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Director—Major Projects and Technical Activities
File Reference No. 1102-100
Financial Accounting Standards Board
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Letter of Comment No: 6429
File Reference: 1102-100

Dear Ms. Bielstein:

BDO Seidman, LLP is pleased to submit this comment letter on the Exposure Draft (ED), *Share-Based Payment*. This letter supplements the summary comment letter dated June 4, 2004 that we submitted in preparation for the Roundtable. While we mention the comments that we first raised in the summary letter, we do not repeat all of the discussion from the summary letter. We have organized our comments around the issues in the ED's Notice for Recipients.

Issue 1: The Board has reaffirmed the conclusion in Statement 123 that employee services received in exchange for equity instruments give rise to recognizable compensation cost as the services are used in the issuing entity's operations (refer to paragraphs C13–C15). Based on that conclusion, this proposed Statement requires that such compensation cost be recognized in the financial statements. Do you agree with the Board's conclusions? If not, please provide your alternative view and the basis for it.

We agree with the Board's conclusion.

Issue 2: Statement 123 permitted enterprises the option of continuing to use Opinion 25's intrinsic value method of accounting for share-based payments to employees provided those enterprises supplementally disclosed pro forma net income and related pro forma earnings per share information (if earnings per share is presented) as if the fair-value-based method of accounting had been used. For the reasons described in paragraphs C26–C30, the Board concluded that such pro forma disclosures are not an appropriate substitute for recognition of compensation cost in the financial statements. Do you agree with that conclusion? If not, why not?

We agree with the Board's conclusion.

Measurement Attribute and Measurement Date

Issue 3: This proposed Statement would require that public companies measure the compensation cost related to employee services received in exchange for equity instruments issued based on the grant-date fair value of those instruments. Paragraphs C16–C19 and C53 explain why the Board believes fair value is the relevant measurement attribute and grant date is the relevant measurement date. Do you agree with that view? If not, what alternative measurement attribute and measurement date would you suggest and why?

We agree that grant date is the appropriate date to measure compensation cost for equity instruments, because (1) that is the date on which employer and employee agree to the terms of the transaction and (2) the objective is to measure the value of the employee services that the company obtains in exchange for the awards. Fluctuations in the value of the employer's equity instruments after the grant date represent a return on the employee's investment and are not representative of a change in the value of the services. Choosing a later measurement date would inappropriately include changes in the value of the employer's equity instruments in the measure of the employee services.

Because of our concerns about the ability of employers to estimate the expected volatility of the share price, we believe that minimum value would be a preferable measurement attribute. Minimum value would represent an evolutionary improvement over the intrinsic value model, because minimum value is more relevant than intrinsic value, more understandable to most preparers and users of financial statements than fair value, and more reliable (verifiable) than fair value.

Fair Value Measurement

Issue 4(a): This proposed Statement indicates that observable market prices of identical or similar equity or liability instruments in active markets are the best evidence of fair value and, if available, should be used to measure the fair value of equity and liability instruments awarded in share-based payment arrangements with employees. In the absence of an observable market price, this proposed Statement requires that the fair value of equity share options awarded to employees be estimated using an appropriate valuation technique that takes into consideration various factors, including (at a minimum) the exercise price of the option, the expected term of the option, the current price of the underlying share, the expected volatility of the underlying share price, the expected dividends on the underlying share, and the risk-free interest rate (paragraph 19 of Appendix A). Due to the absence of observable market prices, the fair value of most, if not all, share options issued to employees would be measured using an option-pricing model. Some constituents have expressed concern about the consistency and comparability of fair value estimates developed from such models. This proposed Statement elaborates on and expands the guidance in Statement 123 for developing the assumptions to be used in an option-pricing model (paragraphs B13–B30). Do you believe that this

proposed Statement provides sufficient guidance to ensure that the fair value measurement objective is applied with reasonable consistency? If not, what additional guidance is needed and why?

