May 28, 2015

Russell G. Golden, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, Connecticut 06856-5116

Submitted via electronic mail to director@fasb.org

Dear Mr. Golden:

The Committees on Corporate Reporting (CCR) of Financial Executives International (FEI) has been following the Board’s simplification projects with great interest. FEI is a leading international organization of 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior-level financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily those of FEI.

CCR greatly supports the project undertaken by the Board to simplify the accounting for tax consequences of stock options. We are following this project closely as, virtually, all our member companies have share-based compensation plans and devote significant resources to tracking the impacts in order to properly account for them. We understand the Board is considering an approach to accounting for the income tax effects of share-based payments that would credit all excess tax benefits (“excess tax benefits”) to earnings and charge all tax shortfalls, wherein the tax benefit realized is less than the initial benefit recorded (“tax deficiencies”) to earnings (the “symmetrical earnings approach which is a concern.

While we acknowledge that the Board may attempt to respond to its constituents’ concerns and simplify the accounting by moving to a symmetrical approach for excess benefits and deficiencies, we believe such action adds significant complexity to the underlying accounting. Further, we do not agree with the conceptual merit of the accounting model. In addition, we believe the accounting result would be counterintuitive with the underlying economics; and accordingly, lack representational faithfulness and decision usefulness to users. We believe the Board should pursue a model wherein all excess tax benefits and tax deficiencies are reflected in equity as additional paid in capital (the “symmetrical equity approach”).

We have always believed the approach in ASC 718-740 (formerly SFAS 123(R)) is without conceptual merit and often, we are unable to explain the logic in the asymmetrical result to our internal business partners. In prior letters on this topic to the FASB at the time SFAS 123(R) was being deliberated and prior to the issuance of the final standard, we
wrote to the Board highlighting our concerns and proposing a symmetrical equity approach. In fact, the Board’s own Basis for Conclusions to SFAS 123(R) provides no support for this inherent inconsistency. We believe the current project to simplify ASC 718 provides the Board with the opportunity to correct this deficiency. Specifically, we believe that:

1) The amount of income tax benefit recognized for the option grant should be reflective of the amount recognized as compensation expense.

2) Any subsequent differences in realized tax benefits, both excess benefits and tax deficiencies, should be recognized in additional paid-in capital along with the effects of underlying option exercise.

The foundation for our position is our belief that the granting of an option by an employer and the exercise of that option by the employee represent two distinct transactions that should be accounted for as such. While the granting of a stock option by the company is accounted for as a compensation transaction, we believe the exercise of a stock option by the option holder represents an equity transaction. Importantly, the Board has acknowledged the conceptual merit of this position in ASC 718. Paragraph 209 in the Basis for Conclusions to SFAS 123(R) addresses the accounting for excess benefits and provides that they should be reflected in equity because they are attributable to an equity transaction. Interestingly, however, the Basis for Conclusion provides no rationale for why tax deficiencies are inherently different from excess benefits. The Board provided no conceptual basis for its conclusion that the write-off of the excess deferred tax asset (except to the extent that there is paid-in capital arising from excess tax deductions from previous awards) should be recognized in the income statement. We believe any rationale in support of this treatment would be inconsistent with the two transaction framework. Accordingly, we believe the current asymmetrical result is both arbitrary and unnecessarily punitive.

Further, we believe a model that reflects all excess tax benefits and tax deficiencies in earnings will confuse users, especially since the impact is counterintuitive. In a situation in which a company’s stock does not perform as well as expected, a lower intrinsic value upon exercise will result in less value to employees. In this case, the final “economic” cost to the company was lower than the initial expense recognized, and yet the symmetrical earnings approach would result in incremental expenses for the company due to write-off of deferred tax assets to earnings. By the same token, when the company’s stock performs better than expected, the higher intrinsic value at exercise (and hence, higher “economic” cost to the company would result in a reduction in expenses for the excess benefits. It is difficult to rationalize this counterintuitive net stock option expense – and we believe the result is less meaningful and more confusing to users than our proposed, less complex approach. We believe the symmetrical equity approach avoids this counterintuitive, confusing result and is much simpler for companies to execute.

The existing ASC 718 approach to accounting for income taxes results in complexity in accounting for equity-based compensation plans. This complexity results from the requirement to track tax effects of each option grant, along with APIC pools for every historical grant that resulted in excess tax benefits, which can be a very significant effort for companies with broad-based option plans. Most CCR member companies have significant APIC pools from a long history of option grants that resulted in excess tax benefits. As a result, these companies effectively had “synthetic” symmetrical equity treatment, which afforded them pragmatic solutions to tracking the information needed to
properly account for any tax deficiencies and the related APIC pool impacts, effectively enabling them to minimize existing complexity.

While the symmetrical earnings approach eliminates that complexity, it introduces a much more invasive complexity in its place. Some of our members have provided the FASB staff with detailed explanations of their underlying systems and processes to illustrate that added complexity, but essentially, the current ASC 718 approach allows companies with existing stock option APIC pools to utilize a grant “pool” approach, whereby they track option grants and exercises and the related amount for excess tax benefits and tax deficiencies at the annual company grant level. The symmetrical earnings model would require companies to assign, track and adjust excess tax benefits and tax deficiencies at the individual grantee level, not only at the time of grant, but at each individual exercise date, which can be multiple dates for each annual grant. Existing systems and process for many companies are not capable of tracking the underlying amounts and activities at that level.

We acknowledge complexity in and of itself may not be a sufficient rationale for not following a preferred accounting method. However, we do not agree with moving to a more complex model in the context of a simplification project, particularly when that more complex model does not have widespread support as being conceptually superior. Accordingly, if the FASB decides to continue with this project as a part of its simplification initiative, we believe the only acceptable alternative would be to propose the symmetrical equity approach. That approach would represent a simplification since it would eliminate the need to continue tracking the APIC pool impacts of option grants. It would also avoid the added complexity of introducing earnings volatility for the many companies that are effectively in a synthetic symmetrical equity approach situation. The symmetrical equity approach would also be consistent with the Board’s own conceptual basis for conclusions in SFAS 123(R). Any project to change to the symmetrical earnings approach would be at odds with that conceptual basis and require a much more comprehensive project that could challenge the underpinnings of the current share based compensation model.

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Please feel free to contact Lorraine Malonza at (973) 765-1047 if you would like additional information on any of the issues or recommendations in this letter.

Sincerely,

Stephen J. Cosgrove
Chair, Committee on Corporate Reporting
Financial Executives International