Testimony of
Robert H. Herz
Chairman
Financial Accounting Standards Board
Before the
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the Committee on Financial Services
June 3, 2003

Full Text of Testimony

Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee:

I am Robert H. Herz, chairman of the Financial Accounting Standards Board ("FASB" or "Board"). I am pleased to appear before you today on behalf of the FASB. My testimony includes a brief overview of (1) the FASB, (2) the basis for the Board's unanimous decision to undertake a project to improve the financial accounting and reporting for stock-based compensation, (3) the current status of, and the FASB's plans relating to, that project, (4) the FASB's tentative views about some of the more common arguments offered by some opponents of the project, and (5) the FASB's views on H.R. 1372, the "Broad-Based Stock Option Plan Transparency Act of 2003" ("HR 1372").

The FASB

The FASB is an independent private-sector organization.[1] Our independence from enterprises, auditors, and other constituents is fundamental to achieving our mission—to establish and improve standards of financial accounting and reporting for both public and private enterprises. Those standards are essential to the efficient functioning of the capital markets and the United States ("US") economy because investors and other users of financial reports rely heavily on credible, transparent, comparable, and unbiased financial information to make rational resource allocation decisions.

[1] See Attachment 1 for information about the Financial Accounting Standards Board.

The FASB's independence, the importance of which was recently reaffirmed by the Sarbanes-Oxley Act of 2002 ("Act"),[2] is fundamental to our mission because our work is technical in nature, designed to provide investors and the capital markets with the most accurate possible yardstick to measure and report on the underlying economic transactions of business enterprises. Like investors, Congress and other policy makers need an independent FASB to maintain the integrity of a properly designed yardstick in order to obtain the financial information necessary to appropriately assess and implement the public policies they favor. While bending the yardstick to favor a particular outcome may seem attractive to some in the short run, in the long run a crooked yardstick (or a biased accounting standard) is harmful to investors, the capital markets, and the US economy.

The FASB's authority with respect to public enterprises comes from the US Securities and Exchange Commission ("SEC"). The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held enterprises. For 30 years, the SEC has looked to the FASB for leadership in establishing and improving those standards. The SEC recently issued a Policy Statement reaffirming this longstanding relationship.[3]

[2] Sarbanes-Oxley Act of 2002, Public Law Number 107-204, Sections 108-109 (July 30, 2002).
[3] Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Exchange Act Release Nos. 33-8221; 34-47743; IC-26028; FR-70 (April 28, 2003).

The Policy Statement, consistent with the language and intent of the Act,[4] also reemphasizes the importance of the FASB's independence described earlier. It states:

> By virtue of today's Commission determination, the FASB will continue its role as the preeminent accounting standard setter in the private sector. In performing this role, the FASB must use independent judgment in setting standards and should not be constrained in its exploration and discussion of issues. This is necessary to ensure that the standards developed are free from bias and have the maximum credibility in the business and investing communities.[5]

The SEC, together with the private-sector Financial Accounting Foundation,[6] maintains active oversight of the FASB's activities.

What Is the Basis for the Board's Unanimous Decision to Undertake a Project to Improve the Financial Accounting and Reporting for Stock-Based Compensation?

A Brief History of the Accounting for Stock-Based Compensation

APB Opinion 25

US accountants and accounting standard setters have long debated the issue of the best way to report employee stock options. In 1972, the Accounting Principles Board ("APB"), the predecessor of the FASB, issued APB Opinion No. 25, *Accounting for*

[4] Sections 108-109; The legislative history of the Sarbanes-Oxley Act of 2002 is clear that the provisions of the Act relating to the FASB were intended to "strengthen the independence of the FASB . . . from . . . companies whose financial statements must conform to FASB's rules." Senate Report 107-205, 107th Congress, 2d Session (July 3, 2002), page 13.
[5] Page 5 of 8.
[6] See Attachment 1 for information about the Financial Accounting Foundation.

Stock Issued to Employees. Partly because techniques to estimate the value of stock options did not yet exist, the drafters of Opinion 25 created an exception to the normal financial reporting model.[7] That model encompasses the general principle that all of an enterprise's costs should be included in the enterprise's financial statements; otherwise, the enterprise's income is overstated.

Under the Opinion 25 exception, only stock options granted to employees that meet certain specified criteria (so-called fixed plan options) are not reported as an expense. All other options and all other forms of stock-based transactions result in expenses to be included in the financial statements consistent with the general principle.

Statement 123

Many constituents agreed that the Opinion 25 exception was not the best approach to transparent financial reporting for employee stock options, and, in 1984, the FASB undertook a project to reconsider the issue. In 1993, after several delays in the project, the FASB issued an Exposure Draft, *Accounting for Stock-based Compensation,* for public comment. The Exposure Draft proposed to replace Opinion 25 and require recognition of compensation cost for all awards that eventually vest, based on their fair value at the grant date. In 1995, however, when the FASB issued Statement No. 123, *Accounting for Stock-Based Compensation,* it permitted companies to continue to apply

[7] Opinion 25 measures stock issued to employees using the "intrinsic value based method." Under that method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date or other measurement date over the amount an employee must pay to acquire the stock (Opinion 25, paragraph 10). The consequence of using the intrinsic value based method is that stock options are frequently issued with the quoted market price of the stock at grant date equal to the amount an employee must pay to acquire the stock and, thus, no expense is reported in the financial statements.

Opinion 25, while also requiring annual footnote disclosures of the fair values of fixed plan employee stock options otherwise omitted from the financial statements.

The following paragraphs of Statement 123 summarize the basis for the Board's decision to only *encourage*, rather than *require*, that all stock-based compensation be measured at fair value at date of grant and reported as an expense in determining an enterprise's net income:

> The Board continues to believe that financial statements would be more relevant and representationally faithful if the estimated fair value of employee stock options was included in determining an entity's net income, just as all other forms of compensation are included. To do so would be consistent with accounting for the cost of all other goods and services received as consideration for equity instruments. . . . However, in December 1994, the Board decided that the extent of improvement in financial reporting that was envisioned when this project was added to its technical agenda . . . was not attainable because the deliberate, logical consideration of issues that usually leads to improvement in financial reporting was no longer present. Therefore, the Board decided to specify as preferable and to encourage but not to require recognition of compensation cost for all stock-based employee compensation, with required disclosure of the pro forma effects of such recognition by entities that continue to apply Opinion 25.
>
> The Board believes that disclosure of the pro forma effects of recognizing compensation cost according to the fair value based method will provide relevant new information that will be of value to the capital markets and thus will achieve some but not all of the original objectives of the project. *However, the Board also continues to believe that disclosure is not an adequate substitute for recognition of assets, liabilities, equity, revenues, and expenses in financial statements. . . . The Board chose a disclosure-based solution for stock-based employee compensation to bring closure to the divisive debate on this*

> *issue—not because it believes that solution is the best way to improve financial accounting and reporting*.[8]

Last year, in Congressional testimony before the Committee on Banking, Housing and Urban Affairs, Dennis R. Beresford, who was the FASB Chairman at the time Statement 123 was issued, shared his views about that Statement and the reasons for the Board's decision:

> As many of you may recall, the FASB had proposed that companies account for the expense represented by the fair value of stock options granted to officers and employees. The business community and accounting firms strongly opposed this proposal and a number of corporations engaged in a lobbying effort to stymie the FASB's initiative.
>
> Certain members of Congress were sufficiently influenced by the appeals from corporate executives that they were persuaded to introduce legislation to counter the FASB's proposal. The legislation would have prohibited public companies from following any final FASB rule on this matter. *More importantly, the legislation would have imposed requirements that the SEC repeat the FASB's process on any new accounting proposals, thus effectively eviscerating the FASB. Faced with the strong possibility that its purpose would have been eliminated by this legislation, the FASB made a strategic decision to require companies to disclose the effect of stock options in a footnote to the financial statements but not record the expense in the income statement.*[9]

Statement 148

Following the issuance of Statement 123, only a handful of companies elected to adopt the fair value method of reporting employee stock options as an expense in the income

---

[8] Paragraphs 61 and 62 (emphasis added).

[9] Prepared statement at a hearing on "Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: Oversight of the Accounting Profession, Audit Quality and Independence, and Formulation of Accounting Principles" (February 26, 2002), page 5 (emphasis added).

statement. In addition, for many years, few investors and other users of financial statements expressed significant concerns with that practice.

Over the past year, however, following the highly publicized bankruptcies of Enron Corp., Global Crossing Ltd., and WorldCom, Inc., many investors and other users of financial statements began questioning enterprises' accounting and reporting for employee stock options. Moreover, many enterprises began considering whether to voluntarily expense all stock-based compensation consistent with the requirements of Statement 123.

In July 2002, as a number of US enterprises began announcing their intention to switch to the fair value method of reporting stock-based compensation, the FASB, in response to requests from some of those enterprises and other constituents, decided to add a limited-scope project to its agenda to address issues related to the transition and disclosure provisions of Statement 123.[10] In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure.*

Statement 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based compensation. In addition, that Statement amends the required disclosures of Statement 123 to provide for more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results.

[10] As of May 23, 2003, 281 enterprises expense or intend to expense employee stock options using the grant date fair value method. See Attachment 6 for a list (alphabetical and by state) of those enterprises.

International

In 2001, the FASB's international counterpart, the International Accounting Standards Board ("IASB") took up the subject of the accounting for stock options. It needed to do so, not only because of the growing use of employee stock options around the world, but also because there was no existing literature in the international standards on this topic.

After a year of thorough deliberations by the IASB, like the FASB decided almost 10 years ago in developing Statement 123, it proposed that the appropriate accounting for employee stock options is to measure compensation for the fair value of the options at the date granted and to recognize the cost over the period the option vests.[11] And, also like the Board decided in developing Statement 123, the IASB proposed that the best way to measure the fair value at grant date is to use established option-pricing models and then make certain adjustments for the unique features of employee stock options. However, the IASB's particular set of adjustments and allocation methods are somewhat different from those under the fair value method developed by the FASB in Statement 123. There also are some other important differences between the IASB's proposal and the Statement 123 approach. Nevertheless, the fundamental conclusions are the same.

The IASB has begun discussing at public meetings the issues raised by constituents in response to its proposal. Of note, a majority of commentators from industry indicated full or qualified support for treating all stock-based compensation as expenses and for

[11] IASB Proposed IFRS, *Share-based Payment* (November 2002); FASB Exposure Draft, *Accounting for Stock-based Compensation* (June 1993).

measuring them at their fair value.[12] The IASB currently plans on issuing a final standard in the fourth quarter of 2003.

Beginning January 1, 2005, all listed companies in the European Union ("EU") will be required to adopt IASB standards. Other countries outside the EU, including Australia and Russia, are also expected to adopt IASB standards en masse. Furthermore, other national accounting standard setters around the world, including those in Canada, are expected to adopt new requirements for the accounting for employee stock options that are the same or similar to those adopted by the IASB.

Invitation to Comment

As the IASB released its exposure draft in November 2002, the FASB issued an Invitation to Comment that explains in detail the similarities of and differences between the IASB proposal and the existing US standards and that solicits comments on those differences.[13] The purpose of the Invitation to Comment was twofold: (1) to solicit comments on certain issues that the Board would discuss when, in accordance with its objectives of improving US financial accounting and reporting standards and promoting international convergence of high-quality accounting standards, it considered whether it should propose any further improvements to the US accounting standards on stock-based compensation and (2) to assist constituents that were planning to respond to the IASB's proposal.

---

[12] Andrew Parker, "IASB to Push on with Option Reform," *Financial Times* (May 3, 2003).
[13] FASB Invitation to Comment, *Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123,* Accounting for Stock-Based Compensation*, and Its Related Interpretations, and IASB Proposed IFRS,* Share-based Payment (November 2002).

The FASB received nearly 300 comment letters in response to the Invitation to Comment. Most commentators from industry that made general observations about the accounting for stock-based compensation, many of whom were from the high-technology industry, were generally against mandatory expense recognition of all stock-based compensation. Those commentators raised a number of issues including (1) whether mandated expensing of fixed plan employee stock options has a clear or widely accepted rationale; (2) whether the real cost of issuing fixed plan employee stock options is potential dilution of existing shareholders' equity interests; (3) whether the cost of fixed plan employee stock options is already reported in corporate financial statements; (4) whether existing option pricing models, including Black-Scholes and binomial models, even when adjusted, produce inaccurate and misleading information; (5) whether expensing all employee stock options is likely to lead to an even more distorted picture of an enterprises' financial performance and condition; and (6) whether mandated expensing of fixed plan employee stock options will destroy broad-based plans and the productivity, innovation, and economic growth they generate.

In contrast, most commentators that were users of financial statements, including individual investors, pension funds, mutual funds, creditors, and financial analysts, were generally supportive of mandatory expense recognition of all employee stock options.[14]

[14] Attachments 4 and 7 include excerpts and letters, respectively, from some of those constituents who responded to the Invitation to Comment.

Some representative examples include the following:

> Stock options have become a disgrace insofar as accurate reporting of expenses is concerned for corporation[s].
>
> I strongly recommend that there be a requirement for stock options to be expensed.
>
> *Benham M. Black, Partner, Black, Noland & Read, PLC, and Director, Virginia Financial Group, Inc. (an independent bank holding company with total assets of $1.04 billion), 1/31/03*

> [A]s a fiduciary, I continue to be infuriated with the tech industry . . . and their blatantly self-serving position on stock options. Options have contributed mightily to the current crisis of confidence that we have in the stock market, and I view the expensing of options as a long-overdue and necessary step towards restoring both confidence and rationality in the market. . . . The tech industry has been masterful at marshalling their shareholders own capital against them, given their vociferous lobbying against the proper accounting treatment of options, but the time has come to treat options for what they are-compensation-and force them to be treated on par with all other forms of compensation.
>
> *Kenneth F. Broad, CFA, Portfolio Manager, Transamerica Investment Management, LLC (a registered investment adviser managing $12.5 billion in equity and fixed-income assets for mutual funds, funds for funds, separately managed accounts, retirement plans and various for-profit and nonprofit entities), 1/31/03*

> CPF . . . supports the view that stock options are compensation, have a cost, and that those costs should be included on reported income statements.
>
> *Michael R. Fanning, Chief Executive Officer, Central Pension Fund of the International Union of Operating Engineers and Participating Employers (on behalf of over 150,000 participants of the CPF), 1/23/03*

> Investors support the core conclusions by the IASB and the FASB that stock based compensation should be recognized as an expense and that the amount of compensation expense should be based on the fair value of stock-based awards at grant date.
>
> *James E. Heard, Chief Executive Officer, Institutional Shareholder Services (serving more than 950 institutional investors and corporate clients worldwide), 1/31/03*
>
> The Institute urges the Board to move forward with a reconsideration of Statement No. 123 as soon as practicable. We continue to believe that accounting standards should (1) require the issuers to treat the fair value of stock options granted to employees to be recognized as expense in the income statement and (2) ensure uniformity in how stock options are valued for this purpose.
>
> *Gregory M. Smith, Director – Operations/Compliance & Fund Accounting, Investment Company Institute (a national association including 8,938 mutual funds, 535 closed-end investment companies and 6 sponsors of unit investment trusts; its mutual fund members have assets of about $6.539 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders), 1/31/03*
>
> <u>The Council supports the principles outlined in the IASB's exposure draft, and we urge the Financial Accounting Standards Board to propose and approve similar rules</u>. The IASB proposal is in line with the Council policy on the issue, which states that since stock options granted to employees, directors and non-employees are compensation and have a cost, companies should include these costs as an expense on their reported income statements and disclose their valuation assumptions.
>
> *Sarah A. B. Teslik, Executive Director, Council of Institutional Investors (an association of more than 130 corporate, public and union pension funds with more than $3 trillion in pension assets), 1/21/03*

In addition, the Board received many letters and emails from individual investors and other members of the general public from around the country urging the Board to mandate expense recognition for all stock-based compensation. Some representative examples include the following:

> I strongly recommend that employee stock options be mandated as an expense on corporate financial statements. As long as these options can be passed out like funny money, thereby encouraging those on the receiving end to manipulate the financial records to their advantage – people like me will stay away from the market.
>
> *John S. Clauss, Jr., Glendale, California, 2/10/03*

> We encourage you to . . . require employee stock options to be counted as an expense. If you don't take this action who do you think will make these greed-monger's start accounting for their massive profits? Do the RIGHT THING, Damn it! . . .
>
> *David and Nancy Gabrielsen, Beavercreek, Oregon, 2/11/03*

> Companies are not required to expense options, which means they can give out as many as they want.
>
> I urge the FASB to require employee stock options to be counted as an expense. . . .
>
> *Rob Rocco, Avon Lake, Ohio, 2/12/03*

Current Project to Improve the Financial Accounting and Reporting for Stock-Based Compensation

In March 2003, at a public meeting, the Board decided to add a project to its agenda to address issues relating to stock-based compensation.[15] That decision was based largely on three factors.

The first factor was the high level of public concern expressed by individual and institutional investors, pension funds, mutual funds, creditors, financial analysts, and other users of financial statements, and the major accounting firms, about the need to improve the financial accounting and reporting for stock-based compensation, in particular the need to eliminate the exception from expense recognition that presently exists *only* for fixed plan employee stock options.[16]

Those users of financial statements that have been urging the FASB to eliminate the exception for fixed plan employee stock options include:

- The Council of Institutional Investors (an association of more than 130 corporate, public, and union pension funds with more than $3 trillion in pension assets)
- Institutional Shareholder Services (serving more than 950 institutional investors and corporate clients worldwide)

[15] See Attachment 3 for a summary of the project on stock-based compensation.
[16] See Attachment 4 for excerpts from investors and other users of financial reports expressing concerns about the existing accounting for stock-based compensation.

- The Office of the State Comptroller of New York (an investor, shareholder, and sole trustee of the nation's second largest pension fund at approximately $100 billion in assets)

- Moody's Investor Services

- The Central Pension Fund of the International Union of Operating Engineers and Participating Employers (on behalf of more than 150,000 participants of the CPF)

- The Teachers Insurance and Annuity Association College Retirement Equities Fund (a financial services company with approximately $262 billion in assets under management, serving nearly 3 million education and research employees at 15,000 institutions)

- The Investment Company Institute (a national association including 8,938 mutual funds, 535 closed-end investment companies, and 6 sponsors of unit investment trusts; its mutual fund members have assets of about $6.539 trillion, accounting for approximately 95 percent of total industry assets, and 90.2 million individual shareholders)

- The Association for Investment Management and Research (a nonprofit professional organization of 61,600 financial analysts, portfolio managers, and other investment professionals)[17]

[17] A 2001 survey conducted by the Association for Investment Management and Research found that more than 80 percent of financial analysts and portfolio managers responding to the survey believed that stock options granted to employees are compensation and should be recognized as an expense in the income statements of the enterprises that grant them. AIMR, "Analysts, Portfolio Managers Want Employee Stock Options Expensed on Income Statements, Global AIMR Survey Shows" (November 19, 2001).

- The American Federation of Labor and Congress of Industrial Organizations (representing 13 million of America's workers in 65 member unions)

- The Conference Board Commission on Public Trust and Private Enterprise (Co-chaired by Peter G. Peterson, chairman of the Blackstone Group, former Secretary of Commerce and chairman of the Federal Reserve Bank of New York, and John W. Snow, chairman, CSX Corporation and former chairman, Business Roundtable)

As indicated above, fixed plan employee stock options are the *only* form of employee stock options that *are not* required to be reported as an expense in the income statements of the enterprises that grant them. All other forms of employee compensation, including cash salaries, bonuses, fringe benefits, restricted stock, stock warrants, performance-based stock options, indexed-based stock options, employee stock ownership plans, are (and have long been) required to be reported as an expense. Moreover, when stock-based grants of any form are issued to nonemployees for goods or services, they also are (and have long been) required to be reported as an expense. The exception for fixed plan employee stock options is clearly an anomaly in today's financial accounting and reporting.

As indicated above, investors and other users of financial reports have urged the Board to address the exception for fixed plan employee stock options. Many have pointed to the negative impact the exception has had on promoting excessive awards of such options, particularly to corporate executives, and the negative behavioral aspects that it has had on corporate responsibility. Clearly, many investors and other users of financial reports want this issued addressed and resolved in the near term.[18]

Last year, President Bush announced a ten-point plan to improve corporate responsibility.[19] That plan including the following statement: "The authors of accounting standards must be responsive to the needs of investors."[20] In my opinion, there is no other issue on the Board's agenda in which investors have been more clear about the need for an improvement in the existing accounting standards.