We do not believe that the ED provides sufficient guidance for estimating the expected volatility of the share price. In the absence of similarly long-lived options with observable prices, we believe that estimates of expected volatility are just guesses. The ED puts employers in an untenable position by stating that unadjusted historical volatility is inappropriate, but that adjustments to historical volatility should be “reasonable and supportable.” In most cases, we suspect that the adjustments to historical volatility will be subjective and judgmental and difficult to substantiate/audit.

We believe the Board could enhance the guidance about expected volatility in the following ways. Even with these enhancements, we still believe the assumption will be a guess, but it will be a more educated guess.

- Explain what the “term structure of the volatility” is and how a company would determine and use it.
- Explain better what the mean reversion tendency of volatility is and how a company would use the concept to estimate expected volatility. That is, explain how a company would determine the long-run average level of the volatility of its stock price.
- The options embedded in convertible securities have terms as long as the expected terms of employee options. Explain whether companies that have marketable convertible securities outstanding, or know of comparable companies that have marketable convertible securities, can derive the implied volatility of the embedded options in those securities. Can the reassessed expected outcomes method, or some other method, estimate the value of the embedded options from the market price of the convertible security, and then solve for the implied volatility?
- Give more guidance on what private and newly public companies should do to estimate expected volatility, including what would constitute a similar public company and what to do if no similar public companies exist. We believe that in many cases no comparable public companies will exist. There may be public companies that offer the same products or services, but through small divisions or subsidiaries of those public companies, or the public company may be bigger, more geographically diversified, older and more established, or in other ways dissimilar to the private or newly public company. We also think it likely that where comparable public companies exist, they may tend to be thinly traded companies that have difficulty establishing their own expected volatility.

The Board and staff have spent significant time studying volatility, and the final standard could be a good educational tool for raising the understanding of the Board’s constituents. Even if a company chooses to hire a specialist to help estimate the fair value of option grants, the company needs to have sufficient understanding of the models and concepts to

take responsibility for the major assumptions. It will be more efficient if constituents can benefit from the research that the FASB has done, rather than having to independently perform research to better understand expected volatility. The additional guidance could be included in the final Statement or posted to the FASB's web site

While Statement 123 required an assumption about expected volatility, our experience is that many employers used unadjusted historical volatility because they were not comfortable that adjustments to historical volatility were supportable.

Issue 4(b): Some constituents assert that the fair value of employee share options cannot be measured with sufficient reliability for recognition in the financial statements. In making that assertion, they note that the Black-Scholes-Merton formula and similar closed-form models do not produce reasonable estimates of the fair value because they do not adequately take into account the unique characteristics of employee share options. For the reasons described in paragraphs C21–C25, the Board concluded that fair value can be measured with an option-pricing model with sufficient reliability. Board members agree, however, that closed-form models may not necessarily be the best available technique for estimating the fair value of employee share options—they believe that a lattice model (as defined in paragraph E1) is preferable because it offers the greater flexibility needed to reflect the unique characteristics of employee share options and similar instruments. However, for the reasons noted in paragraph C24, the Board decided not to require the use of a lattice model at this time. Do you agree with the Board's conclusion that the fair value of employee share options can be measured with sufficient reliability? If not, why not? Do you agree with the Board's conclusion that a lattice model is preferable because it offers greater flexibility needed to reflect the unique characteristics of employee share options. If not, why not?

Although this issue asserts that the Board decided not to require the use of a lattice model at this time, some paragraphs of the ED imply that employers who have the necessary information are required to use a lattice model. We do not believe that any particular model should be required. Because the binomial model is more costly to apply than Black-Scholes, we believe employers always should have the choice, even if they have the necessary data.

Further, we question whether it is even desirable to designate lattice models as preferable to closed-form models. It is likely that option-pricing models will continue to evolve and improve in the future. Designating lattice models as preferable could, at some point in the future, prevent companies from adopting a newer model until the FASB amends the final Statement to permit it.

