Forest Products Association of Canada
Association des produits forestiers du Canada

CL 117

March 7, 2003

Kimberley Clark
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International Accounting Standards Board
30 Cannon Street
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United Kingdom

Copy: CommentLetters@iasb.org.uk

Dear Ms. Clark:

RE: ED2 Share-Based Payment

The Forest Products Association of Canada (FPAC) is pleased to submit comments in response to the Exposure Draft on Share-Based Payment.

Introduction

FPAC was established in February 2001, and builds on almost 100 years of experience as the former Canadian Pulp and Paper Association. Representing 30 of the country's largest producers of pulp, paper and wood products, FPAC speaks nationally and internationally on public policy issues. Its members have responsibility for over 75 percent of the working forests in Canada.

The forest products industry operates within a world market. A significant number of companies have operations and subsidiaries in foreign jurisdictions. In addition, firms may have securities listed on foreign exchanges and be required to reconcile between domestic and foreign GAAP when preparing annual financial reports.

The Canadian Accounting Standards Board (AcSB) has encouraged stakeholders to comment on the IASB Exposure Draft as well as its own. FPAC has also submitted comments to the American Financial Accounting Standards Board (FASB) Invitation to Comment.

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Valuation Methodologies

FPAC concurs with the objective of achieving a high level of transparency in corporate financial reporting and accounting practices. However, it is critical that as new standards are considered transparency does not jeopardize accuracy. Investors, analysts and others in the financial community would not be well served by measures that decrease the level of accuracy in corporate reporting.

The valuation of stock-based compensation is not known to have a high degree of accuracy. The major shortcoming is the reliance on option-pricing models to determine the fair-value measurement. Even the Black-Scholes model calculations are of questionable accuracy, often overestimating the true cost of the compensation. The sensitivity of valuations to assumptions is significant, as the use of alternative assumptions may produce greatly varying results. The level of interaction between assumptions also contributes to varying results.

Many enterprises may find it difficult to select assumptions because they have incomplete information on historical exercise patterns or do not track annual exercises by individual option grants. Including expenses based on these estimated valuations will reduce the accuracy of financial statements. As security markets fluctuate these expenses, re-measured at each reporting period[1], will fluctuate. Stakeholders reviewing such statements may be misled about the true financial position of corporations.

There could be a significant effect on retained earnings and future income measurement. In some cases, awards would be reported as liabilities, negatively impacting on a corporation's equity. The negative impact on earnings could have a negative impact on debt covenants and regulatory requirements. Given the inaccuracies of valuation methodologies, such impacts are inappropriate.

Disclosures

Consideration of greater note disclosure based on option-pricing model results is concerning to FPAC members. Since these disclosures relate to inaccurate estimations, additional disclosures will not inform the user, but more likely create greater confusion and uncertainty. Pro forma impact note disclosure provides adequate information.

Recommendations

Although international convergence of accounting standards is a positive objective, the results will only be positive if convergence is based on best practices. Therefore, FPAC suggests that work be undertaken to develop more accurate valuation methodology. Accordingly, mandating the expensing of stock-based compensation should be deferred until such time that more accurate valuations are possible. Such an initiative should include international experts so that an international consensus is reached. This would lead to more accurate valuations, better reporting and consistent treatment across jurisdictions.

[1] As mandated under Statement 148, adopted December 31, 2002.

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Summary

Expensing stock-based compensation costs at often inaccurate theoretical valuations will decrease the credibility of financial results being reported and create uncertainty in capital markets to the detriment of investors and the forest products sector. FPAC believes that until more accurate valuation methodologies are developed, note disclosures provide an investor the necessary information to assess the impact of stock options without clouding the financial performance of a firm's operations.

Yours truly,

Paul Lansbergen
Association Secretary and
Director, Taxation and Business Issues

PL/fb

cc: AcSB
FASB