The second factor was the noncomparability and, thus, potential lack of transparency created by the alternative accounting treatments presently available for reporting stock-based compensation that have been magnified by the recent trend of enterprises to adopt the voluntary fair value provisions of Statement 123.

More than 280 major US enterprises have adopted or will adopt fair value expensing of all stock options, including fixed plan employee stock options.[21] Those enterprises represent 19 percent of the S&P 500 based on number of companies and 36 percent of

---

[18] The major US accounting firms are also generally supportive of expensing of all employee stock options. "Big Four Shift View on Expensing Options," *Financial Executive's News* (May 1, 2003).
[19] Ten-Point Plan to Improve Corporate Responsibility and Protect America's Shareholders (March 7, 2002).
[20] Ibid.
[21] See Attachment 6.

the S&P 500 based on market capitalization. Those enterprises include Amazon.com Inc.; American Express; Bank of America Corp.; Bank One; BellSouth Corp.; Calpine Corp.; Choice Hotels International, Inc.; Citigroup Inc.; Comerica Inc.; CSX Corp.; Dole Food Co. Inc.; Dow Chemical Co.; Entergy Corp.; Federal Home Loan Mortgage Co.; Ford Motor Company; General Electric Co.; Hartford Financial Services Group, Inc.; Home Depot, Inc.; Household International Inc.; J.P. Morgan Chase & Co; Morgan Stanley; PNC Financial Services Group Inc.; Proctor & Gamble Co.; Provident Financial Group, Inc.; Saks Inc., SBC Communications Inc.; Scotts Co.; State Street Corp.; Sunoco Inc.; Wachovia; and Wal-Mart Stores, Inc., to name a few.

Some of those enterprises, including Citigroup Inc. and J. P. Morgan Chase & Co., have expressly requested that the Board mandate the expensing of all employee stock options. It is also interesting to note that some of those enterprises, including Wal-Mart Stores, Inc. and Home Depot, Inc., have historically offered broad-based stock option plans to many nonexecutive employees and have indicated that adopting fair value expensing for all employee stock options will not result in any curtailment of those programs.[22]

And, during the current proxy season, more than 100 major US companies will be required to issue proxies containing shareholder resolutions calling for expensing of all

[22] News From Carl Levin, U.S. Senator, Michigan, “Stock Option Roundtable Dismissed as One-Sided” (May 8, 2003), page 2.

employee stock options.[23] As recently reported in *BusinessWeek Online*:

> Of the more than 40 proposals on expensing that already have been put to a vote, "yes" ballots have averaged more than 48% -- a degree of across-the-board shareholder support almost unheard of in recent history.[24]

The management of some of the companies in which the nonbinding resolutions on expensing all employee stock options have been approved, including Apple Computer, Inc. and MBNA Corp., has indicated that it will comply with the resolution, but not until the FASB completes its current project on stock-based compensation.[25]

The third factor was the opportunity to achieve convergence to a common, high-quality international accounting standard in this area. As noted earlier, the IASB currently plans on issuing a final standard in the fourth quarter of 2003 that would require that all share-based payments to be expensed at their fair value at grant date. By 2005, many companies in Europe and around the world will be applying the identical or a very similar standard.

The FASB has long been committed to actively working with the IASB and other national accounting standard setters to promote international convergence of accounting standards concurrent with improving the quality of financial reporting.[26] Both the Act[27] and the

---

[23] Louis Lavelle, "Shareholders Unite to Expense Options," *BusinessWeek Online* (May 27, 2003). See Attachment 5.
[24] Ibid.
[25] Jonathan D. Epstein, "MBNA listens, will deduct stock options from earnings," *The News Journal* (May 7, 2003); "Apple Won't Expense Options Before Rule Change," *Reuters* (May 13, 2003).
[26] FASB, *Rules of Procedure* (December 1, 2002, as amended), page 2.
[27] Section 108(a)(2).

Policy Statement[28] indicate the support of the US Congress and the SEC, respectively, for the FASB's convergence efforts.

What Is the Current Status of, and the FASB's Plans Relating to, the Project on Stock-Based Compensation?

For administrative purposes, the Board plans to divide the project on stock-based compensation into two distinct phases. In phase one, the Board will address issues relating to improving the accounting for employee stock-based compensation. In phase two, the Board will address issues relating to improving the accounting for nonemployee stock-based compensation and stock-based compensation arising from employee stock ownership plans and employee stock purchase plans.

The Board began its initial public deliberations of issues related to the project in April. At its April 22, 2003, meeting the Board tentatively decided:

- Goods or services received in exchange for stock-based compensation result in a cost that should be recognized in the income statement as an expense when the goods or services are consumed by the enterprise.

- The measurement attribute for an exchange involving stock-based compensation is fair value.

- With respect to stock-based compensation transactions with employees:

[28] Page 4 of 8.

- The economic event being measured is the exchange of goods or services received for stock-based compensation.

- The measurement objective for equity-settled awards is to determine the fair value of the goods or services received in the exchange, which should be based on (1) the fair value of the goods or services received or (2) the grant-date fair value of the stock-based compensation given, whichever is more reliably measurable.

At its May 7, 2003 public Board meeting, the Board tentatively decided:

- Compensation cost should be recognized over the service period.

- Stock-based compensation awards should be accounted for using the modified grant-date measurement approach in Statement 123; therefore, compensation cost should be adjusted to reflect actual forfeitures and outcomes of performance conditions.

- For awards with service conditions, an enterprise should base accruals of compensation cost on the best available estimate of the number of equity instruments that are expected to vest and to revise that estimate, if necessary, if subsequent information indicates that actual forfeitures are likely to differ from initial estimates.

In the coming weeks and months, at public meetings, the Board will continue its deliberations of issues relating to the project. Any and all decisions reached by the Board at those meetings will be tentative decisions subject to further review by the Board before considering whether to issue a proposed standard for public comment.

The Board currently expects to hold at least ten additional public meetings to discuss issues in connection with developing a proposed standard for public comment for phase one of the project. Those meetings will include discussions of measurement methods, option valuation, attribution methods, modification and settlements, income taxes, disclosures, nonpublic enterprises, transition, and effective date.

The Board's public deliberations of those issues will be systematic, thorough, and objective. The deliberations, consistent with the FASB's Rules of Procedure, will address all of the key conceptual, measurement, disclosure, and cost-benefit issues, including those offered by those constituents who oppose the expensing of all employee stock options.

The deliberations will benefit from the FASB staff and Board's ongoing review and analysis of the vast amount of research and other literature in this area.[29] The deliberations also will benefit from the FASB staff and Board's ongoing discussion of the

---

[29] Some of the relevant published and unpublished research papers and other materials issued just since January 2003 include: Bettis, Bizjak, and Lemmon, "The Cost of Employee Stock Options," working paper, Social Science Research Network (May 2003); Bodie, Kaplan, and Merton, "For the Last Time: Stock Options Are an Expense," *Harvard Business Review* (March 2003); Finnerty, *Valuing Employee Stock Options: A Comparison of Alternative Methods* (Morristown, N.J.: Financial Executives Institute Research Foundation, 2003); Gooch and Lipe, "An Empirical Comparison of Grant-Date and Exercise-Date Measurements in Employee Stock Option Accounting," School of Accounting, University of Oklahoma (February 2003); Mollen, Rodney, Harper, and Jones, *Does the Black-Scholes Model Predict the Value of Employee Options?* (New York: Sibson, 2003); Olagues, "Wrestling with the Value of Your Employee Stock Options," *SFO Magazine* (April 2003).

key issues with a broad range of constituents, including valuation and compensation experts that the FASB will continue to consult with throughout the entire process.

The Board currently plans to be in a position to issue a proposed standard for public comment on phase one of the project in the fourth quarter of this year. Consistent with the FASB's Rules of Procedure, any proposal issued will be exposed for an adequate comment period so as to allow all interested constituents to provide detailed responses. The Board also will consider whether to hold public roundtables or public hearings to solicit additional input on the proposal.

Prior to making any final decisions on any changes to the accounting for stock-based compensation, the Board would consider, at public meetings, all of the input received in response to any proposed standard. Only after carefully evaluating all of the input received in response to a proposal would the Board consider whether to issue a final standard. No final standard may be issued without approval by majority vote of the Board.

As with all of the FASB's activities, the FAF and the SEC will monitor and oversee the Board's due process on this important project.

What Are the FASB's Tentative Views about Some of the More Common Arguments Offered by Some Opponents of the Project on Accounting for Stock-Based Compensation?

The following are three of the more common arguments made by some of the opponents of the Board's project to improve the financial accounting and reporting for stock-based compensation: (1) fixed plan employee stock options do not represent a cost and, therefore, should not required to be expensed; (2) the cost of fixed plan employee stock options cannot be estimated; and (3) the mandatory expensing of fixed plan employee stock options will have negative economic consequences. The Board will, consistent with the FASB's Rules of Procedure, carefully and thoroughly address all three of those arguments. The following is a brief discussion of the Board's deliberations to-date with respect to each argument.

Fixed Plan Employee Stock Options Do Not Represent a Cost

As indicated above, at the public Board meeting on April 22, 2003, the Board tentatively decided by a unanimous vote that goods and services received from any party in exchange for stock-based compensation should result in a cost that is recognized in the financial statements. The tentative decision would eliminate the existing exception that permits fixed plan employee stock options to avoid expense recognition.

The basis for the Board's tentative decision is that the Board agreed that all employee stock options, including fixed plan stock options, have value and that valuable financial instruments given to employees give rise to compensation cost that is properly included in measuring an enterprise's net income. Employee stock options provide an employee a valuable right to buy an enterprise's stock for a fixed price during a fixed time period. Similar rights are bought and sold in organized markets by speculators and other parties. Furthermore, companies issue similar such options and warrants to outside parties to acquire goods and services and in connection with acquisitions and financing transactions (and the value of those exchanges are always reported on the face of the financial statements without exception). If such rights were not valuable, employees, speculators, and other parties would not purchase them. Because employees purchase those rights with services, those consumed services represent an expense that is properly included in measuring an enterprise's net income.

The Board also discussed and disagreed with the related argument made by some constituents that stock-based compensation should not be reported as a cost and deducted from earnings, but instead should only be reflected in diluted earnings per share when the options are exercised. The Board noted that the argument ignores the fact that all stock based-compensation, other than fixed plan employee stock options, is currently reported as a cost and deducted from earnings.

The Board believes that information about dilution from stock and stock option issuances is relevant information for investors. Diluted earnings per share, however, do not reflect all of the effects of stock-based compensation transactions.[30]

---

[30] Of note, the diluted earnings per share calculation takes into account only those stock options that are in-the-money and ignores the potential dilutive impact of options that are either at- or out-of-the-money (FASB Statement No. 128, *Earnings per Share* [February 1997], paragraphs 20-23).

In addition to potential dilution, stock-based compensation transactions also impact the amount of the enterprise's employee compensation costs**.** As noted earlier, under existing accounting standards, all forms of stock-based compensation, except for fixed plan stock-based compensation, are reported as part of an enterprise's employee compensation costs.

The Board believes that all compensation costs, including fixed plan employee stock options costs, must be reported as an expense and deducted from earnings in order to provide investors with sound, fair, and credible information about an enterprise's net income.

The Cost of Fixed Plan Employee Stock Options Cannot Be Estimated

In its current project, the Board has not yet deliberated all of the issues relating to the method of determining the fair value of stock-based compensation. In response to the Invitation to Comment, the FASB received significant input from constituents on more than two dozen issues relevant to determining the fair value of stock-based compensation.[31] Some of those constituents questioned whether existing pricing models, including Black-Scholes and binomial models, even when adjusted, could produce an accurate and reliable fair value for stock-based compensation. As indicated above, the Board will systematically, thoroughly, and objectively deliberate those issues at future public meetings.

From a historical perspective, it should be noted that in the development of Statement 123 almost 10 years ago, when the valuation methodologies for complex financial instruments

[31] Paragraph B1.

were less advanced and far less routine than in today's environment, the Board unanimously concluded that the value of employee stock options could be estimated within acceptable limits for recognition in financial statements. The basis for the Board's conclusion included the following:

> [U]ncertainties inherent in estimates of the fair value of employee stock options are generally no more significant than the uncertainties inherent in measurements of, for example, loan loss reserves, valuation allowances for deferred tax assets, and pension and other postretirement benefit obligations. All estimates, because they are estimates, are imprecise. Few accrual-based accounting measurements can claim absolute reliability, but most parties agree that financial statement recognition of estimated amounts that are approximately right is preferable to the alternative—recognizing nothing—which is what Opinion 25 accounting recognizes for most employee stock options. Zero is not within the range of reasonable estimates of the value of employee stock options at the date they are granted, the date they vest, or at other dates before they expire, with the possible exception of deep-out-of-the-money options that are near expiration. Even those latter options generally have nominal value until very shortly before expiration.
>
> The Board continues to believe that use of option-pricing models, as modified in this Statement, will produce estimates of the fair value of stock options that are sufficiently reliable to justify recognition in financial statements. Imprecision in those estimates does not justify failure to recognize compensation cost stemming from employee stock options. That belief underlies the Board's encouragement to entities to adopt the fair value based method of recognizing stock-based employee compensation cost in their financial statements.[32]

More recently, in the development of the IASB proposal, the IASB unanimously decided that ". . . estimated fair value of employee share options at grant date can be measured

[32] Paragraphs 111 and 117.

with sufficient reliability for the purposes of recognising employee share-based payment transactions in the financial statements."[33] The basis for the IASB's decision included the following:

> The Board noted that there is evidence to support a conclusion that it is possible to make a reliable estimate of the fair value of employee share options. First, there is academic research to support this conclusion (eg Carpenter 1998, Maller, Tan and Van Ed Vyver 2002). Second, users of accounts regard the estimated fair values as sufficiently reliable for recognition in the financial statements. Evidence of this can be found in a variety of sources, such as the comment letters received from users of accounts who responded to the Discussion Paper. Users' views are important, because the objective of financial statements is to provide high quality, transparent and comparable information to help users make economic decisions. In other words, financial statements are intended to meet the needs of users, rather than preparers or other interest groups. The purpose of setting accounting standards is to ensure that, wherever possible, the information provided in the financial statements meets users' needs. Therefore, if the people who use the financial statements in making economic decisions regard the fair value estimates as sufficiently reliable for recognition in the financial statements, this provides strong evidence of measurement reliability.
>
> In summary, if expenses arising from grants of options to employees are omitted from the financial statements, or recognised using the intrinsic value method (which typically results in zero expense) or the minimum value method, that means that there is a permanent error embedded in the accounts. So the question is, which accounting method is more likely to produce the smallest amount of error and the most relevant, comparable information—a fair value estimate, which might result in some understatement or overstatement of the associated expense, or another measurement basis, such as intrinsic value, that will definitely result in substantial understatement of the associated expense?[34]

[33] Paragraph BC294.
[34] Paragraphs BC291 and BC293 (footnote omitted).

Relevance and reliability are the two primary qualities that make accounting information useful for decision making.[35] The balancing of those two qualities is a key element of the Board's objective decision-making process in each and every project it undertakes.

The nature of financial accounting and reporting requires that enterprises utilize numerous methods, estimates, and judgments in the application of accounting standards to their particular economic transactions. Those methods, estimates, and judgments often have a significant impact on the resulting information reported in the enterprise's financial statements.[36]

At upcoming public meetings the Board will continue its systematic, thorough, and objective deliberation of issues, including those relating to the method or methods of accurately valuing the fair value of stock-based compensation. Those deliberations will benefit from enterprises' seven years of experience in valuing and reporting the fair value of stock-based compensation in their audited financial statements; the ample existing research and other literature on the issue; the ongoing input from the FASB's constituents; and the advice and expertise of leading valuation and compensation experts that the FASB will continue to consult with throughout the life of the project.

---

[35] FASB Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information* (May 1980), paragraph 90.

[36] The SEC has provided cautionary advice about public companies' disclosure of critical accounting policies used in financial statements (Cautionary Advice Regarding Disclosure About Critical Accounting Policies, Releases Nos. 33-8040; 34-45149; FR-60 [December 12, 2001]). The required disclosures identify methods, estimates, and judgments that companies' use in applying those accounting policies that have a significant impact on the results reported (page 2 of 3). As one example, Intel Corporation's ("Intel") critical accounting policies disclosure contained in their Form 10-K for the fiscal year ended December 28, 2002, describes methods, estimates, or judgments used in its accounting for goodwill, nonmarketable equity securities, inventory, long-lived assets, and income taxes (Intel, 2002 Form 10-K, pages 29-31). Some companies have disclosed critical accounting policy estimates in over 12 separate areas (see Jack T. Ciesielski, "Ignorance Is Not Bliss: Critical Accounting Policies in the S&P 100," *The Analyst's Accounting Observer* [April 23, 2003]).

Mandatory Expensing of Fixed Plan Employee Stock Options Will Have Negative Economic Consequences

As indicated earlier, the mission of the FASB is to develop and improve financial accounting and reporting standards that result in transparent, credible, and unbiased financial information. Unbiased financial information enhances economic and policy decisions, comparisons between companies, capital allocation, and investor trust and confidence in financial reporting and the capital markets. Conversely, biased accounting standards and the resulting financial information that favor or disfavor a particular transaction, industry, or special interest group thwart the attainment of those objectives.

There will always likely be many different business, economic, and social objectives that many may agree are worthy of encouraging, promoting, or otherwise subsidizing in some manner, but distorting financial accounting and reporting standards and the resulting financial information is not the way to achieve those objectives. The purpose of financial accounting and reporting standards is to facilitate and promote sound, fair, and credible information. Diverging from that purpose to fulfill some other objective severely impairs the benefits and utility of accounting standards.

On a historical note, in the development of Statement 123, the FASB addressed the argument that ". . . a requirement to recognize [stock-based] compensation would have adverse economic consequences. . . ."[37] The Board stated:

> The Board's operating precepts require it to consider issues in an even-handed manner, without

[37] Paragraph 83.

> intentionally attempting to encourage or to discourage specific economic actions. That does not imply that improved financial reporting should not have economic consequences; a change in accounting standards that makes available more relevant and representationally faithful financial information often will have economic consequences. For example, the availability of the new information resulting from application of this Statement may lead an entity to reassess the costs and benefits of its existing stock option plans.[38]

Similarly, in the development of the IASB proposal, the IASB addressed the argument that the required recognition "of employee share-based payment would have adverse economic consequences. . . ."[39] The IASB noted:

> [T]he role of accounting is to report transactions and events in a neutral manner, not to give 'favourable' treatment to particular transactions to encourage entities to engage in those transactions. To do so would impair the quality of financial reporting. If expenses are omitted from the income statement, profits are overstated. The financial statements are less transparent. Comparability is impaired, given that expenses arising from employee share-based payment transactions vary from entity to entity, from sector to sector, and from year to year. More fundamentally, accountability is impaired, because the entities are not accounting for transactions they have entered into and the consequences of those transactions.[40]

The Board is aware that some commentators, like the International Employee Stock Options Coalition, believe that requiring the expensing of all stock-based compensation will likely have a negative economic impact because in their view it "will destroy broad-based plans and the productivity, innovation and economic growth they generate."[41]

---

[38] Paragraph 84.
[39] Paragraph BC53.
[40] Paragraph BC55.
[41] Letter from International Employee Stock Options Coalition to the FASB (January 30, 2003), page 4 of 29.

Others, like the Conference Board Commission on Public Trust and Private Enterprise, have indicated that requiring the expensing of employee stock options will likely have a positive economic impact, in part, because the existing accounting treatment discourages the use of "grants of actual stock and other forms of stock options more closely related to performance."[42]

Many other constituents have explicitly commented on the economic impact of requiring the expensing of all stock-based compensation. One example is Federal Reserve System Chairman Alan Greenspan. Chairman Greenspan stated:

> There is a legitimate question as to whether markets see through the current nonexpensing of options. If they do, moving to an explicit recognition of option expense in reported earnings will be a nonevent. The format of reports to shareholders will change somewhat, but little more will be involved. Making an estimate of option expense requires no significant additional burden to the company.
>
> If, however, markets do not fully see through the failure to expense real factor inputs, market values are distorted and real capital resources are being diverted from their most efficient employment. This *would* be an issue of national concern.
>
> Clearly then, the greater risk is to leave the current accounting treatment in place. If markets have seen through the accounting, required expensing of option grants will have no effect on the nation's capital allocation. If, however, expensing does affect market values, a continuation of current accounting practice could be costly to capital efficiency.[43]

[42] The Conference Board, "Commission on Public Trust and Private Enterprise. Findings and Recommendations, Part I: Executive Compensation" (September 17, 2002), page 6. See Attachments 4 and 7.