Issue 4(c): Some respondents to the Invitation to Comment suggested that the FASB prescribe a single method of estimating expected volatility or even a uniform

volatility assumption that would be used for all companies. Other respondents to the Invitation to Comment disagreed with such an approach. Additionally, some parties believe that historical volatility, which has been commonly used as the estimate of expected volatility under Statement 123 as originally issued, is often not an appropriate measure to use. The proposed Statement would require enterprises to make their best estimate of expected volatility (as well as other assumptions) by applying the guidance provided in paragraphs B24–B26 to their specific facts and circumstances. In that regard, the proposed Statement provides guidance on information other than historical volatility that should be used in estimating expected volatility, and explicitly notes that defaulting to historical volatility as the estimate of expected volatility without taking into consideration other available information is not appropriate. If you believe the Board should require a specific method of estimating expected volatility, please explain the method you prefer.

Our first choice is a uniform assumption of zero for expected volatility. If the Board requires an assumption for expected volatility, we believe the final Statement should provide more guidance about estimating expected volatility (see issue 4a). We do not believe that the Board should specify a particular method for public companies that have been public for many years. We believe the Board should consider providing a uniform volatility assumption for private companies and newly public companies, because of the difficulties they will encounter in developing an assumption and the low reliability of that assumption.

Issue 4(d): This proposed Statement provides guidance on how the unique characteristics of employee share options would be considered in estimating their grant-date fair value. For example, to take into account the non-transferability of employee share options, this proposed Statement would require that fair value be estimated using the expected term (which is determined by adjusting the option's contractual term for expected early exercise and post-vesting employment termination behaviors) rather than its contractual term. Moreover, the Board decided that compensation cost should be recognized only for those equity instruments that vest to take into account the risk of forfeiture due to vesting conditions. Do you agree that those methods give appropriate recognition to the unique characteristics of employee share options? If not, what alternative method would more accurately reflect the impact of those factors in estimating the option's fair value? Please provide the basis for your position.

We agree with the use of expected term and agree that no compensation should be recorded for awards that are forfeited because of failure to meet service or performance conditions.

Issue 5: In developing this proposed Statement, the Board acknowledged that there may be circumstances in which it is not possible to reasonably estimate the fair value of an equity instrument. In those cases, the Board decided to require that

compensation cost be measured using an intrinsic value method with remeasurement through the settlement date (paragraphs 21 and 22 of Appendix A). Do you agree that the intrinsic value method with remeasurement through the settlement date is the appropriate alternative accounting treatment when it is not possible to reasonably estimate the fair value? (Refer to paragraphs C66 and C67 for the Board's reasons for selecting that method.) If not, what other alternative do you prefer, and why?

This approach is not an appropriate alternative accounting treatment. We believe the current requirements of Statement 123 should be retained such that if it is not possible to reasonably estimate the fair value of an option or other equity instrument at the grant date, the final measure of compensation cost would be fair value estimated based on the share price and other factors at the first date at which reasonable estimation is possible. Prior to that date, we believe companies should measure compensation based on intrinsic value and disclose both the fact they are unable to reasonably value equity instruments and the constraints that prevent them from doing so. It appears from the Basis for Conclusions that the Board made a change from the Statement 123 approach due to concerns about potential abuse. Because these kinds of awards are rare, we question whether the Board has evidence that the provision of Statement 123 was abused. Further, if employers are as expert at identifying low points in their stock price as the Basis for Conclusions implies, shouldn't the Board have a broader concern that employers will "load up" on option grants when they think their stock prices are at temporary lows?

Employee Stock Purchase Plans

Issue 6: For the reasons described in paragraph C75, this proposed Statement establishes the principle that an employee stock purchase plan transaction is not compensatory if the employee is entitled to purchase shares on terms that are no more favorable than those available to all holders of the same class of the shares. Do you agree with that principle? If not, why not?

We believe Statement 123 has a better principle—the plan is not compensatory if the proceeds received from the employees are no less than the proceeds that would be received from an offering of the same instruments to investors. Please see our summary letter for further discussion.

Attribution of Compensation Cost

Issue 7: This proposed Statement would require that compensation cost be recognized in the financial statements over the requisite service period, which is the period over which employee services are provided in exchange for the employer's equity instruments. Do you believe that the requisite service period is the appropriate basis for attribution? If not, what basis should be used?

