share-based payment transactions is not a new accounting issue. In addition, the proposed FSP is inconsistent with the current guidance provided in paragraph 20 of FAS 128 and paragraph 66 of FAS 123R, which require the use of the treasury stock method for share-based payment awards when calculating diluted earnings per share. We do not believe the two-class method was ever intended to be used for share-based awards.

As stated in paragraph 2 of the proposed FSP and paragraph 61 of FAS 128, the two-class method should only be used for those participating securities that are <u>not</u> convertible into a class of common stock. If the Board concludes that share-based awards issued to employees are participating securities and that the treasury stock method is no longer appropriate for these awards, then the if-converted method is appropriate, and again <u>not</u> the two-class method, since unvested/unearned share-based awards are convertible into common stock. The entire basis for using the two-class method is when the participating or convertible securities cannot become shares of common stock.

<u>Specific Comments On The Proposed FSP</u>

We do not support the proposed three-step process and the example calculations provided in the Appendix since the two-class method is being applied to securities that are convertible into common stock. In addition, Step 3 of both Scenario 1 and Scenario 3 specifically states that it is not required to be completed because a second class of common stock does not exist. If there are not two classes of stock, then the two-class method should not be applied. The examples provided illustrate the unnecessary complexity that is added by using the two-class method. Additionally, the impact of using the two-class method will be immaterial for a vast majority of companies but will still require reporting because of sensitivity to the EPS number.

As an alternative to applying the two-class method to share-based payment awards, we suggest either 1) leave the current guidance in FAS 123R and FAS 128 unchanged, or 2) expense the dividends paid on share-based awards, or 3) include all of the shares associated with these awards in the basic and diluted EPS calculations, if dilutive. We believe the third alternative would achieve similar dilution of EPS available to common stockholders as compared with the two-class method but would be a less complex approach for users to understand and for companies to apply in practice. However, we believe the current guidance under FAS 123R and FAS 128 already adequately accounts for the dilution of share-based awards.

The proposed examples create an allocation of earnings which results in more dilution under the two-class method (as illustrated in Scenario 3) than simply including all of the earnings and all of the shares in the earnings per share calculation as suggested above. For example in Scenario 3, if the net income of $65,000 is increased by the $18,000 of interest expense relating to the convertible bonds, the result is total earnings of $83,000. If the total outstanding shares of 25,000 are increased by the incremental shares for options of 121, convertible debt of 8,000, and nonvested shares of 2,500, the result is total shares of 35,621. Earnings per share calculated using these two amounts is $2.33 per share, which is higher than the $2.31 shown in the example. It does not seem logical to have more dilution (as determined under the proposal) versus that which would result if the share-based awards were simply fully issued, unrestricted common stock and outstanding as illustrated above. If a final FSP is issued, we would ask that the Board clarify this issue. However, we hope that the above example brings to light the unnecessary complexity that is being introduced with the two-class method as well as illustrates how the proposed method overstates dilution.

Short-Term Convergence Project – Earnings Per Share

It is our understanding that the Board expects to issue an exposure draft in the first quarter of this year based on its short-term international convergence project relating to the calculation of EPS. We believe the Board should address all changes to EPS together. Issuing the proposals separately may result in confusing multiple restatements of EPS. However, if the FSP is issued, it should be revised to apply the two-class method to only those securities that are not convertible into a class of common stock in accordance with paragraph 61 of FAS 128.

Prospective Application

The proposal states that the requirements shall be applied retrospectively for all prior-period earnings per share. We do not agree that the changes suggested in the proposal should require restatement, and therefore, we encourage that as the Board completes its overall project on EPS, that the transition in that expected guidance be applied prospectively. If restatement is required, a long transition period should be permitted.

Conclusion

Overall, we believe the Board should wait until it has completed its short-term convergence project on EPS before issuing any final guidance regarding the EPS calculation since that project will again change how companies must calculate and disclose EPS. Further, the existing guidance in FAS 123R and FAS 128 adequately addresses the calculation of diluted earnings per share for share-based awards and convertible participating securities. Finally, we offer alternatives that we believe are more logical approaches than applying the two-class method to share-based payment awards that receive the same rate of dividends as common stock.

We appreciate the opportunity to respond to the working draft and trust that our comments will be seriously considered in future Board deliberations on this issue.

Sincerely,

Richard J. Schlueter

Richard J. Schlueter
Vice President
& Chief Accounting Officer

cc: Walter J. Galvin
Senior Executive Vice President
& Chief Financial Officer