[43] Federal Reserve System Chairman Alan Greenspan, Remarks at the 2002 Financial Markets Conference of the Federal Reserve Bank of Atlanta, Sea Island, Georgia (May 3, 2002), pages 5 and 6. See Attachments 4 and 7.

Another example is the Republican Senate Staff of the Joint Economic Committee. Their Economic Policy Research Report on "Understanding the Stock Option Debate," concluded:

> Commentators differ greatly on the practical impacts of stock option expensing. Opponents believe it would discourage firms from granting options, reduce investor willingness to invest in option granting companies, and confuse investors. Proponents, however, believe that it would improve the quality of reported earnings, improve the investment decisions of investors who rely on reported earnings, and increase public confidence in financial reporting. *In evaluating these competing claims, policy should focus on one goal: informing investors so they allocate their capital as effectively as possible. Accounting policies should not be designed to favor or disfavor particular forms of compensation or types of companies. Although some arguments can be made for both sides, the weight of evidence appears to favor a switch to stock option expensing.*[44]

Some opponents of virtually every major improvement to accounting that the FASB has promulgated since its origin in 1973 have argued that the proposed accounting standard would have negative economic consequences. Addressing this argument in testimony before Congress last year, former FASB Chairman Edmund L. Jenkins stated:

> Members of Congress . . . must avoid the urge to legislate . . . and must reject the facile arguments and emotional appeals sometimes made by constituents claiming that FASB proposals will destroy Western civilization. Over 60 years of history conclusively demonstrate that accounting standards that result in more transparent financial reporting enhance, rather than hinder, the US economy.[45]

[44] Joint Economic Committee, Republican Senate Staff, Economic Policy Research, "Understanding the Stock Option Debate," Report 107-04 (July 9, 2002), page 18 (emphasis added). See Attachments 4 and 7.
[45] Prepared remarks by Edmund L. Jenkins in testimony before the Subcommittee on Commerce, Trade and Consumer Protection of the Committee on Energy and Commerce (June 26, 2002), page 3.

What Are the FASB's Views on HR 1372?

The FASB has serious concerns about the requirements of HR 1372, particularly the provisions that would prohibit the SEC from recognizing "as generally accepted accounting principles any new accounting standards related to the treatment of stock options" for a period of more than three years following the enactment of the legislation.[46] The Board strongly opposes such a moratorium on improvements to the financial accounting and reporting for stock-based compensation for a several reasons, including the following.

First, the moratorium would unduly interfere with the Board's independent, objective, and open process to make unbiased decisions on the substance and timing of improvements to the accounting for stock-based compensation. As indicated above, such intervention would be in direct conflict with the expressed needs and demands of many investors and other users of financial reports. Such intervention would also appear to be inconsistent with the language and intent of the Act and the related Policy Statement, both of which were intended to enhance the independence of the FASB.

Second, the moratorium would have an adverse impact on the FASB's efforts to achieve timely convergence of high-quality international accounting standards on stock-based compensation. The FASB is actively working with the IASB and other national standard setters in an effort to achieve convergence in this important area. The moratorium would likely hamper those efforts, and again appears to be inconsistent with the language and

[46] Section 4(b).

intent of the Act and the related Policy Statement, both of which indicate support for the FASB's convergence efforts.

As indicated above, the IASB plans to complete its project on stock-based compensation by year-end. Other national accounting standard setters are pursuing similar improvements within similar time frames. To facilitate convergence in this area, the FASB must have maximum flexibility and control over the timing of its project on stock-based compensation so that common issues might be addressed concurrently.

Finally, and perhaps most importantly, the moratorium would likely establish a potentially dangerous precedent in that it would send a clear and unmistakable signal that Congress is willing to intervene in the independent, objective, and open accounting standard setting process based on factors other than the pursuit of sound and fair financial reporting. That signal would likely prompt others to seek political intervention in future technical activities of the FASB.

We all have witnessed the devastating effects and loss of investor confidence in financial reporting that have resulted, at least in part, from companies intentionally violating or manipulating accounting requirements. What impact then on the system, and on investors' trust in financial reports, might there be if it were perceived that accounting standard setting was being biased toward objectives other than those consistent with sound and fair financial reporting? For all of the reasons set forth in my testimony, the FASB strongly opposes HR 1372 and any other legislation that would impair the Board's independent, objective, and open standard setting process.

Thank you, Mr. Chairman. I would be happy to respond to any questions.

FACTS about FASB 2002–2003

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 ● www.fasb.org

Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Professional Conduct, as amended May 1973 and May 1979). Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information.

The Securities and Exchange Commission (SEC) has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest.

THE MISSION OF THE FINANCIAL ACCOUNTING STANDARDS BOARD

The mission of the Financial Accounting Standards Board (FASB) is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.

Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, transparent and understandable financial information. Financial information about the operations and financial position of individual entities also is used by the public in making various other kinds of decisions.

To accomplish its mission, the FASB acts to:

- Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency;

- Keep standards current to reflect changes in methods of doing business and changes in the economic environment;

- Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process;

- Promote the international convergence of accounting standards concurrent with improving the quality of financial reporting; and

- Improve the common understanding of the nature and purposes of information contained in financial reports.

The FASB develops broad accounting concepts as well as standards for financial reporting. It also provides guidance on implementation of standards. Concepts are useful in guiding the Board in establishing standards and in providing a frame of reference, or conceptual framework, for resolving accounting issues. The framework will help to establish reasonable bounds for judgment in preparing financial information and to increase understanding of, and confidence in, financial information on the part of users of financial reports. It also will help the public to understand the nature and limitations of information supplied by financial reporting.

The Board's work on both concepts and standards is based on research aimed at gaining new insights and ideas. Research is conducted by the FASB staff and others, including foreign national and international accounting standard-setting bodies. The Board's activities are open to public participation and observation under the "due process" mandated by formal Rules of Procedure. The FASB actively solicits the views of its various constituencies on accounting issues.

The Board follows certain precepts in the conduct of its activities. They are:

? *To be objective in its decision-making* and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.

? *To weigh carefully the views of its constituents* in developing concepts and standards. However, the ultimate determinant of concepts and standards must be the Board's judgment, based on research, public input and careful deliberation about the usefulness of the resulting information.

? *To promulgate standards only when the expected benefits exceed the perceived costs.* While reliable, quantitative cost-benefit calculations are seldom possible, the Board strives to determine that a proposed standard will meet a significant need and that the costs it imposes, compared with possible alternatives, are justified in relation to the overall benefits.

? *To bring about needed changes in ways that minimize disruption to the continuity of reporting practice.* Reasonable effective dates and transition provisions are established when new standards are introduced. The Board considers it desirable that change be evolutionary to the extent that it can be accommodated by the need for relevance, reliability, comparability and consistency.

? *To review the effects of past decisions* and interpret, amend or replace standards in a timely fashion when such action is indicated.

The FASB is committed to following an open, orderly process for standard setting that precludes placing any particular interest above the interests of the many who rely on financial information. The Board believes that this broad public interest is best served by developing neutral standards that result in accounting for similar transactions and circumstances in a like manner and different transactions and circumstances should be accounted for in a different manner.

AN INDEPENDENT STRUCTURE

Financial Accounting Standards Board (FASB)

The FASB is part of a structure that is independent of all other business and professional organizations. Before the present structure was created, financial accounting and reporting standards were established first by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants (1936–1959) and then by the Accounting Principles Board, also a part of the AICPA (1959–1973). Pronouncements of those predecessor bodies remain in force unless amended or superseded by the FASB.

Financial Accounting Standards Advisory Council (FASAC)

The FASAC has responsibility for consulting with the FASB as to technical issues on the Board's agenda, project priorities, matters likely to require the attention of the FASB, selection and organization of task forces and such other matters as may be requested by the FASB or its Chairman. At present, the Council has more than 30 members who are broadly representative of preparers, auditors and users of financial information.

Financial Accounting Foundation (FAF)

The FAF, which was incorporated to operate exclusively for charitable, educational, scientific and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, is responsible for selecting the members of the FASB and its advisory council, ensuring adequate funding of their activities and for exercising general oversight with the exception of the FASB's resolution of technical issues.

In 1984, the Foundation established a Governmental Accounting Standards Board (GASB) to set standards of financial accounting and reporting for state and local governmental units. As with the FASB, the Foundation is responsible for selecting its members, ensuring adequate funding and exercising general oversight.

The Foundation is separate from all other organizations. However, its Board of Trustees is made up of members from constituent organizations having interest in financial reporting. Nominees from constituent organizations are approved by the Trustees. There also are Trustees-at-large who are not nominated by those organizations, but are chosen by the sitting Trustees. The constituent organizations are:

- American Accounting Association
- American Institute of Certified Public Accountants
- Association for Investment Management and Research
- Financial Executives International
- Government Finance Officers Association
- Institute of Management Accountants

- National Association of State Auditors, Comptrollers and Treasurers
- Securities Industry Association

The members of the FAF Board of Trustees are:

AN OPEN DECISION-MAKING PROCESS

Actions of the FASB have an impact on many organizations within the Board's large and diverse constituency. It is essential that the Board's decision-making process be evenhanded. Accordingly, the FASB follows an extensive "due process" that is open to public observation and participation. This process was modeled on the Federal Administrative Procedure Act and, in several respects, is more demanding.

HOW TOPICS ARE ADDED TO THE FASB'S TECHNICAL AGENDA

The FASB receives many requests for action on various financial accounting and reporting topics from all segments of its diverse constituency, including the SEC. The auditing profession is sensitive to emerging trends in practice and, consequently, it is a frequent source of requests. Requests for action include both new topics and suggested review or reconsideration of existing pronouncements.

The FASB is alert to trends in financial reporting through observation of published reports, liaison with interested organizations and discussions with the EITF. In addition, the staff receives many technical inquiries by letter and telephone, which may provide evidence that a particular topic, or aspect of an existing pronouncement, has become a problem. The FASB also is alert to changes in the financial reporting environment that may be brought about by new legislation or regulatory decisions.

The Board turns to many other organizations and groups for advice and information on various matters, including its agenda. Among the groups with which liaison is maintained are the Accounting Standards Executive Committee (AcSEC) and Auditing Standards Board of the (AICPA), the International Accounting Standards Board (IASB), and the appropriate committees of such organizations as the Association for Investment Management and Research (AIMR), Financial Executives International (FEI) and Institute of Management Accountants (IMA). As part of the agenda process, the Board may make available for public comment agenda proposals that concisely describe the scope of potential projects. The Financial Accounting Standards Advisory Council (FASAC) regularly reviews the Board's agenda priorities and consults on all major projects added to the technical agenda.

After receiving input from the constituency, the Board must make its own decisions regarding its technical agenda. To aid in the decision-making process, the Board has developed a list of factors to which it refers in evaluating proposed topics.

Those factors include consideration of:

- *Pervasiveness of the issue*—the extent to which an issue is troublesome to users, preparers, auditors or others; the extent to which there is diversity of practice; and the likely duration of the issue (i.e., whether transitory or likely to persist);

- *Alternative solutions*—the extent to which one or more alternative solutions that will improve financial reporting in terms of relevance, reliability and comparability are likely to be developed;

- *Technical feasibility*—the extent to which a technically sound solution can be developed or whether the project under consideration should await completion of other projects;

- *Practical consequences*—the extent to which an improved accounting solution is likely to be acceptable generally, and the extent to which addressing a particular subject (or not addressing it) might cause others to act, e.g., the SEC or Congress;

- *Convergence possibilities*—the extent to which there is an opportunity to eliminate significant differences in standards or practices between the U.S. and other countries with a resulting improvement in the quality of U.S. standards; the extent to which it is likely that a common solution can be reached; and the extent to which any significant impediments to convergence can be identified;

- *Cooperative opportunities*—the extent to which there is international support by one or more other standard setters for undertaking the project jointly or through other cooperative means with the FASB; and

- *Resources*—the extent to which there are adequate resources and expertise available from the FASB, the IASB or another standard setter to complete the project; and whether the FASB can leverage off the resources of another standard setter in addressing the issue (and perhaps thereby add the project at a relatively low incremental cost).

It is not possible to evaluate the above factors in precisely the same way and to the same extent in every instance, but identification of factors to be considered helps to bring about consistent decisions regarding the Board's technical agenda.

Board Meetings

The core of the Board's due process is open decision-making meetings and exposure of proposed standards for public comment. Every technical project involves a number of Board meetings. The Board meets as many times as necessary to resolve the issues. A major project generally includes dozens of meetings over several years. All meetings are open to public observers, although observers do not participate in the discussions. The agenda for each meeting is announced in advance.

The staff presents written material, including analysis and recommendations, to the Board members in advance as the basis for discussion in a Board meeting. The meeting format calls for oral presentation of a summary of the written materials by the staff, followed by Board discussion of each issue presented and questioning of the staff on the points raised.

The Exposure Draft

When the Board has reached conclusions on the issues, the staff is directed to prepare a proposed Exposure Draft for consideration by the Board. After further discussion and revisions, Board members vote by written ballot to issue the Exposure Draft. Four votes of the seven-member Board are required to approve a document. Alternative views, if any, are explained in the document.

The Exposure Draft sets forth the proposed standards of financial accounting and reporting, the proposed effective date and method of transition, background information and an explanation of the basis for the Board's conclusions.

At the end of the exposure period, generally 60 days, all comment letters and position papers are analyzed by the staff. This is a search for new information and persuasive arguments regarding the issues; it is not intended to be simply a "nose count" of how many support or oppose a given point of view. In addition to studying this analysis, Board members review the comment letters to help them in reaching conclusions.

Further Deliberation of the Board

After the comments have been analyzed and studied, the Board redeliberates the issues. As in earlier stages of the process, all Board meetings are open to public observation. The Board considers comments received on the Exposure Draft, and often incorporates suggested changes in the final document. If substantial modifications appear to be necessary, the Board may decide to issue a revised Exposure Draft for additional public comment. When the Board is satisfied that all reasonable alternatives have been considered adequately, the staff is directed to prepare a draft of a final document for consideration by the Board. A vote is taken on the final document, again by written ballot. Four votes are required for adoption of a pronouncement.

Statements of Financial Accounting Standards

The final product of most technical projects is a Statement of Financial Accounting Standards (SFAS). Like the Exposure Draft, the Statement sets forth the actual standards, the effective date and method of transition, background information, a brief summary of research done on the project and the basis for the Board's conclusions, including the reasons for rejecting significant alternative solutions. It also identifies members of the Board voting for and against its issuance and includes reasons for any dissents.

Additional Due Process

For major projects, the Board generally goes significantly beyond the core due process described above. Soon after a major project is placed on the Board's technical agenda, a task force or working group usually is appointed, including preparers, auditors and users of financial information who are knowledgeable about the subject matter. Experts from other disciplines also may be appointed. Care is taken to ensure that various points of view on the issues involved are represented.

The task force meets with and advises the Board and staff on the definition and scope of the project, the nature and extent of any additional research that may be needed and the preparation of a discussion document and related material as a basis for public comment. Task force meetings are open to public observers. Task forces and working groups play an important role in the standard-setting process by providing expertise, a diversity of viewpoints and a mechanism for communication with those who may be affected by proposed standards.

Before it begins deliberations on a new major project, the Board often asks the FASB staff to prepare a Discussion Memorandum or other discussion document. The task force provides significant assistance and advice in this effort. The discussion document generally sets forth the definition of the problem, the scope of the project and the financial accounting and reporting issues; discusses research findings and relevant literature; and presents alternative solutions to the issues under consideration and arguments and implications relative to each. The discussion document is published to invite constituents to comment on the project before the Board begins deliberations.

After a discussion document or an Exposure Draft is issued for public comment, the Board may decide to hold a public hearing or a public roundtable meeting. These meetings provide an opportunity for the Board and staff to ask questions about information and viewpoints offered by constituents who participated in the comment process. Any individual or organization may request to be heard at a public hearing, and the FASB attempts to accommodate all such requests. Public observers are welcome.

Statements of Concepts

In addition to Statements of Financial Accounting Standards (SFAS), the FASB also issues Statements of Concepts. Those do not establish new standards or require any change in the application of existing accounting principles; instead, they are intended to provide the Board and constituents with a foundation for setting standards and concepts useful as tools for solving problems. The framework defined in the Statements of Concepts helps the Board identify the right questions to ask in structuring technical projects and contributes to a consistent approach over time. Because of their long-range importance, Statements of Concepts are developed under the same extensive due process the FASB follows in developing Statements of Financial Accounting Standards on major topics.

Other Documents

In addition to broad issues of financial accounting and reporting, the Board considers narrower issues related to implementation of existing standards and other problems arising in practice. Depending on their nature, application and implementation problems may be dealt with by the Board in Statements or Interpretations, by the staff in Technical Bulletins or in Implementation Guidance in question-and-answer form. All of those are subject to discussion at public Board meetings and to exposure for comment, although Technical Bulletins and Implementation Guidance are exposed more narrowly.

Emerging Issues Task Force (EITF)

The EITF was formed in 1984 in response to the recommendations of the FASB's task force on timely financial reporting guidance and an FASB Invitation to Comment on those recommendations. EITF members are drawn primarily from public accounting firms but also include representatives of large companies. The Chief Accountant of the Securities and Exchange Commission attends EITF meetings regularly as an observer with the privilege of the floor. Lawrence W. Smith, FASB Director, Technical Application and Implementation Activities, also serves as Chairman of the EITF.

Composition of the EITF is designed to include persons in a position to be aware of emerging issues before they become widespread and before divergent practices regarding them become entrenched. Therefore, if the group can reach a consensus on an issue, usually that consensus is taken by the FASB as an indication that no Board action is needed. A consensus is defined as an agreement, provided that no more than two of the thirteen voting members object. Consensus positions of the EITF are considered part of GAAP. If consensus is not possible, it may be an indication that action by the FASB is necessary.

The EITF meets six times a year. Meetings are open to the public and, generally, are attended by substantial numbers of observers. Because interest in the EITF is high, the FASB has separate subscription plans for keeping up-to-date on the issues.

Availability of Publications

To encourage public comment, Exposure Drafts and other discussion documents are distributed primarily through the FASB website.

Statements of Standards, Statements of Concepts and Interpretations also are distributed broadly when published through FASB subscription plans and may be purchased separately by placing an order at the FASB website.

The FASB strives to keep the public informed of developments on its projects through a monthly newsletter, *The FASB Report*, and a weekly notice, *Action Alert*, which provides notice of upcoming Board meetings and their agendas with brief summaries of actions taken at previous meetings. *Action Alert* is available by e-mail subscription at the FASB website.

FASB Website

The FASB website includes general information about the Board and its activities, information on upcoming public meetings, announcements of Board actions, summaries and status of all active technical agenda projects, summaries of previously issued FASB Statements and Interpretations, the quarterly plan for FASB projects and information about membership in the Foundation, as well as information on how to order publications online, by phone or mail.

The website can be accessed at www.fasb.org.

The Public Record

Transcripts of public hearings, letters of comment and position papers, research reports and other relevant materials on projects leading to issuance of pronouncements become part of the Board's public record. The public records on all projects are available for inspection in the public reference room at FASB headquarters in Norwalk, Connecticut. Copies of public records also may be purchased at prices that vary according to the volume of material that has to be copied by accessing the FASB website at www.fasb.org or by contacting Records Retention at (203) 847-0700, ext. 270, for more information.

MEMBERS OF THE FASB

The seven members of the FASB serve full time and are required to sever all connections with the firms or institutions they served prior to joining the Board. While collectively they represent diverse backgrounds, they also must possess "knowledge of accounting, finance and business, and a concern for the public interest in matters of financial accounting and reporting."

Board members are appointed for five-year terms and are eligible for reappointment to one additional five-year term.