We agree that compensation cost should be recognized over the requisite service period. As stated in our summary letter, however, we strongly disagree with the Board's definition of requisite service period in a situation in which the employee begins providing services before the option is approved by the relevant authority. Employee services cannot be provided in exchange for equity instruments that have not been approved. If an employee begins providing services knowing that his option grant is subject to nontrivial approval, he is knowingly rendering service in exchange for the authorized compensation only. Once the option grant is approved, the terms of the exchange shift, and services are now being exchanged for the total authorized compensation including the options. The Board would establish an undesirable precedent by requiring accounting recognition for unapproved transactions. Furthermore, requiring accounting recognition for unapproved transactions is inconsistent with the approach in other recent FASB Statements, such as Nos. 144 and 146.

Issue 8: Determining the requisite service period would require analysis of the terms and conditions of an award, particularly when the award contains more than one service, performance, or market condition. Paragraphs B37–B49 provide guidance on estimating the requisite service period. Do you believe that guidance to be sufficient? If not, how should it be expanded or clarified?

We believe the guidance in estimating the requisite service period is sufficient.

Issue 9: For the reasons described in paragraphs C89–C91, the Board concluded that this proposed Statement would require a single method of accruing compensation cost for awards with a graded vesting schedule. This proposed Statement considers an award with a graded vesting schedule to be in substance separate awards, each with a different fair value measurement and requisite service period, and would require that they be accounted for separately. That treatment results in a recognition pattern that attributes more compensation cost to early portions of the combined vesting period of an award and less compensation cost to later portions. Do you agree with that accounting treatment? If not, why not?

We have mixed feelings on this issue. A grant that cliff vests at the end of four years and a grant that vests 25% per year for four years are economically different, and different attribution is appropriate. However, the approach in the ED makes the employer's accounting more complex, particularly for employers who grant many options or whose grants vest monthly. We are uncertain whether the benefits of the more theoretically correct attribution are sufficient to justify the costs.

Modifications and Settlements

Issue 10: This proposed Statement establishes several principles that guide the accounting for modifications and settlements, including cancellations of awards of equity instruments (paragraph 35 of Appendix A). Paragraphs C96–C115 explain

the factors considered by the Board in developing those principles and the related implementation guidance provided in Appendix B. Do you believe those principles are appropriate? If you believe that additional or different principles should apply to modification and settlement transactions, please describe those principles and how they would change the guidance provided in Appendix B.

We believe the principles are generally appropriate. As we noted in our summary letter, we believe the principles do not provide clear guidance on how to account for the acceleration of vesting of equity awards to a terminated employee.

Income Taxes

Issue 11: This proposed Statement changes the method of accounting for income tax effects established in Statement 123 as originally issued. Paragraphs 41–44 of Appendix A describe the proposed method of accounting for income tax effects and paragraphs C128–C138 describe the Board’s rationale. That method also differs from the one required in International Financial Reporting Standard (IFRS) 2, Share-based Payment. Do you agree with the method of accounting for income taxes established by this proposed Statement? If not, what method (including the method established in IFRS 2) do you prefer, and why?

As stated in our summary letter, we believe that all tax benefits for share-based payment transactions should be recognized in the provision for income taxes and that none of the benefits should be allocated to capital. We wanted to elaborate on this point in response to the discussion at the Roundtable. The ED states that a grant of an option consists of two transactions—the grant of the option in exchange for employee services, which gives rise to compensation cost for financial reporting purposes, and the exercise of the option, which is viewed as a capital transaction that gives rise to the income tax deduction. We request that the Board consider the following points:

- While the employee’s exercise is the trigger for the income tax deduction, we believe the government provides the deduction because it views the transaction as an exchange of equity instruments for employee services.
- The model that the Board establishes needs to encompass all forms of equity instruments used as share-based payment. As we noted in our summary letter and at the Roundtable, for nonvested stock the trigger for the income tax deduction is the lapsing of restrictions on the shares (the vesting date); there is no second transaction.
- The model also needs to encompass a variety of income tax approaches that could be used in different countries or in different periods. For options, exercise is not the only possible trigger for recognizing an income tax deduction. Many years ago, Congress asked Treasury to investigate grant date fair value as a basis for the tax deduction. Treasury concluded at the time that the valuation tools were inadequate, but this issue could be reconsidered in the US or elsewhere. It also

would be feasible to compute a tax deduction for options at the vesting date, similar to nonvested stock.

