CL 44

March 3, 2003

Ms. Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH, United Kingdom

Dear Ms. Crook:

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants appreciates the opportunity to comment on the IASB's Exposure Draft, *Share-Based Payment* (ED). Because of the increasing use of share-based compensation by entities world-wide, AcSEC believes that development of an international standard addressing the accounting for share-based payments will improve financial reporting.

Overall Comment

AcSEC agrees that all share-based payment transactions should be recognized in financial statements and measured at fair value. While AcSEC continues to have concerns about the reliability of valuations of share-based arrangements, AcSEC believes that, all things considered, share-based payment transactions measured at fair value result in more relevant financial information.

Reconciliation to Past AcSEC View

In its January 19, 1994 comment letter on FASB's ED *Accounting for Stock-based Compensation*, a majority of AcSEC did not support "recognition of compensation cost for fixed stock options with an exercise price not less than market price at date of grant." That majority of AcSEC set forth two principal reasons for its position: "(1) the models used to calculate the fair value of such options were designed for use with traded options and (2) the expense amount for such options based on those models cannot be validated by reference to transactions with third parties and therefore lacks sufficient reliability for recognition in financial statements."

AcSEC believes that, over the past decade, preparers, auditors, and users of financial statements have become more familiar with transactions that include share-based payments and the related valuation issues. Considerable progress has been achieved in understanding the use of option models to measure option values and their use in the design of compensation arrangements. In addition, pro forma disclosures made in accordance with FASB Statement No. 123, *Accounting for Stock-Based Compensation*, have provided analysts and other users with alternative stock compensation information that has been increasingly used to evaluate company performance. Accordingly, AcSEC now believes that entities should recognize those transactions in financial statements at fair value.

Specific Comments

Employee Stock Purchase Plans. AcSEC agrees with the inclusion of employee stock purchase plans in the scope of the ED for practical and conceptual reasons. To do otherwise would result in an arbitrary exclusion, and AcSEC finds no overwhelming basis to support such exclusion.

Measurement Presumption. Paragraph 7 of the ED includes the concept that the fair value of equity instruments granted is a surrogate (or indirect) measure of the fair value of goods or services received. AcSEC recommends that the IASB drop this concept from the final standard, and instead require an entity to measure fair value using the more readily determinable of what is given up or received in the transaction, with no presumptions indicated.

Measurement Date. AcSEC agrees with the IASB proposal that the grant date is the most appropriate date to measure the fair value of exchange transactions with employees and nonemployees, regardless of whether an entity measures what is given up or received in a transaction.

Forfeitures. AcSEC disagrees with the ED's requirement that an entity consider the effect of forfeitures in determining the fair value of an equity instrument. AcSEC believes that forfeitures do not affect the value of an equity instrument at the time of issuance and that estimates of the effect of forfeitures on the fair value of an award may not be reliable. However, AcSEC believes that the effect of subsequent forfeitures should be accounted for as a reversal of expense previously recognized. AcSEC believes that there should be comparability in the principles of recognition for cash-based and equity-based compensation arrangements. Therefore, forfeitures should have accounting consequences similar to cash awards that are forfeited, that is, any amounts previously recognized should be reversed. Recognizing an adjustment to compensation expense for the effect of forfeitures is consistent with accounting for other compensation arrangements.

Performance-Based Awards. Consistent with its views on forfeitures, AcSEC believes that compensation cost for performance-based awards should be adjusted for changes in expected outcome until vesting date. AcSEC believes that the initial reported compensation cost should be based on the best estimate of the outcome of a performance condition. AcSEC believes that compensation cost for performance-based awards should be adjusted based on the final outcome of the awards because it is uncertain whether the awards will vest and it would be inappropriate to recognize compensation expense when conditions are not met and awards do not vest. AcSEC's suggested approach is consistent with accounting for other performance-based compensation arrangements.

Volatility Input. Paragraphs BC137-143 of the ED note that unlisted entities are required to use the volatility input to an option-pricing model. AcSEC believes that unlisted entities should be permitted to use the minimum value method, which excludes the effects of expected volatility from an option-pricing model, because of the difficulties in making reliable estimates of the expected volatility of the share price of unlisted entities. AcSEC believes that the minimum value method for unlisted entities will result in useful information for those entities and users of the related financial statements.

Although a majority of AcSEC members agrees with the IASB proposal to include volatility in the option-pricing model for listed entities, other AcSEC members believe that volatility should be excluded from the option-pricing model for both listed and unlisted entities because of difficulties in making reliable estimates of volatility. Some AcSEC members cite studies that demonstrate that the implied volatility tends to overstate fair values of traded equity securities.

Valuation models. AcSEC supports mandating the use of an option-pricing model at this time to obtain a level of comparability and consistency in practice. However, AcSEC recommends that the final standard explicitly acknowledge and allow for improvements to current valuation models. AcSEC believes that the final standard will have a longer useful life if it acknowledges inevitable improvements in finance theory.

Income Tax Effects. AcSEC disagrees with the ED's requirement that all tax effects related to equity instruments granted should be recognized in the income statement. AcSEC believes realized tax benefits from equity instruments granted that exceed the tax benefits based on cumulative stock compensation expense recognized for financial reporting purposes should be credited directly to equity. AcSEC believes that the excess tax benefits resulting from different measurement dates and methods for financial reporting and tax purposes are attributable to an equity transaction for financial reporting purposes. In addition, the IASB proposal to report tax benefits for tax deductions in excess of the compensation expense recognized for financial reporting purposes is inconsistent with the overall approach to intraperiod tax allocation. AcSEC believes that the excess tax benefits should not be reported as an income tax benefit attributable to continuing operations because the related excess tax deduction was not reported in operations.

Disclosures. Although AcSEC agrees with the IASB proposal that an entity should disclose information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements, AcSEC questions whether all of the extensive disclosures set forth in the ED following that general principle are necessary. AcSEC recommends that the IASB obtain specific recommendations from analysts, creditors, and other users of financial statements to ensure that the disclosures meet their needs and that unnecessary disclosures do not detract from useful disclosures.

Representatives of AcSEC are available to discuss these comments with the IASB Board members or staff.

Sincerely,

Mark V. Sever, Chairman
Accounting Standards Executive Committee

Mark M. Bielstein, Chairman
Comment Letter Task Force