Robert H. Herz *was appointed FASB Chairman, effective July 1, 2002. He was a Senior Partner with PricewaterhouseCoopers, its North America Theater Leader of Professional, Technical, Risk & Quality and a member of the firm's Global and U.S. Boards. He also served as a part-time member of the IASB. Mr. Herz joined Price Waterhouse upon graduating from the University of Manchester in England with a B.A. degree in economics. He later joined Coopers & Lybrand as its Senior Technical Partner and later held a similar position with PricewaterhouseCoopers. He has authored numerous* *publications and chaired the AICPA SEC Regulations Committee, the Transnational Auditors Committee of the International Federation of Accountants and was a member of the EITF.*

G. Michael Crooch *was a Partner with Arthur Andersen and Director of the firm's International Professional Standards Group before joining the FASB on July 1, 2000. Mr. Crooch was the American Institute of Certified Public Accountants' (AICPA) delegate to the International Accounting Standards Committee (IASC) and served on the IASC's Executive Committee. He also served on the Institute's Accounting Standards Executive Committee, including three years as the Committee Chairman. He earned bachelor's and master's degrees from Oklahoma State University and a Ph.D. from Michigan State University.*

John M. (Neel) Foster *was appointed as a member of the FASB, effective July 1, 1993. Previously, he had been the Vice President and Treasurer of Compaq Computer Corporation. Mr. Foster also worked in public accounting and was employed by Price Waterhouse for eight years, serving clients in the energy, construction and electronics industries. He was a member of the FASB's Advisory Council (FASAC) from January 1992 until his appointment to the FASB. Mr. Foster holds a bachelor's degree with honors from Colorado College where he majored in economics and was Phi Beta Kappa.*

Edward W. Trott *was appointed as a member of the FASB, effective October 1, 1999. Since 1992, he headed the Accounting Group of KPMG's Department of Professional Practice. Before joining the Board, he was a member of the FASB's Emerging Issues Task Force, the Financial Reporting Committee of the Institute of Management Accountants, the FASB's Advisory Council and the Accounting Standards Executive Committee and Auditing Standards Board of the AICPA. He holds a bachelor's degree from the University of North Carolina and an M.B.A. degree from the University of Texas.*

Katherine Schipper *was appointed to the FASB, effective September 2001. Prior to joining the FASB, she was the L. Palmer Fox Professor of Business Administration at Duke University's Fuqua School of Business. She has served the American Accounting Association (AAA) as President and as Director of Research. She was a member of the FASB's Advisory Council (FASAC) from 1996 to 1999. Ms. Schipper holds a B.A. degree from the University of Dayton and M.B.A., M.A. and Ph.D. degrees from the University of Chicago.*

Gary S. Schieneman *was appointed to the FASB, effective July 1, 2001. Prior to joining the FASB, Mr. Schieneman served as Director, Comparative Global Equity Analysis, of Merrill Lynch. He is a member of the American Institute of Certified Public Accountants (AICPA), the New York Society of Security Analysts and the Association for Investment Management and Research (AIMR). He received a bachelor's degree in accounting from the University of Illinois and earned an M.B.A. degree from New York University.*

John K. Wulff *was appointed to the FASB, effective July 1, 2001. Prior to joining the FASB, he was Chief Financial Officer of Union Carbide Corporation where he directed the company's global financial operations, including its internal and external audits, treasury, control, financial analysis and corporate financial reporting. He is a past*

Chairman of the Financial Executive Institute's Committee on Corporate Reporting and is a member of the American Institute of Certified Public Accountants. He is a graduate of the Wharton School of the University of Pennsylvania.

FASB Staff

The Board is assisted by a staff of approximately 40 professionals drawn from public accounting, industry, academe and government, plus support personnel. The staff works directly with the Board and task forces, conducts research, participates in public hearings, analyzes oral and written comments received from the public and prepares recommendations and drafts of documents for consideration by the Board.

FASB Fellows are an integral part of the research and technical activities staff. The Fellowship program provides the Board the benefit of current experience in industry, academe and public accounting and offers the Fellows first-hand experience in the accounting standard-setting process. Fellows take a leave of absence from their firms or universities and serve as project managers or consultants on a variety of projects.

Suzanne Q. Bielstein *is Director, Major Projects and Technical Activities for the FASB. Previously, she served in various capacities at the FASB, including Assistant Director of Technical Research and Project Manager on the business combinations and combinations for not-for-profit organizations. Prior to joining the FASB in early 1999, she spent five years with Caradon plc in two different roles—Vice President of Planning, North America, and Vice President and Corporate Controller of Clarke American Checks, Inc. (a subsidiary of Caradon). Before joining Caradon, Ms. Bielstein was an Audit Partner at KPMG in Boston. Ms. Bielstein earned a B.B.A. degree in accounting from the University of Notre Dame.*

Kimberley Ryan Petrone, *who has been a member of the FASB staff since 1989, was named Director, Planning, Development and Support Activities in April 2002. Previously, Ms. Petrone was a Project Manager on the Board's business combinations project from 1997 through issuance of Statements 141 and 142 in July 2001 and has been involved in a number of other FASB projects. Before joining the FASB, Ms. Petrone was a Corporate Accounting and Financial Reporting Manager with Savin Corporation. Prior to Savin, she was with AMAX Inc. She earned a B.S. degree in accounting from the University of Bridgeport and an M.B.A. degree from the University of Connecticut.*

Lawrence W. Smith *was named Director, Technical Application and Implementation Activities of the FASB in August 2002. Prior to assuming this post, he was a Partner with KPMG for 14 years, headquartered most recently in Stamford, Connecticut. From 1992–1996, Mr. Smith served as a Partner in KPMG's Department of Professional Practice in New York. During his 25-year tenure with KPMG, he served as Engagement Partner and SEC Reviewing Partner on a number of international* Fortune *1000 clients. He is a past member of the Technical Standards Subcommittee of the Professional Ethics Committee of the AICPA. Mr. Smith received an M.S. degree in accounting from Northeastern University.*

ADDITIONAL INFORMATION

General Information

For further information about the FASB, including Board meeting schedules, access the FASB website at www.fasb.org, call or write Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, telephone (203) 847-0700 or via e-mail at director@fasb.org.

To Order Publications

Statements, Interpretations, Exposure Drafts and other documents published by the FASB may be obtained by placing an order on the FASB website at www.fasb.org or by contacting the FASB Order Department at 1-800-748-0659, weekdays 9:00 a.m. to 5:00 p.m. EST.

Public Hearings and Comment Letters

For information about submitting written comments on documents or about public hearings, access the FASB website at www.fasb.org or contact the FASB Project Administration Department at (203) 847-0700, ext. 389.

Public Reference Room and Files

The FASB maintains a public reference room open during office hours, Monday through Friday. The public reference room contains all FASB publications, comment letters on documents and transcripts of public hearings. Copies of this material may be obtained for a specified charge by accessing the FASB website at www.fasb.org or by contacting Records Retention at (203) 847-0700, ext. 270, for an appointment.

* * *

To order additional copies of *FACTS about FASB* without charge, contact Public Relations at (203) 847-0700, ext. 252, or fax a request to (203) 849-9714.

Viewpoints

The Meaning of Neutral Financial Reporting
by James J. Leisenring, Vice Chairman, Financial Accounting Standards Board

"The purpose of accounting standards is to assure that financial information is presented in a way that enables decision makers to make informed judgments. To the extent that accounting standards are subverted to achieve objectives unrelated to a fair and accurate presentation, they fail in their purpose."

> SEC Chairman Richard C. Breeden
> Testimony to Senate Banking Committee
> September 10, 1990

Persons who study the role of financial reporting in a free-market economy will find the words of Chairman Breeden to be obvious. To try and achieve any other purpose when establishing the standards by which companies report financial information would destroy the value of the reported information, contradict the purpose of financial reporting, and potentially undermine the capital markets.

Fortunately our predecessors at the Financial Accounting Standards Board (FASB or Board) understood the role of financial reporting in our capital markets.1 The Board's mission statement indicates: "Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, and understandable financial information."

Fundamental to providing information useful to readers of financial reports is that the information be neutral. Neutral information reports economic activity as faithfully as possible, without coloring the image communicated in order to influence behavior in any particular direction. Neutral information is information free from bias towards a predetermined result.

Neutrality in accounting is an important criterion by which to judge financial reporting standards, for information that is not neutral does lose credibility and value. Presumably, we would all agree there would be little value to purposely altered information about inflation, census data, or unemployment. That information would no longer be useful for decision making. If information can be verified and can be relied on faithfully to represent what it purports to represent—and if there is no bias in the selection of what is reported—it cannot be slanted to favor one set of interests over another. Remember, there are two parties in any marketplace—buyer and seller. If accounting information favors one side, it must disfavor the other. Neutral financial information may in fact favor certain interests, but only because the verifiable information points that way, much as a good examination grade favors a good student who has honestly earned it.

That is not to say that reporting neutral information will not have consequences. Of course neutral information, if relevant and useful, has consequences. To the extent that financial reporting provides information that helps distinguish between efficient and inefficient uses of resources, or helps assess relative returns and risks of alternative investment opportunities, it will discriminate between entities. When that occurs, financial information is playing an important role in both pricing capital provided or even in denying capital to some entities or for some activities. Financial reporting will be properly doing its intended job by providing the information useful in making economic decisions that result in the efficient allocation of capital across entities and activities.

Unfortunately, it is once again fashionable to suggest that the FASB should abandon the notion that decision-useful information must be neutral and should consider the "economic consequences" of its decisions. Some would even assert that the FASB should try to determine in advance who will be relatively helped or hurt by the result of applying a particular accounting standard, and consider "public policy implications" when it establishes accounting standards. In a word, bias the information reported to influence the capital allocation or other economic decisions toward some predetermined objective, thereby undermining the proper functioning of the capital markets and impairing investors' and creditors' capital allocation decisions.

The FASB must resist any inclination to try and manage or otherwise influence the capital allocation process by distorting financial information. The Securities and Exchange Commission and Congress must do the same. One of the primary reasons the United States enjoys the most efficient capital market in the world is that investors and creditors can depend on receiving relevant and reliable financial information. It is essential to our market place that the providers of capital perceive that the information they receive is credible. Protecting the public confidence in financial reporting is the goal of the FASB and the only defensible public-policy objective to be pursued by anyone interested in preserving an effective and efficient capital allocation process in a market economy. The dissemination of biased and thus potentially misleading information is bad for all interests in market-driven economies. Even a perception that the information has been manipulated may have significant adverse consequences for the cost and availability of capital.

---

[1]*The points raised in this* Viewpoints *are for the most part included in FASB Concepts Statement No. 2,* Qualitative Characteristics of Accounting Information, *particularly in paragraphs 98–110.*

James J. Leisenring is Vice Chairman at the FASB. The views expressed in this article are those of Mr. Leisenring. Official positions of the FASB are determined only after extensive due process and deliberations.

Project Updates

Stock-Based Compensation

Last Updated: May 23, 2003

The staff has prepared this summary of Board decisions for information purposes only. Those Board decisions are tentative and do not change current accounting. Official positions of the FASB are determined only after extensive due process and deliberations.

Project Description and Background

In March 2003, the Board added a project to address issues related to share-based payment (SBP). The objective of this project is to cooperate with the IASB to achieve convergence to one single, high-quality global accounting standard on SBP. The Board added this project to its agenda because of user concerns, concerns about comparability and the Board's goal of convergence.

Currently, SBP transactions with employees and nonemployees are accounted for under various standards, including FASB Statement No. 123, *Accounting for Stock-Based Compensation;* APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and its related interpretations; AICPA Statement of Position 93-6, *Employers' Accounting for Employee Stock Ownership Plans;* and EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.* The result of those standards is that similar SBP transactions can be accounted for differently; consequently, there is a lack of comparability among enterprises that use SBP. That lack of comparability has been exacerbated by the recent trend of public enterprises adopting the fair value provisions of Statement 123.

This project will address that lack of comparability by resolving the following main issues: 1) whether compensation paid in the form of equity instruments (and other share-based arrangements) should be recognized in the financial statements and 2) how should compensation in the form of equity instruments (and other share-based arrangements) be measured in the financial statements. The ultimate goal is the establishment of one method for the recognition and measurement of SBP transactions that would be followed by all companies applying U.S. GAAP and international accounting standards.

Recent Developments

At the May 7, 2003 Board meeting, the Board reached the following decisions regarding measurement and attribution issues related to stock-based compensation transactions:

- Compensation cost would be recognized over the service period.

- Stock-based compensation awards would be accounted for using the modified grant-date measurement approach in FASB Statement No. 123, *Accounting for Stock-Based Compensation;* therefore, compensation cost would be adjusted to reflect actual forfeitures and outcomes of performance conditions.

- The method of attribution would be consistent with the approach presented in Statement 123; rather than by the units-of-service attribution method proposed in IASB Exposure Draft 2, *Share-based Payment.*

- For awards with service conditions, an enterprise would base accruals of compensation cost on the best available estimate of the number of equity instruments that are expected to vest and to revise that estimate, if necessary, if subsequent information indicates that actual forfeitures are likely to differ from initial estimates.

At the April 22, 2003 Board meeting, the Board discussed issues related to the recognition and measurement of stock-based compensation, and the Board decided the following with respect to stock-based compensation transactions with employees and nonemployees:

- Goods or services received in exchange for stock-based compensation result in a cost that should be recognized in the income statement as an expense when the goods or services are consumed by the enterprise.

- The measurement attribute for an exchange involving stock-based compensation is fair value.

With respect to stock-based compensation transactions with employees, the Board made the following additional decisions:

- The economic event being measured is the exchange of goods or services received for stock-based compensation.

- The measurement objective for equity-settled awards is to determine the fair value of the goods or services received in the exchange, which should be based on (1) the fair value of the goods or services received or (2) the grant-date fair value of the stock-based compensation given, whichever is more reliably measurable.

At the March 12, 2003 Board meeting the Board reviewed and discussed the comment letters received in response to the Invitation to Comment (See below). The Board also discussed issues relating to whether a project on stock-based compensation should be added to its agenda. At that meeting, the Board decided to add a project on stock-based compensation to the agenda. The Board also decided that the project should be undertaken in cooperation with the IASB in order to achieve maximum convergence to a single, high-quality accounting standard on stock-based compensation.

In November 2002, the FASB issued an **Invitation to Comment**, *Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123,* Accounting for Stock-Based Compensation, *and Its Related Interpretations, and IASB Proposed IFRS,* Share-based Payment, that compares the fair value based method of accounting for SBC in Statement 123 with the fair value based method of accounting for SBC in the proposed IFRS. The Board issued the Invitation to Comment to achieve two objectives: the first objective was to provide information that would be useful to constituents that wished to comment on the IASB's proposed IFRS (the comment letter deadline for the proposed IFRS was March 7, 2003), and the second objective was to solicit views from constituents on the key differences between the proposed IFRS and Statement 123 and on certain other issues associated with accounting for SBC at fair value. The comment letter deadline for the Invitation to Comment was February 1, 2003; as of February 28, 2003, the FASB had received 293 comment letters responding to the Invitation to Comment. Those comment letters were reviewed and discussed at the March 12, 2003 Board meeting.

Additional Information for Interested Constituents

The FASB has received requests from constituents for information on 1) arguments for and against recognizing SBC as an expense in the income statement, 2) historical background on the deliberations and issuance of Statement 123, and 3) other issues related to SBC. That information is contained in Statement 123's basis for conclusions. The proposed IFRS's basis for conclusions also addresses arguments for and against recognizing SBC as an expense in the income statement. Both bases for conclusions are contained in appendixes to the **Invitation to Comment**. Those appendixes can be downloaded from this website at no cost.

- **Comment Letters—Stock Compensation—Unsolicited Letters**

- **Comment Letters—Invitation to Comment—Stock-Based Compensation**

Excerpts from Recent Letters, Reports, and Other Materials about the FASB and the Accounting for Stock-Based Compensation

FAPC believes that the *only* appropriate method of accounting for stock-based compensation is the recognition of the fair value of such compensation as an expense in the income statement. The ED indicates that the FASB intends to reconsider the provisions of FASB Statement No. 123 once the IASB has issued its proposals on stock-based compensation. We strongly urge the Board to do so. When all companies are required to expense the fair value of compensation awarded, regardless of the form, their reported earnings will better reflect the economic reality of operations, and investors will have a more consistent and comparable basis for making informed investment decisions. The needs of investors for timely, relevant, and transparent information should supersede other considerations.

Jane Adams, Chair, Financial Accounting Policy Committee, Rebecca McEnally, Ph.D., CFA, Vice-President, Advocacy, Association for Investment Management and Research (a non-for-profit professional organization of 61,000 financial analysts, portfolio managers, and other investment professionals), 10/31/02

Stock options have become a disgrace insofar as accurate reporting of expenses is concerned for corporation[s].

I <u>strongly recommend</u> that there be a requirement for stock options to be expensed.

Benham M. Black, Partner, Black, Noland & Read, PLC, and Director, Virginia Financial Group, Inc. (an independent bank holding company with total assets of $1.04 billion), 1/31/03

I read the NASDAQ comment letter and, as a fiduciary, I continue to be infuriated with the tech industry (using NASDAQ letter as a proxy for their opinion) and their blatantly self-serving position on stock options. Options have contributed mightily to the current crisis of confidence that we have in the stock market, and I view the expensing of options as a long-overdue and necessary step towards restoring both confidence and rationality in the market. . . . The tech industry has been masterful at marshalling their shareholders own capital against them, given their vociferous lobbying against the proper accounting treatment of options, but the time has come to treat options for what they are-compensation-and force them to be treated on par with all other forms of compensation.

Kenneth F. Broad, CFA, Portfolio Manager, Transamerica Investment Management, LLC (a registered investment adviser managing $12.5 billion in equity and fixed income assets for mutual funds, funds for funds, separately managed accounts, retirement plans and various for-profit and nonprofit entities), 1/31/03

The Chicago Tribune ran a four-part series on Arthur Andersen last September that did a great job of illuminating how accounting standards and audit quality have eroded in recent years. A few decades ago, an Arthur Andersen audit opinion was the gold standard of the profession. Within the firm, an elite Professional Standards Group (PSG) insisted on honest reporting, no matter what pressures were applied by the client. Sticking to these principles, the PSG took a stand in 1992 that the cost of stock options should be recorded as the expense it clearly was. The PSG's position was reversed, however, by the "rainmaking" partners of Andersen who knew what their clients wanted – higher reported earnings no matter what the reality. Many CEOs also fought expensing because they knew that the obscene megagrants of options they craved would be slashed if the true costs of these had to be recorded.

Soon after the Andersen reversal, the independent accounting standards board (FASB) voted 7-0 for expensing options. Predictably, the major auditing firms and an army of CEOs stormed Washington to pressure the Senate – what better institution to decide accounting questions? – into castrating the FASB. The voices of the protestors were amplified by their large political contributions, usually made with corporate money belonging to the very owners about to be bamboozled. It was not a sight for a civics class.

To its shame, the Senate voted 88-9 against expensing. Several prominent Senators even called for the demise of the FASB if it didn't abandon its position. (So much for independence.) Arthur Levitt, Jr., then Chairman of the SEC – and generally a vigilant champion of shareholders – has since described his reluctant bowing to Congressional and corporate pressures as the act of his chairmanship that he most regrets. (The details of this sordid affair are related in Levitt's excellent book, *Take on the Street*.)

With the Senate in its pocket and the SEC outgunned, corporate America knew that it was now boss when it came to accounting. With that, a new era of anything-goes earnings reports – blessed and, in some cases, encouraged by big-name auditors – was launched. The licentious behavior that followed quickly became an air pump for The Great Bubble.

After being threatened by the Senate, FASB backed off its original position and adopted an "honor system" approach, declaring expensing to be preferable but also allowing companies to ignore the cost if they wished. The disheartening result: Of the 500 companies in the S&P, 498 adopted the method deemed less desirable, which of course let them report higher "earnings." Compensation-hungry CEOs loved this outcome: Let FASB have the honor; *they* had the system.

Warren E. Buffett, Chairman of the Board, Berkshire Hathaway Inc., 2/21/03

In analyzing the situation recently, the Conference Board identified one of the current barriers to proper management of these issues – the absence of accounting neutrality regarding treatment of different forms of equity compensation. Until the properly authorized expert independent organization, FASB, acts to correct this problem, many companies will hide behind differing earnings treatments and disdain performance-based options even while recognizing that they are the better approach to executive compensation. Congress should be careful not to politicize this issue and should permit

FASB to take on this issue on its intrinsic merits. The recent support of the FASB by SEC Chairman Donaldson is encouraging as to the view at the SEC.

Peter C. Clapman, Senior Vice President, Chief Counsel-Corporate Governance, Teachers Insurance and Annuity Association College Retirement Equities Fund (a financial services company with approximately $262 billion in assets under management, serving nearly 3 million education and research employees at 15,000 institutions), 5/20/03

I strongly recommend that employee stock options be mandated as an expense on corporate financial statements. As long as these options can be passed out like funny money, thereby encouraging those on the receiving end to manipulate the financial records to their advantage – people like me will stay away from the market.