In addition to the classification of tax benefits, we disagree with the conclusion in footnote 29 to paragraph B67 that a tax benefit is not considered realized until it reduces taxes payable. This conclusion seems inconsistent with the approach in FASB Statement No. 109 for recording the benefits of net operating loss carryforwards.

Disclosures

Issue 12: Because compensation cost would be recognized for share-based compensation transactions, the Board concluded that it was appropriate to reconsider and modify the information required to be disclosed for such transactions. The Board also decided to frame the disclosure requirements of this proposed Statement in terms of disclosure objectives (paragraph 46 of Appendix A). Those objectives are supplemented by related implementation guidance describing the minimum disclosures required to meet those objectives (paragraphs B191–B193). Do you believe that the disclosure objectives set forth in this proposed Statement are appropriate and complete? If not, what would you change and why? Do you believe that the minimum required disclosures are sufficient to meet those disclosure objectives? If not, what additional disclosures should be required? Please provide an example of any additional disclosure you would suggest.

We like the approach of stating the objectives of disclosure, and then specifying the minimum disclosures needed to satisfy the objectives. However, we hope that in the final Statement the minimum disclosures will follow immediately behind the objectives, rather than being two appendices away.

As stated in our summary letter, we believe the ED proposes excessive intrinsic value disclosure. We also question how an employer using a lattice model would compute the expected term of the options for disclosure purposes, because the approach proposed in the ED does not seem workable.

Upon further reflection, we also question the usefulness of the proposed disclosure in paragraph B191.h. of the total compensation cost not yet recognized and the weighted-average period over which it is expected to be recognized. That disclosure will not allow users to project compensation expense in future periods, because the enterprise is likely to make additional grants in future years.

Transition

Issue 13: This proposed Statement would require the modified prospective method of transition for public companies and would not permit retrospective application (paragraphs 20 and 21). The Board's rationale for that decision is discussed in

paragraphs C157–C162. Do you agree with the transition provisions of this proposed Statement? If not, why not? Do you believe that entities should be permitted to elect retrospective application upon adoption of this proposed Statement? If so, why?

We did not agree with the Board’s decision to allow three transition methods under Statement 148. However, given that decision, we disagree with the Board’s conclusion now that the modified prospective method should be the only permitted transition method for public companies. We believe the Board should allow public companies to choose modified retrospective adoption, under which the compensation previously disclosed on a pro forma basis in the notes to financial statements would be reflected in prior years’ income statements. A public company can achieve retrospective adoption by making a voluntary change to the fair value method under Statement 148 during 2004. Therefore, we do not understand the purpose of prohibiting retrospective adoption in the ED.

We also believe that public companies that voluntarily adopted the fair value method in 2003 or earlier using the prospective method should be permitted to continue with that method. We believe that many companies adopted the fair value method with a reasonable expectation that the FASB would not reverse the transition decisions in Statement 148 when it issued the expected Statement on share-based payment. That view was based, in part, on the reasoning in paragraph A12 of Statement 148, which states:

“...the Board believes that the new disclosures required by this Statement mitigate those [comparability] concerns by providing information that enables users of financial statements to make comparisons.”

Given that the Board permitted the prospective method in Statement 148, we believe it is inappropriate for the Board to require those companies that voluntarily adopted the fair value method prospectively, to have to “readopt” under the new Statement. A prospective approach to applying the provisions of the new standard is the fairest way to deal with those companies that already adopted using that method. Because Statement 148 does not permit the prospective method for accounting changes after 2003, no additional companies would be permitted to use the prospective method.

Nonpublic Entities

Issue 14(a): This proposed Statement would permit nonpublic entities to elect to use an intrinsic value method of accounting (with final measurement of compensation cost at the settlement date) rather than the fair-value-based method, which is preferable. Do you agree with the Board’s conclusion to allow an intrinsic value method for nonpublic entities? If not, why not?

