Infosys

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Via E-mail

February 4, 2003

Ms Kimberley Crook

Project Manager

International Accounting Standards Board

30 Cannon Street, London EC4M 6XH, United Kingdom

Comments on IASB ED 2, *Share-based Payment*

Dear Ms. Crook,

We are pleased to provide our comments on the following issues to be included in the staff's analysis of comments on the above referenced Exposure Draft.

We are a leading global technology services firm and believe that intellectual capital resident in the workforce is a key competitive advantage. The use of broad based stock options not only helps corporations attract and retain talented employees, but also becomes the primary motivator for employees to act like shareholders. We view the continued availability of broad based stock options principally as means of wealth creation and wealth sharing, and also as an incentive to innovate and develop new technologies. We appreciate and support the Board's objective of promoting international convergence of high-quality accounting standards, but believe that action to require fair value accounting of employee stock options under International Accounting Standards could deter the growth of emerging and established companies in industries that rely heavily on broad based stock option grants to reward employees. Even though economic and public policy concerns are not within the scope of the Board's research and technical activities, we request that the standard setting process takes a more holistic perspective while evaluating the need for mandatory fair value accounting..

Whether stock options granted to employees result in compensation expense for the issuing entity?

We agree conceptually with the Board's basis for conclusions that employee stock options have value and that financial instruments given to employees give rise to compensation cost that should be properly included in measuring an entity's net income. However, we do not agree with the conclusion that the *fair value* of stock options can be estimated within acceptable limits for recognition in financial statements. We do not believe that financial statements would be more relevant and representatively faithful if the estimated fair value of stock options which lacks the necessary attribute of reliability were included in determining an entity's net income.

Whether stock options issued to employees should be measured at something other than fair value?

We believe that the measurement of all elements of financial statements should posses an acceptable level of reliability for recognition of the elements in the financial statements. The fair value of fixed stock options or the benefit derived by the employer issuing them cannot be measured to an acceptable level of reliability. Since this basic requisite is not met, the cost of stock options issued to employees should not be measured at fair value. It is only the intrinsic value method that can provide an accepted level of reliability in the determination of the cost of issuing stock options.

Whether the fair value of stock options can be reliably measured?

We do not believe that the fair value of stock options can be reliably measured. Corporations have used employee stock options as a recruitment and retention tool. Any attempt to measure the fair value of these recruitment and retention tools would produce results that are as unreliable as attempts to value the corporation's workforce.

There is no empirical evidence to support the assertion that the results produced by option pricing models are identical or similar to trading values for similar securities in the market place. So it is possible that the value assigned to employee stock options by the option pricing models may not be its true value at all in a market place transaction conducted at arms length.

Option pricing models measure the value of an option based on a number of variables. The models suggest that option fair values are higher when the equity markets are on a cyclical high and lower when markets are on a cyclical low. This will lead to wide distortions in the earnings of corporations if the cost of stock options were charged to earnings on a fair value basis. Volatility of the underlying stock is another variable considered by the options pricing models in valuation. There is considerable difficulty in estimating the future volatility for a corporation stock leading often to wide ambiguity in estimating volatility and consequently in measurement of the fair value of stock options issued. The value of the employee stock option is also dependent on its estimated life or the estimated time period within which the employee will exercise the option. There is considerable difficulty in predicting employee behavior and hence the unreliability of the option value which is dependant on this variable.

The value of stock option to the employee is different from the value of the option to a non-employee who trades options. This has not been factored in by the options pricing models. Volatility of the underlying stock is generally a key factor guiding the decision making of the non-employee options trader but not the employee who has to serve the vesting period, exercise the option and pay the exercise price. Employee stock options cannot be freely traded and generally do not vest for several years. There are other restrictions like non-transferability, performance conditions and "black out" periods. However, the option pricing models were developed for shorter-lived and freely traded options and do not take into account the restrictions inherent in employee stock options. This results in significant overvaluation of employee stock options by the options pricing models.

Over the years, the Board has taken and implemented significant initiative aimed at improving the quality of reported earnings. If the fair value of stock options, which cannot be reliably measured, were to be included in earnings, it will only distort and lessen the quality of reported earnings. Recording the fair value of stock option grants arrived at by using subjective assumptions will produce financial information lacking in reliability and value to the users. This will force many users of financial statements to adjust the value of the ambiguous stock option fair value charge from reported earnings before making investment decisions. This will lead to more confusion than clarity for the users of financial statements. We believe that the creation of a fictitious expense in the financial statement should be avoided.

The disclosure alternative under SFAS 123 in the United States

We believe that the fair value of employee stock options is relevant information and hence support the current disclosure requirements under SFAS 123 in the United States. Users who want to make decisions based on the pro-forma information may continue to do so despite the reliability of such information being questionable. It is widely accepted that market factors into account all available information while it attributes value to an entity and hence the pro-forma information will be used by all those who want to factor in the same while valuing an entity.

We also support recommendations of the Technology Network of the United States that shareholders should have access to more meaningful, comprehensive, accurate information about company stock option activity on a periodic basis. The recommended disclosures include:

- Employee and executive option grants;
- Year-to-date option activity, as well as option activity in the prior fiscal year;
- "above water" and "under water" option information as of the reporting date;
- The portion of options that go to executives versus the portion provided to the rest of the company's employees; and
- Detailed information about options granted to a company's listed officers.

In summary, we believe that issuance of accounting rules for that would require fair value accounting of stock compensation is undesirable as recognizing the cost of employee stock options on a fair value basis is controversial and lacks empirical support. Any move in that direction will not necessarily lead to an improvement in the quality of financial reporting. However, we recommend that the pro-forma disclosure provisions of SFAS 123 of the United States should be adopted in the IAS also, as some users might find the pro-forma information relevant.

We appreciate the opportunity to offer these comments and thank you for considering our response.

Sincerely,

T. V. Mohandas Pai
Director and Chief Financial Officer