John S. Clauss, Jr., Glendale, California, 2/10/03

To eliminate accounting bias in favor of one form of equity-based compensation, fixed price stock options should be expensed on financial statements of public companies. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), as organizations with technical expertise in this area, should move expeditiously in order to determine the appropriate accounting treatment for equity-based compensation including a uniform and broadly accepted method of valuing options.

The Conference Board Commission on Public Trust and Private Enterprise (Co-chaired by Peter G. Peterson, Chairman of the Blackstone Group, former Secretary of Commerce and Chairman of the Federal Reserve Bank of New York, and John W. Snow, Chairman, CSX Corporation and former Chairman, Business Roundtable; Commissioner Andrew S. Grove, Chairman of Intel Corporation, wrote a dissenting opinion) (footnote omitted), 9/17/02

In response to the Financial Accounting Standards Board's (FASB) Invitation to Comment on the proper accounting for employee stock options, we wish to strongly voice our support for an honest accounting standard that would require all employee stock option compensation to be shown as an expense on corporate financial statements.

. . . .

Some opponents of stock option expensing argue that, due to the difficulty of precisely estimating stock option values, expensing will confuse rather than educate financial analysts and investors about a company's financial condition. But many accounting standards require estimated valuations and, as Warren Buffett has pointed out, the only value that everyone agrees is incorrect for a stock option is zero. The better approach to curtail stock option abuses and restore investor confidence in the financial statements is to require all companies to use the same stock option valuation methodology to ensure stock options are expensed and the comparability of financial statements is strengthened.

Some critics also contend that expensing stock options would eliminate broad based stock option plans and hurt average workers, but this contention is contradicted by the factual record. First, successful U.S. companies that offer broad-based stock option plans to their workforce have already determined that they can expense employee stock option plans without having to end this form of compensation. Two recent examples are Home Depot and Wal-mart, which offer broad-based plans to many average employees and have announced they will begin expensing options this year. Secondly, only a small percentage of U.S. companies now issue stock options broadly to average workers, even when those workers are eligible to receive them. A recent nationwide survey conducted by the U.S. Bureau of Labor Statistics found that in 2000 – a banner year for stock options – only 1.7 percent of non-executive workers actually received any stock options. This survey, the most extensive review of actual worker receipt of stock options in corporate America demonstrates that most workers do not now receive stock options and would be wholly unaffected by any changes in stock option plans, even assuming any change were actually to take place. In short, neither broad based stock option plans nor average workers would be hurt by honest accounting.

. . . .

Requiring companies to expense employee stock options would strengthen the accuracy of financial statements and help restore public trust in our financial reporting system, our companies, and our markets. We urge FASB to issue a proposed stock option accounting standard as soon as possible and to promulgate a final standard by the end of 2003.

Letter signed by 30 Members of the United States Congress (9 Senators and 21 Representatives), 2/3/03

It was my dubious pleasure to review the footnote expensing of stock options proposal by TechNet and AeA. My duties include analyzing and recommending technology investments for our convertible bond portfolio. Other than their usual specious claims that stock options do not represent an expense, all employees at all levels participate, and the usual bashing of Black-Scholes as a meaningless – misleading – inaccurate – “bad number,” it was impressive and magnanimous of them to voluntarily agree to present the same repackaged information on a quarterly basis. Also, I’m always impressed by their wide use of adjectives to lambaste the Black-Scholes Model. Essentially, their proposal consolidates data already available in the 10K and Proxy, making it timely. As usual, their argument lacks veracity and intellectual integrity. I didn’t notice them disclosing anything new or not previously available. The following are my thoughts and critique.

1. The expensing of stock options should be mandatory and expensed using the Black-Scholes options pricing model, like any other form of compensation. Also, the above-water and under-water options should be included in the expense – all options – regardless of the relationship between exercise and market price. The expense should be

a deduction to operating income in the income statement, anything less is not accounting reform and will not accurately represent a firm's profitability.

. . . .

Even though, the board of my organization, the California Public Employees' Retirement System (CalPERS) addressed the expensing of stock options and concluded it had no merit, I disagree with their decision. My employer's decision was very annoying, since I analyze the most egregious abusers of employee stock option – technology companies.

The enclosed report describes how TechNet persuaded our board not to support expensing of stock options. There is no excuse for supporting the siphoning off of investors' wealth to senior Silicon Valley executives. You have to question political appointees as pension fund board members, especially those taking campaign contributions, it creates untold conflicts-of-interest. If ever there was a breach of fiduciary duty of care and loyalty, this decision was it.

Andrew H. Dral, Sacramento, Calfornia , 1/8/03

CPF . . . supports the view that stock options are compensation, have a cost, and that those costs should be included on reported income statements.

Michael R. Fanning, Chief Executive Officer, Central Pension Fund of the International Union of Operating Engineers and Participating Employers (on behalf of more than 150,000 participants of the CPF), 1/23/03

After reading and hearing about "sky-is-falling" predictions from opponents of mandatory stock option expensing, I feel compelled to make my own views heard. First, I believe that several of their conclusions are based on faulty assumptions. Besides the rubric that start-up companies won't be able to attract talented employees, it's been mooted that if companies are forced to expense stock option grants, then employees won't be able to share in the nation's productive assets (which then will drive employees to protest, riot, etc.). Besides the fact that I find that contention absolute nonsense, I believe opponents of stock option expensing are missing the point. It's imperative that investors have trust and confidence in financial statement reporting. In my opinion, improving financial statement transparency is crucial in maintaining investor confidence. Mandatory expensing of stock options directly speaks to transparency. Thus, if stock options grants are just another form of employee compensation, then companies should report stock option grants as an expense. In my opinion, any other form of treatment is dishonest and self-serving.

. . . .

In short, I believe that the "the sky-is-falling" predictions by stock option expensing opponents such as NASD and Silicon Valley, are shrill, inaccurate, and again, very self-serving.

Robert E. Friedman, CPA, Aerospace & Defense Analyst, Accounting Analyst, Standard & Poor's Equity Group, 1/31/03

We encourage you to . . . require employee stock options to be counted as an expense. If you don't take this action who do you think will make these greed-monger's start accounting for their massive profits? Do the RIGHT THING, Damn it!

David and Nancy Gabrielsen, Beavercreek, Oregon, 2/11/03

To assume that option grants are not an expense is to assume that the real resources that contributed to the creation of the value of the output were free. Surely the existing shareholders who granted the options to employees do not consider the potential dilution of their share in the market capitalization of their corporation as having no cost to them.

. . . .

Some have argued against option expensing on the grounds that the Black-Scholes formula, the prevailing means of estimating option expense, is approximate. It is. But, as I indicated earlier, so is a good deal of all other earnings estimation. Moreover, every corporation already implicitly reports an estimate of option expense on its income statement. That number for most companies, of course, is exactly zero. Are options grants truly without value?

. . . .

It is no more valid, in my judgment, to assume that option grant expense is zero than to arbitrarily assume depreciation charges are zero. Both assumptions, excluding interest, increase reported pretax earnings. Both imply that the inputs that produce valued corporate outputs are free.

. . . .

I want to emphasize that expensing in no way inhibits the legal authority to issue options. Yes, if investors take currently reported earnings as real, expensing will reduce a corporation's perceived earnings and conceivably its stock price. Employees, accordingly, will consider options less valuable and presumably fewer will be issued. But confusing markets is neither helpful nor permanent. If underlying corporate input costs are real, they cannot be obscured indefinitely.

. . . .

With an accounting system that is, or should be, measuring the success or failure of individual corporate strategies, the evolution of accounting rules is essential as the nature of our economy changes. As the measurement needs change, rules must change with them. This does not lend itself to hard-wired legislation, which makes flexibility of rule-making difficult. We would be best served, in my judgment, by leaving issues such as option grant expense to regulatory bodies and the private sector.

. . . .

Clearly then, the greater risk is to leave the current accounting treatment in place. If markets have seen through the accounting, required expensing of option grants will have no effect on the nation's capital allocation. If, however, expensing does affect market values, a continuation of the current accounting practice could be costly to capital efficiency.

Federal Reserve Chairman Alan Greenspan (footnote omitted), 5/3/02

Investors support the core conclusions by the IASB and the FASB that stock based compensation should be recognized as an expense and that the amount of compensation expense should be based on the fair value of stock-based awards at grant date.

James E. Heard, Chief Executive Officer, Institutional Shareholder Services (serving more than 950 institutional investors and corporate clients worldwide), 1/31/03

I am writing to express my support for the U.S. Financial Accounting Standards Board's ("FASB") recommendation that employee and non-employee stock options be treated as measurable expenses of a corporation. I applaud the Board for making this recommendation notwithstanding the broad and intense opposition to the notion of expensing stock options, and strongly urge the Board to insist that common sense prevail by requiring a standard that will place an assessable value on this popular equity instrument.

As the State Comptroller of New York (an investor, shareholder, and sole trustee of the nation's second largest pension fund at approximately $100 billion in assets), I would like to emphasize the importance of reporting and disclosure of stock options as expenses. Although higher expenses translate into lower returns, corporations must be obligated to show their shareholders an accurate depiction of performance and financial health, and not to withhold disclosure of expenses associated with numerous and lofty stock option plans in order to keep shareholder and other financial reports superficially pleasing. The disclosure of stock options as an expense is important information for investors and shareholders to have in order to make informed decisions, especially in light of the recent scandalous stock market manipulations that have caused pension funds around the nation substantial losses.

Alan G. Hevesi, Comptroller, Office of the State Comptroller of New York (an investor, shareholder, and sole trustee of the nation's second largest pension fund at approximately $100 billion in assets), 1/31/03

Moody's Investor Services supports the International Accounting Standards Board's view of expensing share based payment transactions as set forth in the IASB's proposed IFRS, *Share-Based Payment.* In fact, Moody's issued a special comment in December 2002 . . . discussing the analytical implications of employee stock-based compensation and concluded that we believe that stock-based compensation should be expensed.

Gregory J. Jonas, Managing Director, Moody's Investors Service, 3/3/03

Basic principles of financial accounting imply that stock option awards should be treated as a cost in corporate financial statements; this cost should be recognized at the time of grant, not exercise. Although debate continues about the best method for valuing stock options, existing techniques appear sufficiently accurate for accounting purposes.

. . . .

Commentators different greatly on the practical impacts of stock option expensing. Opponents believe it would discourage firms from granting options, reduce investor willingness to invest in option granting companies, and confuse investors. Proponents, however, believe it would improve the quality of reported earnings, improve the investment decisions of investors who rely on reported earnings, and increase public confidence in financial reporting. In evaluating these competing claims, policy should focus on one goal: informing investors so they allocate their capital as effectively as possible. Accounting policies should not be designed to favor or disfavor particular forms of compensation or types of companies. Although some arguments can be made for both sides, the weight of evidence appears to favor a switch to stock option expensing.

Donald B. Marron, Principal Economist to the Senate Minority, Joint Economic Committee, 7/9/02

We fundamentally support this initiative, particularly given the global nature of the marketplace in which the financial services industry operates.

. . . .

We believe that, rather than revisit all of the accounting issues associated with share-based awards, a simple solution to this issue would be to eliminate the voluntary adoption provision in SFAS 123 and mandate expense recognition for share-based payments in the income statement. We believe that this presents a much more practical solution, given the host of other significant accounting issues on the IASB's agenda and the limited resources available.

Esther Mills, First Vice President, Accounting Policy, Merrill Lynch & Co., Inc., 3/7/03

Companies are not required to expense options, which means they can give out as many as they want.

. . . .

I urge the FASB to require employee stock options to be counted as an expense . . . .

Rob Rocco, Avon Lake, Ohio, 2/12/03

As I normally have neither the time nor the inclination to engage in letter writing to standard-setting bodies, this letter is a tangible measure of the extent of my astonishment, outrage, and incredulity. Frankly, it is difficult for me to believe that the idea of <u>not</u> expensing options is still subject to any debate. I am left sputtering like a madman. I am dumbfounded. I am stunned. It is incredible. It is an *opera bouffe*.

. . . .

Now comes the likes of John Doerr, Wick Simmons, Al Berkeley, and T.J. Rogers *et al* to obfuscate the issue with magical thinking. They raise fuzzy issue after fuzzy issue. When rendered in the trypot of reason, all of the arguments against expensing ultimately boil down to a simple inconsistency:

> "Don't account for the expense of options because, if you do, the enormous cost will be seen (i.e., accounted for)."

I fervently hope the Board will decide in favor of honest and truthful accounting in this matter. Please make the recognition of all stock option expense mandatory on the income statement as of the date of grant.

"Bucky" Rulon-Miller, CFA, 2/3/03 (emphasis omitted)

I have just read a letter to you from the Chairman of Nasdaq recommending you take no action on requiring public corporations to expense stock options when granted.

I serve as the Audit Committee Chairman in a Nasdaq listed company; but I am writing to say that I disagree with the stand taken by Nasdaq's Chairman.

I believe it is time for rulemaking to put the cost of options on the corporate books to reflect their value when granted.

. . . .

The Chairman is Nasdaq is selling smoke. He is grossly underestimating the level of disappointment and even anger that exists outside New York City among us corporate shareholders.

Richard J. Schulte, Brecksville, Ohio, 1/31/03

. . . Stock options need to be expensed so they can be managed and so they can be on a level playing field with other types of executive compensation that are better suited to aligning executive interests with the long-term interests of their companies. There is no good reason not to expense options. But there are a number of bad reasons. These bad reasons include the spurious assertion that options cannot be valued, that options turn up in earnings per share calculations, and that options vary in value after they are granted.

Options can be valued using Black-Scholes and a variety of other pricing methods related to Black-Scholes. Though these values are estimates, so are the values used for numerous other line items on corporate financial statements, including depreciation, amortization, and inventory-related adjustments. Options do vary in value after they are granted—but so do a variety of payments and agreements made by companies—for example payments made in foreign currencies or long-term commodity contracts. No one would suggest they should be left off the companies' financial statements. Finally, the inclusion of options in the creation of the fully diluted earnings per share figure does not treat options as a cost, which in fact they clearly are.

Frankly, the only reason why option expensing is an issue at all is because FASB's efforts to require expensing have been thwarted in the past by political pressure. Similar pressures are now being brought to bear as FASB tries once again to do its job. The AFL-CIO strongly supports Bob Herz's efforts to restore credibility to GAAP in this area, and commends the Chairman and Senator Levin for their leadership in supporting FASB's independence. In our opinion, more is at stake here than just option accounting or executive compensation. Our markets will be damaged if after the events of the last two years it appears that our accounting standards are still being held hostage to the very political dynamics that prevented effective regulation in the 1990's….

Damon A. Silvers, Associate General Counsel, American Federation of Labor and Congress of Industrial Organizations (representing 13 million of America's workers in 65 member unions), 5/20/03

The Institute urges the Board to move forward with a reconsideration of Statement No. 123 as soon as practicable. We continue to believe that accounting standards should (1) require the issuers to treat the fair value of stock options granted to employees to be recognized as expense in the income statement and (2) ensure uniformity in how stock options are valued for this purpose.

Gregory M. Smith, Director – Operations/Compliance & Fund Accounting, Investment Company Institute (a national association including 8,938 mutual funds, 535 closed-end investment companies and 6 sponsors of unit investment trusts; its mutual funds members have assets of about $6.539 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders), 1/31/03

When FASB made its proposal for what would have clearly been an improvement in accounting practices, Silicon Valley and Wall Street were united in their opposition. The arguments put forward then are the same as those put forward today, and they are as specious and self-serving now as they were eight years ago.

. . . .

Which brings us back to the argument that it is "impossible" to value options. Companies do, of course, have ways of calculating the value of options and do it themselves all the time for their own internal planning purposes.

As for the question of whether an estimate based on a publicly-disclosed formula would be misleading, because it is only an estimate, that is true of many line items that are central to our accounting frameworks, such as depreciation. Calculations about the value of options would be just as, or even more, accurate than standard depreciation estimates are of the market value of the declines in asset values that come with use and obsolescence – something which is a line item on every accounting framework in corporate America and most of the world. Of this much we can be sure: zero, the implied valuation used by companies now when describing the cost of options in their balance sheets and income statements, is a vast underestimate.

Those who argue against including options within the standard accounting frameworks try to have it both ways: They believe that market participants are smart enough to read through dozens of footnotes to figure out the implications of options for the value of their shares, but so dumb that they would be misled by the more accurate numbers that would be provided under the reform proposals, and unable to redo the calculations themselves.

. . . .

Many of the same forces that allied themselves in the 1990s against changes in accounting for options are now trying to suppress this attempt to make our market economy work better. In the earlier episode, the National Economic Council, the U.S. Treasury, and the Department of Commerce intervened in what was supposed to be an independent accounting board, and put pressure on the FASB to rescind its proposed regulations. They won, and the country lost. Today, there is a risk again of political intervention. At least this time, the voices of responsible economic leadership, such as Alan Greenspan, are speaking out. I only hope that this time they will succeed.

Joseph E. Stiglitz, Professor of Economics at Columbia (Awarded 2001 Nobel Prize for Economics), 5/3/02

<u>The Council supports the principles outlined in the IASB's exposure draft, and we urge the Financial Accounting Standards Board to propose and approve similar rules</u>. The IASB proposal is in line with the Council policy on the issue, which states that since stock options granted to employees, directors and non-employees are compensation and have a cost, companies should include these costs as an expense on their reported income statements and disclose their valuation assumptions.

Sarah A. B. Teslik, Executive Director, Council of Institutional Investors (an association of more than 130 corporate, public and union pension funds with more than $3 trillion in pension assets), 1/21/03

Recent Articles about the FASB and the Accounting for Stock-Based Compensation

1. Louis Lavelle, "Shareholders Unite to Expense Options," *BusinessWeek Online*, May 27, 2003

2. Julie Kosterlitz, "Fiddling with the FASB," *National Journal*, May 24, 2003

3. "No Accounting for Politics," *Washington Post*, May 21, 2003

4. Kevin Drawburg, "Senators Clash on Stock Options, Probe CEO Pay," *Reuters*, May 20, 2003

5. Mark Schwanhausser, "Technology Firms Finding Little Support in Bid to Slow Stock Options Expensing," *San Jose Mercury News*, May 14, 2003

6. Ed Leefeldt, "Donaldson Supports Expensing Options: Backs Greenspan and Accounting Standards Group," *National Post*, May 10, 2003

7. Paul R. La Monica, "Optional Expensing of Options?" *CNN/Money*, May 8, 2003

8. Alan Murray, "Corporate Reforms Tamed Only Part of the 3-Headed Beast," *Wall Street Journal*, May 6, 2003

9. Jack T. Ciesielski, "Another Options War: The Political Defense of Stock Options Threatens Accounting Standards," *Barron's*, May 5, 2003

10. David Greising, "Valuing Options As an Expense Adds a Key Vote," *Chicago Tribune*, May 4, 2003

11. Lindling Wei, "FASB Chmn: Rule-Maker Aims at 'Producing Good Accounting,'" *Dow Jones News Service*, April 10, 2003

12. Andrew Bary, "Off With the Blinders: Tech Investors May Start Paying Attention Once Big Stock-Options Expenses Are Counted," *Barron's*, March 31, 2003

13. Zvi Bodie, Robert S. Kaplan, and Robert C. Merton, "Footnote Reporting Distorts Impact of Options," *Boston Globe*, March 16, 2003

14. Deepa Babington, "Investors Hit FASB with Options Queries," *Reuters*, March 16, 2003

15. “Now for Plan B. The Battle to Fend Off Sensible Accounting,” *Economist*, March 15, 2003

16. Jackie Spinner, “New Option Rule Has Key Backers As Panel Meets,” *Washington Post*, March 12, 2003

17. Zvi Bodie, Robert S. Kaplan, and Robert C. Merton, “For the Last Time: Stock Options Are an Expense,” *Harvard Business Review*, March 2003

18. Warren E. Buffett, “Who Really Cooks the Books?” *New York Times*, July 24, 2002

BEAR STEARNS

Accounting and Taxation Research
Pat McConnell, CPA (212) 272-4193
Janet Pegg, CPA (212) 272-4191
Chris Senyek, CPA (212) 272-2509
Dane Mott (212) 272-4080

May 23, 2003

Companies that currently expense or intend to expense stock options using the fair value method:

Of the 281 companies that have adopted or will adopt fair value expensing of stock options, 94 (33%) are S&P 500 companies.