As stated in our summary letter, we agree that nonpublic entities should have a less costly alternative method. However, the alternative method proposed in the ED is neither conceptually appropriate nor less costly. We strongly believe that the alternative method should preserve grant date measurement for equity instruments, for the reasons stated in our response to issue 3. Our preference is the minimum value method of Statement 123. An alternative would be a closed form model with a standardized measure of volatility.

Issue 14(b): Consistent with its mission, when the Board developed this proposed Statement it evaluated whether it would fill a significant need and whether the costs imposed to apply this proposed Statement, as compared to other alternatives, would be justified in relation to the overall benefits of the resulting information. As part of that evaluation, the Board carefully considered the impact of this proposed Statement on nonpublic entities and made several decisions to mitigate the incremental costs those entities would incur in complying with its provisions. For example, the Board decided to permit those entities to elect to use either the fair-value-based method or the intrinsic value method (with final measurement of compensation cost at settlement date) of accounting for share-based compensation arrangements. Additionally, the Board selected transition provisions that it believes will minimize costs of transition (most nonpublic entities would use a prospective method of transition rather than the modified prospective method required for public entities). Moreover, the Board decided to extend the effective date of this proposed Statement for nonpublic entities to provide them additional time to study its requirements and plan for transition. Do you believe those decisions are appropriate? If not, why not? Should other modifications of this proposed Statement's provisions be made for those entities?

We believe the modifications to mitigate the implementation cost are appropriate.

Please see our comments at the end of this letter about another issue that should be addressed for nonpublic entities.

Small Business Issuers

Issue 15: Some argue that the cost-benefit considerations that led the Board to propose certain accounting alternatives for nonpublic entities should apply equally to small business issuers, as defined by the Securities Act of 1933 and the Securities Exchange Act of 1934. Do you believe that some or all of those alternatives should be extended to those public entities?

We believe that all public companies should follow the same accounting guidance.

Cash Flows

Issue 16: For the reasons discussed in paragraphs C139–C143, the Board decided that this proposed Statement would amend FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined by this proposed Statement, be reported as a financing cash inflow rather than as a reduction of taxes paid (paragraphs 17–19). Do you agree with reflecting those excess tax benefits as financing cash inflows? If not, why not?

Our preferred approach is to reflect all income tax benefits in earnings, in which case the tax benefits should be reflected as operating cash flows and no amendment of Statement 95 is needed. If the Board retains the proposed approach of splitting the tax benefit between earnings and capital, then we agree that the tax benefit recorded to capital should be a financing cash flow.

Differences between This Proposed Statement and IFRS 2

Issue 17: Certain accounting treatments for share-based payment transactions with employees in this proposed Statement differ from those in IFRS 2, including the accounting for nonpublic enterprises, income tax effects, and certain modifications. Those differences are described more fully in Appendix C. If you prefer the accounting treatment accorded by IFRS 2, please identify the difference and provide the basis for your preference. If you prefer the accounting treatment in the proposed Statement, do you believe the Board nonetheless should consider adopting the accounting treatment prescribed in IFRS 2 in the interest of achieving convergence?

Overall, the FASB will achieve a high degree of convergence with IFRS 2. In the specific areas where the accounting treatment differs, we prefer the FASB approach. We would not favor changing to an inferior treatment from IFRS 2 in the interest of achieving convergence. While we support international convergence as an ideal, we believe that the quality of a standard is more important than the degree of convergence.

Understandability of This Proposed Statement

Issue 18: The Board's objective is to issue financial accounting standards that can be read and understood by those possessing a reasonable level of accounting knowledge, a reasonable understanding of the business and economic activities covered by the accounting standard, and a willingness to study the standard with reasonable diligence. Do you believe that this proposed Statement, taken as a whole, achieves that objective?

With the exception of needing a more complete discussion of how to estimate expected volatility (Issue 4a), we believe the ED accomplishes this objective.

We believe this issue of understandability is an important issue with respect to all projects, and that the Board should initiate broad discussions with its constituents on this issue at the earliest feasible time. Otherwise, some constituents may become frustrated because they believe that this objective is incomplete or that the Board has an unrealistic idea of what is “reasonable.”