The 94 companies from the S&P 500 represent 19% of the index based on number of companies and 36% of the index based on market capitalization.

($ and shares in millions, except per share data)

Ticker	Company	2002 Fiscal Yearend	Adoption Year	Announcement Date of Adoption	Current Market Cap	S&P 500	Industry
ABER	Aber Diamond Corp.	01/2003	2003	12/3/2002	$ 1,057.2	No	Metals & Mining
AKR	Acadia Rlty Trust	12/2002	2002	3/28/03	255.4	No	Real Estate
AES	AES Corp.	12/2002	2003	3/26/03	3,930.6	Yes	Multi-Utilities & Unregulated Power
	Aimco Properties LP	12/2002	2003	3/25/03	NA	No	Real Estate
AC	Alliance Capital Management Holdings LP	12/2002	2003	5/14/2003	2,438.6	No	Diversified Financials
ALL	Allstate Corp.	12/2002	2003	8/12/02	24,919.5	Yes	Insurance
NYNY	Alpha Hospitality Corp.	12/2002	2003	5/15/2003	48.0	No	Casinos & Gaming
AMZN	Amazon (f)	12/2002	2003	7/23/02	12,437.1	No	Internet & Catalog Retail
AMB	AMB Property Corp	12/2002	2002	7/8/02	2,257.1	No	Real Estate
AEE	Ameren Corp.	12/2002	2003	5/14/2003	6,934.0	Yes	Electric Utilities
AXP	American Express	12/2002	2003	8/12/02	51,995.1	Yes	Diversified Financials
AIG	American International Group	12/2002	2003	8/11/02	144,583.6	Yes	Insurance
ANL	American Land Lease Inc.	12/2002	2003	3/26/03	118.5	No	Real Estate
APC	Anadarko Petroleum Corp.	12/2002	2003	3/14/03	12,266.4	Yes	Oil & Gas
AIV	Apartment Investment & Mangt Co.	12/2002	2003	3/7/03	3,316.9	Yes	Real Estate
ARTL	Aristotle Corporation	06/2003	2002	11/7/02	55.4	No	Health Care Equipment & Supplies
T	AT&T	12/2002	2003	10/22/02	14,475.0	Yes	Diversified Telecommunication Services
BDG	Bandag Inc.	12/2002	2002	11/14/02	685.3	No	Auto Components
BAC	Bank of America Corp	12/2002	2003	8/12/02	109,431.8	Yes	Banks
BK	Bank of New York Co. Inc.	12/2002	TBA	8/13/02	19,703.2	Yes	Banks
BNS	Bank of Nova Scotia	10/2002	2003	12/4/02	21,873.8	No	Banks
ONE	Bank One	12/2002	2002	7/16/02	42,301.6	Yes	Banks
MWH	BayCorp Holdings Corp.	12/2002	2003	8/14/02	9.5	No	Multi-Utilities & Unregulated Power
BCE	BCE INC	12/2002	2003	12/18/02	19,141.3	No	Diversified Telecommunication Services
BSC	Bear Stearns Cos Inc.	11/2002	2003	2/28/03	6,930.5	Yes	Diversified Financials
BED	Bedford Property Investors Inc.	12/2002	2003	3/11/03	460.3	No	Real Estate
BLS	BellSouth Corp.	12/2002	2003	2/28/03	48,756.6	Yes	Diversified Telecommunication Services
BRTL	Bert Logic Inc.	12/2002	2003	4/23/03	NA	No	Communications Equipment
BETA	Beta Oil & Gas Inc.	12/2002	2003	3/31/03	16.2	No	Oil & Gas
BCRAE	Biocoral Inc.	12/2002	2003	3/13/03	593.1	No	Health Care Equipment & Supplies
BA	Boeing Co	12/2002	1998	1998	23,044.0	Yes	Aerospace & Defense
BSHI	Boss Holdings Inc.	12/2002	2003	3/28/03	7.4	No	Textiles Apparel & Luxury Goods
BRE	BRE Properties, Inc.	12/2002	2003	10/14/02	1,514.4	No	Real Estate
CPN	Calpine Corp.	12/2002	2003	8/27/02	1,825.8	Yes	Multi-Utilities & Unregulated Power
CAC	Camden National Corporation	12/2002	TBA	8/27/02	186.0	No	Banks
CLU	Canada Life Financial Corporation (e)	12/2002	2003	12/9/02	5,330.1	No	Insurance
CATY	Cathay Bancorp, Inc.	12/2002	2003	4/15/2003	713.7	No	Banks
CBL	CBL & Associates Properties, Inc.	12/2002	2003	10/29/2002	1,335.4	No	Real Estate
	CBRE Holding Inc.	N/A	2002	4/30/2003	N/A	No	Real Estate
CZ	Celanese AG	12/2002	2002	10/22/02	1,080.4	No	Chemicals
CD	Cendant Corporation	12/2002	2003	8/28/02	15,532.4	Yes	Commercial Services & Supplies
CTX	Centex Corporation	03/2003	2004	9/12/02	4,325.0	Yes	Household Durables
CHG	CH Energy Group Inc.	12/2002	2003	2/19/03	676.8	No	Electric Utilities
CHTR	Charter Communications	12/2002	2002	8/6/02	630.4	No	Media
CME	Chicago Mercantile Exchange Holdings Inc.	12/2002	2003	1/10/03	1,928.9	No	Diversified Financials
CHH	Choice Hotels International, Inc.	12/2002	2003	9/25/2002	825.1	No	Hotels Restaurants & Leisure
CWON	Choice One Communications	12/2002	2003	11/21/02	13.9	No	Diversified Telecommunication Services
CB	Chubb Corp.	12/2002	2003	8/14/02	10,104.6	Yes	Insurance
CSB	Ciba Specialty Chemicals Holdings Inc.	12/2002	2003	2/4/03	4,288.1	No	Chemicals
CIN	Cinergy	12/2002	2003	7/24/02	6,290.0	Yes	Electric Utilities
C	Citigroup	12/2002	2003	8/7/02	200,052.8	Yes	Diversified Financials
CMS	CMS Energy Corp.	12/2002	2003	5/14/2003	986.9	Yes	Electric Utilities
KO	Coca-Cola Co.	12/2002	2002	7/14/02	108,728.3	Yes	Beverages
COHT	Cohesant Technologies Inc.	11/2002	2003	3/31/03	9.2	No	Machinery
CLP	Colonial Properties Trust	12/2002	2003	3/28/03	814.2	No	Real Estate
CMA	Comerica	12/2002	2002	8/6/02	7,672.4	Yes	Banks
CBSH	Commerce Bancshares, Inc.	12/2002	2003	2/3/03	2,569.8	No	Banks

Accounting and Taxation Research
Pat McConnell, CPA (212) 272-4193
Janet Pegg, CPA (212) 272-4191
Chris Senyek, CPA (212) 272-2509
Dane Mott (212) 272-4080

($ and shares in millions, except per share data)

Ticker	Company	2002 Fiscal Yearend	Adoption Year	Announcement Date of Adoption	Current Market Cap	S&P 500	Industry
CMT	Compton Petroleum Corp.	12/2002	2001	5/12/2003	15.6	No	Oil & Gas
CA	Computer Associates	03/2003	2003	7/29/02	12,006.7	Yes	Software
COP	ConocoPhillips	12/2002	2003	9/25/2002	36,075.0	Yes	Oil & Gas
MCF	Contango Oil & Gas	06/2002	2002	8/5/02	30.4	No	Oil & Gas
CBE	Cooper Industries	12/2002	2003	8/6/02	3,507.9	Yes	Electrical Equipment
COST	Costco Wholesale Corporation	08/2002	2003	8/14/02	15,791.6	Yes	Multiline Retail
CEI	Crescent Real Estate Equities Co.	12/2002	2003	3/28/03	1,591.7	No	Real Estate
CSX	CSX Corp.	12/2002	2003	2/26/03	6,736.5	Yes	Road & Rail
CUM	Cummins Inc.	12/2002	2003	5/12/2003	1,132.4	Yes	Machinery
DPL	Dayton Power & Light Co.	12/2002	2003	5/1/2003	1,907.6	No	Electric Utilities
DB	Deutsche Bank AG	12/2002	2003	3/27/03	31,643.6	No	Banks
DVS	Diversified Security Solutions Inc.	12/2002	2003	5/15/2003	34.2	No	Commercial Services & Supplies
DOL	Dole Foods (b)	12/2002	2003	7/19/02	NA	No	Food Products
DTG	Dollar Thrifty Automotive Group Inc.	12/2002	2003	5/14/2003	432.0	No	Road & Rail
DRL	Doral Financial Corporation	12/2002	2003	2/4/03	2,761.0	No	Banks
DOW	Dow Chemical Company	12/2002	2003	8/26/02	28,555.7	Yes	Chemicals
DPL	DPL Inc.	12/2002	2003	2/20/03	1,907.6	No	Electric Utilities
DW	Drew Industries Inc.	12/2002	2002	4/1/03	157.7	No	Building Products
DRE	Duke Realty	12/2002	2002	7/31/02	3,873.4	No	Real Estate
DD	DuPont	12/2002	2003	11/5/02	40,656.3	Yes	Chemicals
DYII	Dynacq International Inc.	8/2002	2003	4/14/03	182.38	No	Health Care Providers & Services
DYN	Dynegy Inc.	12/2002	2003	4/11/03	1,703.0	Yes	Multi-Utilities & Unregulated Power
EGAM	EGames Inc.	06/2002	2003	11/14/02	2.7	No	Software
EMR	Emerson Electronics	09/2002	2003	8/6/02	20,597.2	Yes	Electrical Equipment
ETR	Entergy Corp.	12/2002	2003	3/19/03	10,959.8	Yes	Electric Utilities
ENT	Equant NV - ADR	12/2002	2002	3/17/03	1,752.8	No	Diversified Telecommunication Services
EOP	Equity Office Properties	12/2002	2003	5/15/2003	11,001.7	Yes	Real Estate
EQR	Equity Residential	12/2002	2003	5/13/2003	7,445.8	Yes	Real Estate
RE	Everest Re Group, Ltd.	12/2002	2002	10/21/02	3,586.0	No	Insurance
EXPE	Expedia, Inc.	06/2003	2003	2/5/03	7,861.8	No	Internet Software & Services
XOM	Exxon Mobil Corp. (d)	12/2002	2003	3/27/03	239,055.4	Yes	Oil & Gas
FNM	Fannie Mae	12/2002	2003	7/23/02	70,155.1	Yes	Diversified Financials
FFG	FBL Financial Group, Inc.	12/2002	2003	8/29/02	555.3	No	Insurance
FCH	FelCor Lodging Trust Incorporated	12/2002	2003	10/30/2002	488.4	No	Real Estate
FR	First Industrial Realty Trust, Inc.	12/2002	2003	2/12/2003	1,210.3	No	Real Estate
FKYS	First Keystone Corp.	12/2002	2003	5/13/2003	93.8	No	Banks
FBF	FleetBoston Financial Corporation	12/2002	2002	8/14/02	30,326.1	Yes	Banks
FLM	Fleming Companies Inc.	12/2002	2003	8/8/02	9.3	No	Food & Drug Retailing
F	Ford Motor Company	12/2002	2003	9/12/02	17,699.4	Yes	Automobiles
FRE	Freddie Mac	12/2002	2002	7/23/02	41,627.3	Yes	Diversified Financials
GBL	Gabelli Asset Management Inc.	12/2002	2003	7/26/02	881.1	No	Diversified Financials
GBP	Gables Residential	12/2002	2003	11/4/02	736.3	No	Real Estate
GE	General Electric	12/2002	2002	7/31/02	275,844.3	Yes	Industrial Conglomerates
JOB	General Employment Enterprises, Inc.	09/2002	2002	8/5/02	2.7	No	Commercial Services & Supplies
GM	General Motors	12/2002	2003	8/6/02	18,803.5	Yes	Automobiles
GG	Goldcorp Inc.	12/2002	2003	10/23/2002	2,172.4	No	Metals & Mining
GS	Goldman Sachs Group Inc.	11/2002	2003	8/13/02	35,266.2	Yes	Diversified Financials
GXP	Great Plains Energy	12/2002	2003	11/14/2002	1,923.5	No	Electric Utilities
	Great West Lifeco Inc. (e)	12/2002	2003	3/28/03	NA	No	Insurance
GREY	Grey Global Group Inc.	12/2002	2003	8/14/02	830.1	No	Media
GNTY	Guaranty Bancshares, Inc.	12/2002	2002	9/6/02	46.6	No	Banks
HRB	H&R Block Inc. (c)	04/2003	2004	9/11/02	6,824.2	Yes	Commercial Services & Supplies
HAF	Hallmark Financial Services Inc.	12/2002	2003	5/15/2003	9.4	No	Insurance
HDL	Handleman Company	04/2003	2003	9/10/02	431.6	No	Distributors
HAR	Harman International Industries	06/2002	2003	8/19/02	2,221.2	No	Household Durables
HIG	Hartford Financial Services Group, Inc.	12/2002	2003	9/24/2002	11,426.7	Yes	Insurance
HNR	Harvest Natural Resources	12/2002	2003	3/31/03	210.6	No	Oil & Gas
HE	Hawaiian Electric Industries Inc	12/2002	2002	1/21/03	1,580.6	No	Electric Utilities
HCP	Health Care Property Investors Inc.	12/2002	2002	2/20/03	2,407.1	No	Real Estate
HCN	Health Care REIT Inc.	12/2002	2003	5/1/2003	1,191.0	No	Real Estate
HIW	Highwoods Properties Inc.	12/2002	2003	3/20/03	1,125.8	No	Real Estate
HB	Hillenbrand Industries Inc.	09/2002	2003	9/26/2002	3,178.6	No	Health Care Equipment & Supplies
HD	Home Depot Inc.	01/2003	2003	8/23/02	70,235.6	Yes	Specialty Retail
HME	Home Properties of New York Inc.	12/2002	2003	8/7/02	1,016.5	No	Real Estate
HMT	Host Marriott Corporation	12/2002	2002	10/16/02	2,233.5	No	Real Estate
HI	Household International Inc.	12/2002	2002	8/12/02	13,237.9	No	Diversified Financials
THX	Houston Exploration Company	12/2002	2003	2/24/03	944.8	No	Oil & Gas
HU	Hudson United Bancorp	12/2002	2003	3/14/03	1,489.2	No	Banks
ICOC	ICO Inc.	09/2002	2003	2/14/2003	35.4	No	Energy Equipment & Services
N	Inco Limited	12/2002	2003	2/4/03	3,413.1	No	Metals & Mining

Accounting and Taxation Research
Pat McConnell, CPA (212) 272-4193
Janet Pegg, CPA (212) 272-4191
Chris Senyek, CPA (212) 272-2509
Dane Mott (212) 272-4080

($ and shares in millions, except per share data)

Ticker	Company	2002 Fiscal Yearend	Adoption Year	Announcement Date of Adoption	Current Market Cap	S&P 500	Industry
IFS	Insignia Financial Group, Inc.	12/2002	2002	7/24/02	261.1	No	Real Estate
INVS	INVESTools Inc.	12/2002	2003	3/21/03	8.2	No	Commercial Services & Supplies
IOM	Iomega	12/2002	2003	7/24/02	515.8	No	Computers & Peripherals
IRM	Iron Mountain Inc.	12/2002	2003	5/15/2003	3,205.2	No	Commercial Services & Supplies
SFI	iStar Financial	12/2002	2003	7/24/02	3,229.4	No	Real Estate
JPM	J.P. Morgan Chase & Co.	12/2002	2003	8/12/02	62,054.4	Yes	Diversified Financials
JEF	Jefferies Group, Inc.	12/2002	2003	2/5/03	1,134.6	No	Diversified Financials
JAS.A	Jo-Ann Stores Inc.	12/2002	2003	5/14/2003	396.8	No	Specialty Retail
JCI	Johnson Controls Inc.	09/2002	2003	10/9/02	7,162.5	Yes	Auto Components
JNY	Jones Apparel	12/2002	2003	7/31/02	3,600.2	Yes	Textiles Apparel & Luxury Goods
KWD	Kellwood Co.	01/2003	2003	8/28/02	750.8	No	Textiles Apparel & Luxury Goods
KEY	KeyCorp	12/2002	2003	10/17/02	10,650.3	Yes	Banks
KSE	Keyspan Corp.	12/2002	2003	9/26/2002	5,473.2	Yes	Gas Utilities
KTR	Keystone Property Trust	12/2002	2003	4/14/03	393.4	No	Real Estate
KRC	Kilroy Realty Corp.	12/2002	2002	8/13/02	720.0	No	Real Estate
KIM	Kimco Realty Corp.	12/2002	2003	3/27/03	4,002.4	No	Real Estate
	Knology	12/2002	2003	3/31/03	NA	No	Diversified Telecommunication Services
LAB	Labranche & Co. Inc.	12/2002	2003	5/15/2003	1,130.3	No	Diversified Financials
LEA	Lear Corporation	12/2002	2003	10/18/02	2,576.0	No	Auto Components
LEE	Lee Enterprises	09/2002	2003	7/22/02	1,636.6	No	Media
LEG	Leggett & Platt	12/2002	2003	11/20/02	4,033.2	Yes	Household Durables
LVLT	Level 3 Communications, Inc	12/2002	1998	1998	3,006.1	No	Diversified Telecommunication Services
LECO	Lincoln Electric Holdings, Inc.	12/2002	2003	10/16/02	799.5	No	Machinery
LNC	Lincoln National Corporation	12/2002	2003	8/8/02	5,546.7	Yes	Insurance
LOW	Lowe's Companies, Inc.	01/2003	2003	8/19/02	31,500.1	Yes	Specialty Retail
LTC	LTC Properties Inc.	12/2002	2003	3/31/03	138.9	No	Real Estate
LUME	Lumenis LTD	12/2002	2003	3/28/03	63.5	No	Health Care Equipment & Supplies
LYO	Lyondell Chemical Co.	12/2002	2003	8/13/02	2,193.8	No	Chemicals
MTB	M & T Bank Corporation	12/2002	2003	9/19/02	10,038.6	No	Banks
MRD	MacDermid Inc.	03/2003	2001	4/1/01	760.9	No	Chemicals
MAC	Macerich Company	12/2002	2002	8/12/02	1,839.3	No	Real Estate
CLI	Mack Cali Realty Corp.	12/2002	2002	2/26/03	1,969.0	No	Real Estate
MHC	Manufactured Home Communities Inc.	12/2002	2003	5/13/2003	725.1	No	Real Estate
MRO	Marathon Oil	12/2002	2003	8/6/02	7,545.3	Yes	Oil & Gas
MXRE	Max Re Capital Ltd.	12/2002	2003	9/9/02	581.4	No	Insurance
MAY	May Dept. Stores	01/2003	2003	8/16/02	5,850.7	Yes	Multiline Retail
MBI	MBIA Inc.	12/2002	2002	7/29/02	6,632.4	Yes	Insurance
MIG	Meadowbrook Insurance Group, Inc.	12/2002	2003	5/8/2003	85.6	No	Insurance
MEL	Mellon Financial Corp.	12/2002	2003	8/13/02	11,011.1	Yes	Banks
MRBK	Mercantile Bankshares	12/2002	1995	1995	2,693.6	No	Banks
MER	Merrill Lynch & Co.	12/2002	2003	8/13/02	37,986.4	Yes	Diversified Financials
MCC	Mestek Inc.	12/2002	2003	5/15/2003	158.7	No	Household Durables
MET	MetLife Inc.	12/2002	2003	8/12/02	18,657.9	Yes	Insurance
MOL.A	Molson Inc.	03/2003	2003	11/6/02	4,352.5	No	Beverages
MNRTA	Monmouth Real Estate Investment Corp.	09/2002	2003	5/14/2003	106.3	No	Real Estate
MRH	Montpelier Re Holdings Ltd.	12/2002	2002	11/5/02	1,958.8	No	Insurance
MCO	Moody's Corporation	12/2002	2003	12/13/02	7,710.7	Yes	Diversified Financials
MWD	Morgan Stanley	11/2002	2003	8/13/02	46,742.6	Yes	Diversified Financials
NCC	National City Corporation	12/2002	2003	10/29/2002	19,249.6	Yes	Banks
NWLIA	National Western Life Insurance Co	12/2002	2003	5/15/2003	382.1	No	Insurance
NEU	Neuberger Berman	12/2002	2003	7/24/02	2,065.4	No	Diversified Financials
NJR	New Jersey Resources Corporation	09/2002	2003	10/30/2002	904.1	No	Gas Utilities
NXL	New Plan Excel Realty Trust Inc.	12/2002	2003	3/6/03	2,000.3	No	Real Estate
NMR	Nomura Holdings Inc.	03/2003	2002	12/18/02	19,326.0	No	Diversified Financials
NT	Nortel Networks	12/2002	2003	1/24/03	11,403.8	No	Communications Equipment
NWAC	Northwest Airlines Corp.	12/2002	2003	3/20/03	708.1	No	Airlines
OKE	Oneok Inc	12/2002	2003	2/21/03	1,918.7	No	Gas Utilities
PCAR	PACCAR Inc.	12/2002	2003	9/24/2002	7,014.3	Yes	Machinery
SPOT	Panamsat Corp.	12/2002	2003	3/6/03	2,633.4	No	Media
PZZA	Papa John's International, Inc.	12/2002	2002	7/30/02	421.4	No	Hotels Restaurants & Leisure
PHC	Peoples Holding Company	12/2002	2002	11/19/02	229.6	No	Banks
PNX	Phoenix Companies Inc.	12/2002	2003	5/15/2003	758.7	No	Insurance
PCL	Plum Creek Timber Co.	12/2002	2002	8/2/02	4,453.2	Yes	Real Estate
PNC	PNC Financial Services Group, Inc.	12/2002	2003	9/30/02	13,172.2	Yes	Banks
PPP	Pogo Producing Company	12/2002	2003	8/9/02	2,542.0	No	Oil & Gas
BPOP	Popular, Inc.	12/2002	2002	10/9/02	4,982.6	No	Banks
PRAA	Portfolio Recovery Association Inc.	12/2002	2002	3/17/03	366.5	No	Miscellaneous Commercial Services
PPS	Post Properties Inc.	12/2002	2003	5/15/2003	983.8	No	Real Estate
PPL	PPL Corporation	12/2002	2003	10/4/02	6,563.7	Yes	Electric Utilities
PRDS	Predictive Systems Inc.	12/2002	2002	9/19/02	17.6	No	IT Consulting & Services

Accounting and Taxation Research
Pat McConnell, CPA (212) 272-4193
Janet Pegg, CPA (212) 272-4191
Chris Senyek, CPA (212) 272-2509
Dane Mott (212) 272-4080

($ and shares in millions, except per share data)

Ticker	Company	2002 Fiscal Yearend	Adoption Year	Announcement Date of Adoption	Current Market Cap	S&P 500	Industry
PCO	Premcor	12/2002	2002	8/6/02	1,661.7	No	Oil & Gas
PSMT	PriceSmart	08/2002	2003	8/5/02	107.5	No	Multiline Retail
PFG	Principal Financial Group	12/2002	2002	8/7/02	9,956.6	Yes	Diversified Financials
PG	Procter & Gamble (a)	06/2002	2004	8/5/02	115,785.0	Yes	Household Products
PL	Protective Life	12/2002	1995	1995	1,815.3	No	Insurance
PFGI	Provident Financial Group, Inc.	12/2002	2003	1/15/03	1,158.7	No	Banks
PRU	Prudential Financial Inc.	12/2002	2003	8/13/02	17,803.0	Yes	Insurance
PSB	PS Business Parks, Inc.	12/2002	2002	9/9/02	723.4	No	Real Estate
PSA	Public Storage Inc.	12/2002	2002	11/14/02	4,322.1	No	Real Estate
PHM	Pulte Homes, Inc.	12/2002	2003	3/17/03	3,677.3	Yes	Household Durables
QUIP	Quipp Inc.	12/2002	2003	3/14/03	15.0	No	Machinery
RAEE	Rae Systems Inc.	12/2002	2003	5/8/2003	51.7	No	Machinery
RAVN	Raven Industries	01/2003	2002	8/20/02	162.8	No	Industrial Conglomerates
RJF	Raymond James Financial	09/2002	2003	2/3/2003	1,380.7	No	Diversified Financials
RCNC	RCN Corporation	12/2002	2000	2000	123.9	No	Diversified Telecommunication Services
O	Realty Income	12/2002	2002	7/26/02	1,333.2	No	Real Estate
RA	Reckson Associated Realty Corp.	12/2002	2002	12/16/02	1,135.2	No	Real Estate
RFCG	Refocus Group Inc.	12/2002	2002	3/31/03	47.3	No	Internet Software & Services
RGA	Reinsurance Group of America, Inc.	12/2002	2003	1/30/03	1,463.8	No	Insurance
RNR	RenaissanceRe Holdings Ltd.	12/2002	2003	10/14/02	3,084.8	No	Insurance
RVP	Retractable Technologies Inc.	12/2002	2002	11/14/02	113.4	No	Health Care Equipment & Supplies
RFS	RFS Hotel Investors, Inc.	12/2002	2003	8/1/02	348.2	No	Real Estate
RJR	RJ Reynolds Tobacco Holdings Inc.	12/2002	2003	5/15/2003	2,806.2	Yes	Tobacco
ROH	Rohm & Haas Co.	12/2002	2003	3/17/03	7,005.0	Yes	Chemicals
RML	Russell Corp.	12/2002	2003	5/14/2003	615.9	No	Textiles Apparel & Luxury Goods
SAFC	Safeco Corporation	12/2002	2003	10/25/2002	5,080.1	Yes	Insurance
SKS	Saks Incorporated	01/2003	2003	8/20/02	1,282.8	No	Multiline Retail
SBC	SBC Communication	12/2002	2002	3/14/03	79,937.1	Yes	Diversified Telecommunication Services
BUNZ	Schlotzskys Inc.	12/2002	2003	8/13/02	22.5	No	Hotels Restaurants & Leisure
SMG	Scotts Co.	09/2002	2003	7/25/02	1,584.6	No	Chemicals
SECX	SED International Holdings inc.	06/2002	2003	2/14/03	2.0	No	Electronic Equipment & Instruments
SVM	Service Master	12/2002	2003	7/31/02	2,965.4	No	Commercial Services & Supplies
SPG	Simon Property	12/2002	2002	7/31/02	7,280.4	Yes	Real Estate
SSD	Simpson Manufacturing Co. Inc.	12/2002	2003	5/9/2003	835.7	No	Building Products
SFD	Smithfield Foods, Inc.	04/2003	2002	8/22/02	2,163.7	No	Food Products
SONX	Sonex Research Inc.	12/2002	2003	5/14/2003	4.9	No	Auto Components
SBNK	Sonoma Valley Bancorp	12/2002	2003	3/25/03	40.6	No	Banks
SWHI	SonomaWest Holdings Inc.	06/2002	2002	2002	6.6	No	Real Estate
SWWC	Southwest Water Co.	12/2002	2002	3/28/03	128.0	No	Water Utilities
SOV	Sovereign Bancorp	12/2002	2002	7/19/02	3,922.7	No	Banks
SFG	StanCorp Financial Group, Inc.	12/2002	2003	1/30/03	1,530.1	No	Insurance
STSI	Star Scientific Inc.	12/2002	2003	5/14/2003	77.6	No	Tobacco
STT	State Street Corp.	12/2002	2003	8/13/02	11,966.4	Yes	Diversified Financials
SCS	Steelcase Inc.	02/2003	2004	9/23/2002	1,452.5	No	Commercial Services & Supplies
STU	Student Loan Corp.	12/2002	2003	3/25/03	2,218.0	No	Diversified Financials
SLC	Sun Life Financial Services of Canada	12/2002	2002	7/31/02	12,625.7	No	Insurance
SUN	Sunoco, Inc.	12/2002	2002	9/11/02	2,864.4	Yes	Oil & Gas
STI	SunTrust Banks, Inc.	12/2002	2002	8/13/02	16,424.7	Yes	Banks
SKT	Tanger Factory Outlet Centers	12/2002	2003	5/14/2003	300.9	No	Real Estate
TGT	Target Corp.	01/2002	2003	4/10/03	30,104.4	Yes	Multiline Retail
TARR	Tarragon Realty Investors	12/2002	2002	8/5/02	184.1	No	Real Estate
TCB	TCF Financial Corporation	12/2002	2000	2000	2,751.9	No	Banks
TNL	Technitrol, Inc.	12/2002	2003	10/21/02	680.6	No	Electronic Equipment & Instruments
TIN	Temple-Inland	12/2002	2003	8/5/02	2,463.8	Yes	Containers & Packaging
THC	Tenet Healthcare Corporation	5/2003	2003	3/18/03	7,372.6	Yes	Health Care Providers & Services
TD	Toronto Dominion Bank	10/2002	2003	3/26/03	17,487.4	No	Banks
RIG	Transocean Inc.	12/2002	2003	3/26/03	7,415.5	Yes	Energy Equipment & Services
TAP.B	Travelers Property Casualty Corp.	12/2002	2003	10/16/02	16,857.9	Yes	Insurance
TUP	Tupperware International	12/2002	2003	8/6/02	848.0	Yes	Household Durables
UNBJ	United National Bancorp	12/2002	2002	3/20/03	487.9	No	Banks
UPS	United Parcel Service Inc.	12/2002	2003	8/14/02	69,519.8	Yes	Air Freight & Logistics
UTR	Unitrin, Inc.	12/2002	2003	4/10/03	1,652.6	No	Banks
USAI	USA Interactive	12/2002	2003	7/24/02	17,585.8	No	Internet & Catalog Retail
VLY	Valley National Bancorp	12/2002	2002	7/17/02	2,468.0	No	Banks
VMDC	VantageMed Corp.	12/2002	2003	5/15/2003	5.5	No	Health Care Providers & Services
VZ	Verizon Communications Inc.	12/2002	2003	12/5/02	98,321.4	Yes	Diversified Telecommunication Services
VC	Visteon Corporation	12/2002	2003	10/18/02	793.4	Yes	Auto Components
VNO	Vornado Realty Trust	12/2002	2003	8/7/02	4,607.7	No	Real Estate
WHI	W Holding Co. Inc.	12/2002	2003	3/31/03	1,098.5	No	Banks
BER	W R Berkley Corp.	12/2002	2003	5/15/2003	2,636.0	No	Insurance

Accounting and Taxation Research
Pat McConnell, CPA (212) 272-4193
Janet Pegg, CPA (212) 272-4191
Chris Senyek, CPA (212) 272-2509
Dane Mott (212) 272-4080

($ and shares in millions, except per share data)

Ticker	Company	2002 Fiscal Yearend	Adoption Year	Announcement Date of Adoption	Current Market Cap	S&P 500	Industry
WPL	W.P. Stewart & Co., Ltd.	12/2002	2003	7/31/02	827.1	No	Diversified Financials
WB	Wachovia	12/2002	2002	7/18/02	51,708.7	Yes	Banks
WMT	Wal-Mart Stores Inc.	01/2003	2003	8/14/02	230,643.4	Yes	Multiline Retail
WRNC	Warnaco Group, Inc	12/2002	2003	5/15/2003	480.6	No	Textiles Apparel & Luxury Goods
WM	Washington Mutual, Inc.	12/2002	2003	1/29/03	36,289.1	Yes	Banks
WPO	Washington Post Co.	12/2002	2002	7/15/02	6,648.4	No	Media
WBST	Webster Financial	12/2002	2002	7/24/02	1,664.6	No	Banks
WRI	Weingarten Realty Investors	12/2001	2003	4/30/2003	2,186.5	No	Real Estate
WINA	Winmark Corp.	12/2002	2002	3/19/03	75.0	No	Specialty Retail
WIN	Winn-Dixie Stores Inc	06/2002	1996	1996	1,860.3	Yes	Food & Drug Retailing
INT	World Fuel Services	03/2003	2002	8/1/02	244.6	No	Aerospace & Defense
WPPGY	WPP Group PLC -ADR	12/2002	2002	8/20/02	8,564.2	No	Media
XL	XL Capital Ltd	12/2002	2003	2/11/2003	11,174.9	Yes	Insurance
ZNT	Zenith National Insurance Corp.	12/2002	2002	3/14/03	496.8	No	Insurance

Source: Company reports and press releases; FactSet Research Systems Inc.; Bear Stearns estimates.

NM - Not meaningful.
NA - Information unavailable
TBA - Company has not named a specific date or is awaiting board approval.

Highlighted companies represent new additions to the list.

(a) Procter & Gamble said it is prepared to begin expensing options no later than fiscal 2004, but the company stopped short of guaranteeing the change.

(b) On March 28, 2003, Dole Food Company, Inc. (NYSE: DOL) became a private company when it was acquired by David H. Murdock, Dole's Chairman and Chief Executive Officer.

(c) H&R Block stated that it intends to begin expensing the cost of stock options in its next fiscal year, assuming that the Financial Accounting Standards Board (FASB) clarifies its rules on this issue.

(d) Rather than grant stock options or stock appreciation rights (SARs), Exxon Mobil granted 11.072 million shares of restricted common stock and restricted common stock units in November 2002.

(e) On February 17, 2003, Great-West Lifeco Inc. announced that it has entered into a definitive agreement with Canafa Life Financial Corporation to acquire 100% of the outstanding common shares of Canada Life.

(f) In a July 23, 2002 press release, Amazon stated that "The Company announced that by the beginning of 2003 all stock-based awards granted thereafter will be expensed." To the company has not formally adopted the fair value method. The company has not granted any options in 2003. IT has used other compensation methods such as restricte

Pat McConnell, CPA (212) 272-4193
Janet Pegg, CPA (212) 272-4191
Chris Senyek, CPA (212) 272-2509
Dane Mott (212) 272-4080

($ and shares in millions, except per share data)

Ticker	Company	2002 Fiscal Yearend	Adoption Year	Announcement Date of Adoption	Current Market Cap	S&P 500	Industry

DISCLOSURES

Bear, Stearns & Co. Equity Research Rating System:
Ratings for Stocks (vs. analyst coverage universe):
Outperform (O) - Stock is projected to outperform analyst's industry coverage universe over the next 12 months.
Peer Perform (P) - Stock is projected to perform approximately in line with analyst's industry coverage universe over the next 12 months.
Underperform (U) - Stock is projected to underperform analyst's industry coverage universe over the next 12 months.

Ratings for Sectors (vs. regional broader market index):
Market Overweight (MO) - Expect the industry to perform better than the primary market index for the region over the next 12 months.
Market Weight (MW) - Expect the industry to perform approximately in line with the primary market index for the region over the next 12 months.
Market Underweight (MU) - Expect the industry to underperform the primary market index for the region over the next 12 months.

Bear, Stearns & Co. Ratings Distribution as of April 14, 2003:
(%Rated companies / %Banking client in the last 12 months)
Outperform: 37.0 / 24.8
Peer Perform: 44.7 / 17.7
Underperform: 17.3 / 9.6
Not Rated: 1.0 / 20.0

The costs and expenses of Equity Research, including the compensation of the analyst(s) that prepared this report, are paid out of the Firm's total revenues, a portion of which is generated through investment banking activities.

The analysts that prepared this report are actively associated with various organizations such as the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).

Companies* That Currently Expense or Intend to Expense Stock Options Using the Fair Value Method Arranged by State, Compiled by the FAF Library Based upon May 23, 2003 Report by Accounting and Taxation Research, Bear Stearns

PROTECTIVE LIFE CORP
2801 HIGHWAY 280 SOUTH
BIRMINGHAM, AL 35223

SAKS INC
750 LAKESHORE DRIVE
BIRMINGHAM, AL 35211

WAL-MART STORES INC
702 SOUTH WEST EIGHTH STREET
BENTONVILLE, AR 72716

CALPINE CORP
50 WEST SAN FERNANDO STREET
SAN JOSE, CA 95113

CATHAY BANCORP INC
777 NORTH BROADWAY
LOS ANGELES, CA 90012

CBRE HOLDING INC
355 S. GRAND AVENUE
LOS ANGELES, CA 90071

DOLE FOOD CO INC
ONE DOLE DRIVE
WESTLAKE VILLAGE, CA 91362

IOMEGA CORP
3RD FLOOR
4435 EASTGATE MALL
SAN DIEGO, CA 92121

PRICESMART INC
4649 MORENA BOULEVARD
SAN DIEGO, CA 92117

*Excluding REITS and international companies.

RAE SYSTEMS INC
1339 MOFFETT PARK DRIVE
SUNNYVALE, CA 94089

SIMPSON MANUFACTURING CO. INC
SUITE 400
4120 DUBLIN BOULEVARD
DUBLIN, CA 94568

SONOMA VALLEY BANCORP
202 WEST NAPA STREET
SONOMA, CA 95476

SONOMAWEST HOLDINGS INC
2064 HIGHWAY 116 NORTH
SEBASTOPOL, CA 95472-2662

SOUTHWEST WATER CO
SUITE 200
225 NORTH BARRANCA AVENUE
WEST COVINA, CA 91791-1605

TENET HEALTHCARE CORP
3820 STATE STREET
SANTA BARBARA, CA 93105

VANTAGEMED CORP
SUITE 180
3017 KILGORE ROAD
RANCHO CORDOVA, CA 95670

ZENITH NATIONAL INSURANCE CORP
21255 CALIFA STREET
WOODLAND HILLS, CA 91367-5021

GREAT WEST LIFE & ANNUITY INSURANCE CO
8515 EAST ORCHARD ROAD
GREENWOOD VILLAGE, CO 80111

LEVEL 3 COMMUNICATIONS INC
1025 ELDORADO BOULEVARD
BROOMFIELD, CO 80021

ARISTOTLE CORP
96 CUMMINGS POINT ROAD
STAMFORD, CT 06902

GENERAL ELECTRIC CO
3135 EASTON TURNPIKE
FAIRFIELD, CT 06828-0001

HARTFORD FINANCIAL SERVICES GROUP, INC
HARTFORD PLAZA
HARTFORD, CT 06115

MACDERMID INC
245 FREIGHT STREET
WATERBURY, CT 06702

PANAMSAT CORP
20 WESTPORT ROAD
WILTON, CT 06897

PHOENIX COS INC
ONE AMERICAN ROW
HARTFORD, CT 06102-5056

PREMCOR INC
SUITE 500
1700 EAST PUTNAM AVENUE
OLD GREENWICH, CT 06870

STUDENT LOAN CORP
750 WASHINGTON BOULEVARD
STAMFORD, CT 06901

TRAVELERS PROPERTY CASUALTY CORP
ONE TOWER SQUARE
HARTFORD, CT 06183

W R BERKLEY CORP
475 STEAMBOAT ROAD
GREENWICH, CT 06830

WEBSTER FINANCIAL CORP
WEBSTER PLAZA
WATERBURY, CT 06720

FANNIE MAE
3900 WISCONSIN AVENUE NORTH WEST
WASHINGTON, DC 20016

HARMAN INTERNATIONAL INDUSTRIES INC
1101 PENNSYLVANIA AVENUE NORTH WEST
WASHINGTON, DC 20004-2504

WASHINGTON POST CO
1150 15TH STREET NORTH WEST
WASHINGTON, DC 20071

E. I. DU PONT DE NEMOURS & CO
1007 MARKET STREET
WILMINGTON, DE 19898

CSX CORP
15TH FLOOR
500 WATER STREET
JACKSONVILLE, FL 32202

QUIPP INC
4800 NORTH WEST 157TH STREET
MIAMI, FL 33014

RAYMOND JAMES FINANCIAL INC
880 CARILLON PARKWAY
ST PETERSBURG, FL 33716

TUPPERWARE CORP
14901 SOUTH ORANGE BLOSSOM TRAIL
ORLANDO, FL 32837

WINN DIXIE STORES INC
5050 EDGEWOOD COURT
JACKSONVILLE, FL 32254-3699

WORLD FUEL SERVICES CORP
SUITE 800
700 SOUTH ROYAL POINCIANA BOULEVARD
MIAMI SPRINGS, FL 33166

BELLSOUTH CORP
ROOM 15G03
1155 PEACHTREE STREET NORTH EAST
ATLANTA, GA 30309-3610

COCA COLA CO
ONE COCA COLA PLAZA
ATLANTA, GA 30313

HOME DEPOT INC
2455 PACES FERRY ROAD NORTH WEST
ATLANTA, GA 30339-4024

KNOLOGY INC
1241 O.G. SKINNER DRIVE
WEST POINT, GA 31833

RUSSELL CORP
SUITE 800
3330 CUMBERLAND BOULEVARD
ATLANTA, GA 30339

SED INTERNATIONAL HOLDINGS INC
4916 NORTH ROYAL ATLANTA DRIVE
ATLANTA, GA 30085

SUNTRUST BANKS INC
303 PEACHTREE STREET NORTH EAST
ATLANTA, GA 30308

UNITED PARCEL SERVICE INC
55 GLENLAKE PARKWAY NORTH EAST
ATLANTA, GA 30328

HAWAIIAN ELECTRIC INDUSTRIES INC
900 RICHARDS STREET
HONOLULU, HI 96813-2956

BANDAG INC
2905 NORTH HIGHWAY 61
MUSCATINE, IA 52761-5886

FBL FINANCIAL GROUP INC
5400 UNIVERSITY AVENUE
WEST DES MOINES, IA 50266-5997

LEE ENTERPRISES INC
215 NORTH MAIN STREET
DAVENPORT, IA 52801

PRINCIPAL FINANCIAL GROUP INC
711 HIGH STREET
DES MOINES, IA 50392

ALLSTATE CORP
2775 SANDERS ROAD
NORTHBROOK, IL 60062

ALPHA HOSPITALITY CORP
SUITE 600
707 SKOKIE BOULEVARD
NORTHBROOK, IL 60062

BANK ONE CORP
1 BANK ONE PLAZA
CHICAGO, IL 60670

BOEING CO
100 NORTH RIVERSIDE
CHICAGO, IL 60606-1596

BOSS HOLDINGS INC
221 WEST FIRST STREET
KEWANEE, IL 61443

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC
30 SOUTH WACKER DRIVE
CHICAGO, IL 60606-7499