We would refine the objective as follows:

The Board’s objective is to issue financial accounting standards that can be read, and understood, *and implemented* by those possessing a reasonable level of accounting knowledge, a reasonable understanding of the business and economic activities covered by the accounting standard, and a willingness to study the standard with reasonable diligence. *Further, the Board’s objective is that the results of applying those standards will be understandable by users of financial statements possessing a reasonable level of accounting knowledge, a reasonable understanding of the business and economic activities covered by the accounting standard, and a willingness to keep their accounting knowledge reasonably current. The standard for reasonableness recognizes that those affected by the Board’s standards have demanding careers and personal lives and a finite amount of time to devote to mastering new standards.*

Our suggested changes to the objectives reflect three primary thoughts:

- Understandability should encompass the ability of normal accountants to implement a pronouncement.
- Only a tiny minority of users of financial statements will read FASB pronouncements. They might read summaries prepared by accounting firms or others, but they aren’t likely to read the pronouncements. As a result, understandability for users should be assessed by whether they understand the results, not whether they understand the pronouncements.
- The standard for reasonableness should be an average accountant or user. The people who predominate in the FASB’s due process—Board members and staff, national office partners of the major accounting firms, chief accounting officers and chief financial officers of large public companies with large accounting staffs, and users who serve on their profession’s financial reporting committees—are not representative of the great majority of accountants and users. Relative to the average accountant or user, the group that the FASB deals with has a stronger technical accounting background and more time to devote to following FASB projects and studying FASB pronouncements. What is reasonable for them is unreasonable for the majority.

Other Issues

Effective Date.

The Board proposes that public companies adopt the new standard in fiscal years beginning after December 15, 2004, which will be January 1, 2005 for most public companies. We recommend a one-year delay in the effective date for public companies to fiscal years beginning after December 15, 2005.

The final Statement won't be issued until late in 2004. It is unreasonable to expect public companies to immediately adopt a newly issued standard. While companies have been measuring the fair value of option grants since the effective date of Statement 123, the ED proposes some significant changes that will require systems modifications—for example, tracking income tax benefits by individual grant and using accelerated attribution for awards with graded vesting. Many employers will want to implement, or at least explore, lattice valuation models, and likely will need to engage valuation specialists. Finally, with recognition in the income statement rather than in pro forma disclosures, some employers may want to explore changing the terms of their share-based awards. In particular, equity plans with features (for example, performance conditions or indexed exercise prices) that would have caused variable accounting under APB Opinion No. 25, *Accounting for Stock Issued to Employees*, become relatively more attractive under the ED. Plan design issues may involve engaging specialists, as well as discussions by boards of directors. While companies could do some of this work in the second half of 2004, they are rightly reluctant to incur costs related to provisions in the ED that may change in the final Statement.

The Board also should consider the current financial reporting environment. If the final Statement is issued late in 2004, the proposed implementation in the first quarter of 2005 will coincide with year-end 2004 closing under newly accelerated filing deadlines and with first time compliance with Section 404 of the Sarbanes-Oxley Act.

Nonpublic Entities

It is not clear to us how nonpublic entities should account for formula price share-based payment transactions that are driven by shareholders' agreements to which all shareholders are bound. For example, a nonpublic entity may always sell shares at a formula price, and all of the shareholders agree as a condition of purchase that they will only sell their shares to the entity at the same formula price. The formula price effectively is the market price, because it is the transaction price for all willing buyers and sellers. It is not clear to us whether the ED would treat the formula price in that circumstance as fair value.

A Freestanding Statement

As we stated in our summary letter, we recommend that the final Statement should be a freestanding document (FASB Statement No. 15X) that supersedes Statement 123. While the format of the ED may have been helpful in highlighting changes from Statement 123, the document is disorganized and hard to use.



We would be pleased to discuss our comments with the Board or the FASB staff. Please direct questions to Ben Neuhausen at 312-616-4661.

Very truly yours,

s/ BDO Seidman, LLP