GENERAL EMPLOYMENT ENTERPRISES INC
SUITE 2100
ONE TOWER LANE
OAKBROOK TERRACE, IL 60181-4664

HOUSEHOLD INTERNATIONAL INC
2700 SANDERS ROAD
PROSPECT HEIGHTS, IL 60070-2799

SERVICEMASTER CO
2300 WARRENVILLE ROAD
DOWNERS GROVE, IL 60515-1700

UNITRIN INC
ONE EAST WACKER DRIVE
CHICAGO, IL 60601

COHESANT TECHNOLOGIES INC
SUITE 102
5845 WEST 82ND STREET
INDIANAPOLIS, IN 46278

CUMMINS INC
500 JACKSON STREET
P O BOX 3005
COLUMBUS, IN 47202-3005

HILLENBRAND INDUSTRIES INC
700 STATE ROUTE 46 EAST
BATESVILLE, IN 47006-8835

PAPA JOHN’S INTERNATIONAL INC
2002 PAPA JOHN S BOULEVARD
LOUISVILLE, KY 40299-2334

ENTERGY CORP
639 LOYOLA AVENUE
NEW ORLEANS, LA 70113

FLEETBOSTON FINANCIAL CORP
100 FEDERAL STREET
BOSTON, MA 02110

IRON MOUNTAIN INC
745 ATLANTIC AVENUE
BOSTON, MA 02111

MESTEK INC
260 NORTH ELM STREET
WESTFIELD, MA 01085

STATE STREET CORP
225 FRANKLIN STREET
BOSTON, MA 02110-2804

CHOICE HOTELS INTERNATIONAL INC
10750 COLUMBIA PIKE
SILVER SPRING, MD 20901

MERCANTILE BANKSHARES CORP
TWO HOPKINS PLAZA
P O BOX 1477
BALTIMORE, MD 21203

SONEX RESEARCH INC
23 HUDSON STREET
ANNAPOLIS, MD 21401-3100

CAMDEN NATIONAL CORP
2 ELM STREET
CAMDEN, ME 04843

CMS ENERGY CORP
FAIRLANE PLAZA SOUTH SUITE 1100
330 TOWN CENTER DRIVE
DEARBORN, MI 48126

COMERICA INC
COMERICA TOWER AT DETROIT CENTER
500 WOODWARD AVENUE
DETROIT, MI 48226-1101

DOW CHEMICAL CO
2030 DOW CENTER
MIDLAND, MI 48674

FORD MOTOR CO
ONE AMERICAN ROAD
DEARBORN, MI 48126

GENERAL MOTORS CORP
300 RENAISSANCE CENTER
DETROIT, MI 48265-3000

HANDLEMAN CO
500 KIRTS BOULEVARD
TROY, MI 48084-4142

LEAR CORP
21557 TELEGRAPH ROAD
SOUTHFIELD, MI 48034

MEADOWBROOK INSURANCE GROUP INC
26600 TELEGRAPH ROAD
SOUTHFIELD, MI 48034

PULTE HOMES INC
SUITE 300
100 BLOOMFIELD HILLS PARKWAY
BLOOMFIELD HILLS, MI 48304

STEELCASE INC
901 44TH STREET
GRAND RAPIDS, MI 49508

VISTEON CORP
17000 ROTUNDA
DEARBORN, MI 48120

NORTHWEST AIRLINES CORP
2700 LONE OAK PARKWAY
EAGAN, MN 55121

TARGET CORP
1000 NICOLLET MALL
MINNEAPOLIS, MN 55403

TCF FINANCIAL CORP
200 LAKE STREET EAST
MAIL CODE EX0 03 A
WAYZATA, MN 55391-1693

WINMARK CORP
SUITE 100
4200 DAHLBERG DRIVE
GOLDEN VALLEY, MN 55422-4837

AMEREN CORP
1901 CHOUTEAU AVENUE
ST LOUIS, MO 63103

CHARTER COMMUNICATIONS INC
12405 POWERSCOURT DRIVE
ST LOUIS, MO 63131

COMMERCE BANCSHARES INC
1000 WALNUT
P O BOX 13686
KANSAS CITY, MO 64106

EMERSON ELECTRIC CO
8000 WEST FLORISSANT AVENUE
P O BOX 4100
ST LOUIS, MO 63136

GREAT PLAINS ENERGY INC
1201 WALNUT STREET
KANSAS CITY, MO 64106

H & R BLOCK INC
4400 MAIN STREET
KANSAS CITY, MO 64111-1812

KELLWOOD CO
600 KELLWOOD PARKWAY
P O BOX 14374
ST LOUIS, MO 63178

LEGGETT & PLATT INC
NUMBER 1 LEGGETT ROAD
CARTHAGE, MO 64836

MAY DEPARTMENT STORES CO
611 OLIVE STREET
ST LOUIS, MO 63101

REINSURANCE GROUP OF AMERICA INC
1370 TIMBERLAKE MANOR PARKWAY
CHESTERFIELD, MO 63017

PEOPLES HOLDING CO
209 TROY STREET
P O BOX 709
TUPELO, MS 38802-0709

BANK OF AMERICA CORP
BANK OF AMERICA CORPORATE CENTER
CHARLOTTE, NC 28255

LOWE'S COS INC
1605 CURTIS BRIDGE ROAD
WILKESBORO, NC 28697

R J REYNOLDS TOBACCO HOLDINGS INC
401 NORTH MAIN STREET
WINSTON SALEM, NC 27102-2866

WACHOVIA CORP
ONE WACHOVIA CENTER
C O WACHOVIA CORP
CHARLOTTE, NC 28288-0013

BAYCORP HOLDINGS LTD
SUITE 301
20 INTERNATIONAL DRIVE
PORTSMOUTH, NH 03801-6809

AT&T CORP
900 ROUTE 202 206 NORTH
BEDMINSTER, NJ 07921

CHUBB CORP
15 MOUNTAIN VIEW ROAD
P O BOX 1615
WARREN, NJ 07061-1615

DIVERSIFIED SECURITY SOLUTIONS INC
280 MIDLAND AVENUE
SADDLE BROOK, NJ 07663

HUDSON UNITED BANCORP
1000 MACARTHUR BOULEVARD
MAHWAH, NJ 07430

NEW JERSEY RESOURCES CORP
1415 WYCKOFF ROAD
WALL, NJ 07719-1468

PRUDENTIAL FINANCIAL INC
751 BROAD STREET
NEWARK, NJ 07102

RCN CORP
105 CARNEGIE CENTER
PRINCETON, NJ 08540

UNITED NATIONAL BANCORP
1130 ROUTE 22 EAST
BRIDGEWATER, NJ 08807-0010

VALLEY NATIONAL BANCORP
1455 VALLEY ROAD
WAYNE, NJ 07470

ALLIANCE CAPITAL MANAGEMENT HOLDING LP
1345 AVENUE OF THE AMERICAS
NEW YORK, NY 10105

AMERICAN EXPRESS CO
WORLD FINANCIAL CENTER
200 VESEY STREET
NEW YORK, NY 10285

AMERICAN INTERNATIONAL GROUP INC
70 PINE STREET
NEW YORK, NY 10270

BANK OF NEW YORK CO INC
ONE WALL STREET
NEW YORK, NY 10286

BEAR STEARNS COS INC
383 MADISON AVENUE
NEW YORK, NY 10179

CENDANT CORP
9 WEST 57TH STREET
NEW YORK, NY 10019

CH ENERGY GROUP INC
284 SOUTH AVENUE
POUGHKEEPSIE, NY 12601-4879

CHOICE ONE COMMUNICATIONS INC
SUITE 600
100 CHESTNUT STREET
ROCHESTER, NY 14604-2417

CITIGROUP INC
399 PARK AVENUE
NEW YORK, NY 10043

COMPUTER ASSOCIATES INTERNATIONAL INC
ONE COMPUTER ASSOCIATES PLAZA
ISLANDIA, NY 11749

DREW INDUSTRIES INC
200 MAMARONECK AVENUE
WHITE PLAINS, NY 10601

GABELLI ASSET MANAGEMENT INC
ONE CORPORATE CENTER
RYE, NY 10580

GOLDMAN SACHS GROUP INC
85 BROAD STREET
NEW YORK, NY 10004

GREY GLOBAL GROUP INC
777 THIRD AVENUE
NEW YORK, NY 10017-1379

INSIGNIA FINANCIAL GROUP INC
200 PARK AVENUE
NEW YORK, NY 10166

JEFFERIES GROUP INC
12TH FLOOR
520 MADISON AVENUE
NEW YORK, NY 10022

J P MORGAN CHASE & CO
FLOOR 35
270 PARK AVENUE
NEW YORK, NY 10017-2070

KEYSPAN CORP
ONE METROTECH CENTER
BROOKLYN, NY 11201

LABRANCHE & CO INC
ONE EXCHANGE PLAZA
NEW YORK, NY 10006

M&T BANK CORP
ONE M&T PLAZA
BUFFALO, NY 14203

MBIA INC
113 KING STREET
ARMONK, NY 10504

MERRILL LYNCH & CO INC
4 WORLD FINANCIAL CENTER
NEW YORK, NY 10080

METLIFE INC
ONE MADISON AVENUE
NEW YORK, NY 10010-3690

MOODY'S CORP
99 CHURCH STREET
NEW YORK, NY 10007

MORGAN STANLEY
1585 BROADWAY
NEW YORK, NY 10036

NEUBERGER BERMAN INC
605 THIRD AVENUE
NEW YORK, NY 10158

PREDICTIVE SYSTEMS INC
19 WEST 44TH STREET
NEW YORK, NY 10036

USA INTERACTIVE
152 WEST 57TH STREET
NEW YORK, NY 10019

VERIZON COMMUNICATIONS INC
1095 AVENUE OF THE AMERICAS
NEW YORK, NY 10036

WARNACO GROUP INC
90 PARK AVENUE
NEW YORK, NY 10016

CINERGY CORP
139 EAST FOURTH STREET
CINCINNATI, OH 45202

DPL INC
1065 WOODMAN DRIVE
DAYTON, OH 45432

JO ANN STORES INC
5555 DARROW ROAD
HUDSON, OH 44236

KEYCORP OHIO
127 PUBLIC SQUARE
CLEVELAND, OH 44114-1306

LINCOLN ELECTRIC HOLDINGS INC
22801 ST CLAIR AVENUE
CLEVELAND, OH 44117

NATIONAL CITY CORP
1900 EAST NINTH STREET
CLEVELAND, OH 44114-3484

PROCTER & GAMBLE CO
ONE PROCTER & GAMBLE PLAZA
CINCINNATI, OH 45202

PROVIDENT FINANCIAL GROUP INC
ONE EAST FOURTH STREET
CINCINNATI, OH 45202

SCOTTS CO
14111 SCOTTSLAWN ROAD
MARYSVILLE, OH 43041

BETA OIL & GAS INC
SUITE 813
6120 SOUTH YALE
TULSA, OK 74136

DOLLAR THRIFTY AUTOMOTIVE GROUP INC
5330 EAST 31ST STREET
TULSA, OK 74135

ONEOK INC
100 WEST FIFTH STREET
TULSA, OK 74103

STANCORP FINANCIAL GROUP INC
1100 SOUTH WEST SIXTH AVENUE
PORTLAND, OR 97204

EGAMES INC
SUITE 110
2000 CABOT BOULEVARD WEST
LANGHORNE, PA 19047-1811

FIRST KEYSTONE CORP
111 WEST FRONT STREET
BERWICK, PA 18603

JONES APPAREL GROUP INC
250 RITTENHOUSE CIRCLE
BRISTOL, PA 19007

LINCOLN NATIONAL CORP
SUITE 3900
1500 MARKET STREET
PHILADELPHIA, PA 19102-2112

MELLON FINANCIAL CORP
ONE MELLON CENTER
PITTSBURGH, PA 15258-0001

PNC FINANCIAL SERVICES GROUP INC
ONE PNC PLAZA
249 FIFTH AVENUE
PITTSBURGH, PA 15222-2707

PPL CORP
TWO NORTH NINTH STREET
ALLENTOWN, PA 18101-1179

ROHM & HAAS CO
100 INDEPENDENCE MALL WEST
PHILADELPHIA, PA 19106

SOVEREIGN BANCORP INC
1500 MARKET STREET
PHILADELPHIA, PA 19103

SUNOCO INC
TEN PENN CENTER
1801 MARKET STREET
PHILADELPHIA, PA 19103-1699

TECHNITROL INC
SUITE 385
1210 NORTHBROOK DRIVE
TREVOSE, PA 19053-8406

DORAL FINANCIAL CORP
1451 F D ROOSEVELT AVENUE
SAN JUAN, PR 00920-2717

POPULAR INC
POPULAR CENTER BUILDING
209 MUNOZ RIVERA AVENUE
HATO REY
SAN JUAN, PR 00918

W HOLDING CO INC
19 WEST MCKINLEY STREET
MAYAGUEZ, PR 00680

RAVEN INDUSTRIES INC
205 EAST 6TH STREET
P O BOX 5107
SIOUX FALLS, SD 57117-5107

ANADARKO PETROLEUM CORP
1201 LAKE ROBBINS DRIVE
THE WOODLANDS, TX 77380-1046

CENTEX CORP
2728 NORTH HARWOOD
DALLAS, TX 75201

CONOCOPHILLIPS
600 NORTH DAIRY ASHFORD ROAD
HOUSTON, TX 77079

CONTANGO OIL & GAS CO
SUITE 960
3700 BUFFALO SPEEDWAY
HOUSTON, TX 77098

COOPER INDUSTRIES LTD
SUITE 5800
600 TRAVIS
HOUSTON, TX 77002-1001

DYANCQ INTERNATIONAL INC
SUITE 369
10304 INTERSTATE 10 EAST
HOUSTON, TX 77029

DYNEGY INC
SUITE 5800
1000 LOUISIANA STREET
HOUSTON, TX 77002

EXXON MOBIL CORP
5959 LAS COLINAS BOULEVARD
IRVING, TX 75039-2298

FLEMING COS INC
1945 LAKEPOINT DRIVE
LEWISVILLE, TX 75029

GUARANTY BANCSHARES INC
100 WEST ARKANSAS
MOUNT PLEASANT, TX 75455

HALLMARK FINANCIAL SERVICES INC
SUITE 900
14651 DALLAS PARKWAY
DALLAS, TX 75254

HARVEST NATURAL RESOURCES INC
SUITE 115
15835 PARK TEN PLACE DRIVE
HOUSTON, TX 77084

HOUSTON EXPLORATION CO
SUITE 2000
1100 LOUISIANA
HOUSTON, TX 77002-5215

ICO INC
SUITE 600
5333 WESTHEIMER
HOUSTON, TX 77056

INVESTOOLS INC
SUITE LL250
5959 CORPORATE DRIVE
HOUSTON, TX 77036

LYONDELL CHEMICAL CO
SUITE 700
1221 MCKINNEY STREET
P O BOX 3646
HOUSTON, TX 77010-2006

MARATHON OIL CORP
5555 SAN FELIPE ROAD
P O BOX 3128
HOUSTON, TX 77056-2723

NATIONAL WESTERN LIFE INSURANCE CO
850 EAST ANDERSON LANE
AUSTIN, TX 78752-1602

POGO PRODUCING CO
5 GREENWAY PLAZA SUITE 2700
HOUSTON, TX 77046-0504

RETRACTABLE TECHNOLOGIES INC
511 LOBO LANE
LITTLE ELM, TX 75068-0009

SBC COMMUNICATIONS INC
175 EAST HOUSTON
SAN ANTONIO, TX 78205-2233

SCHLOTZSKY'S INC
203 COLORADO STREET
AUSTIN, TX 78701

TEMPLE INLAND INC
1300 SOUTH MOPAC EXPRESSWAY
AUSTIN, TX 78746

TRANSOCEAN INC
4 GREENWAY PLAZA
HOUSTON, TX 77046

AES CORP
20TH FLOOR
1001 NORTH 19TH STREET
ARLINGTON, VA 22209

FEDERAL HOME LOAN MORTGAGE CORP
8200 JONES BRANCH DRIVE
MCLEAN, VA 22102

PORTFOLIO RECOVERY ASSOCIATES INC
120 CORPORATE BOULEVARD
NORFOLK, VA 23502

SMITHFIELD FOODS INC
200 COMMERCE STREET
SMITHFIELD, VA 23430

STAR SCIENTIFIC INC
801 LIBERTY WAY
CHESTER, VA 23836

AMAZON COM INC
SUITE 1200
1200 12TH AVENUE SOUTH
SEATTLE, WA 98144-2734

COSTCO WHOLESALE CORP DE
999 LAKE DRIVE
ISSAQUAH, WA 98027

EXPEDIA INC
SUITE 400
13810 SOUTH EAST EASTGATE WAY
BELLEVUE, WA 98005

PACCAR INC
777 106TH AVENUE NORTH EAST
BELLEVUE, WA 98004

SAFECO CORP
SAFECO PLAZA
SEATTLE, WA 98185-0001

WASHINGTON MUTUAL INC
1201 THIRD AVENUE
SEATTLE, WA 98101

JOHNSON CONTROLS INC
5757 NORTH GREEN BAY AVENUE
P O BOX 591
MILWAUKEE, WI 53201

Copies of Recent Letters, Reports, and Other Materials Excerpted in Attachment 4

1. Jane Adams, Chair, Financial Accounting Policy Committee, and Rebecca McEnally, Ph.D., CFA, Vice President, Advocacy, Association for Investment Management and Research

2. Benham M. Black, partner in law firm of Black, Noland & Read, PLC and Director of Virginia Financial Group, Inc.

3. Kenneth F. Broad, CFA, Portfolio Manager, Transamerica Investment Management, LLC [attachment not included]

4. Warren E. Buffett, Chairman of the Board, Berkshire Hathaway Inc. [excerpts from report to shareholders]

5. Peter C. Clapman, Senior Vice President & Chief Counsel, Corporate Governance, Teachers Insurance and Annuity Association College Retirement Equities Fund

6. John S. Clauss, Jr., Glendale, California

7. The Conference Board, Commission on Public Trust and Private Enterprise, Findings and Recommendations, Part 1: Executive Compensation

8. Thirty Members of the Congress of the United States

9. Andrew H. Dral, Sacramento, California [attachment not included]

10. Michael R. Fanning, Chief Executive Officer, Central Pension Fund of the International Union of Operating Engineers and Participating Employees

11. Robert E. Friedman, CPA, Aerospace & Defense Analyst, Accounting Analyst, Standard & Poor's Equity Group

12. David and Nancy Gabrielsen, Beavercreek, Oregon

13. Federal Reserve Chairman Alan Greenspan

14. James E. Heard, Chief Executive Officer, Institutional Shareholder Services

15. Alan G. Hevesi, Comptroller, Office of the State Comptroller of New York

16. Gregory J. Jonas, Managing Director, Moody's Investor Services [attachment not included]

17. Donald B. Marron, Principal Economist to the Senate Minority, Joint Economic Committee

18. Esther Mills, First Vice President Accounting Policy, Merrill Lynch & Co, Inc.

19. Rob Rocco, Avon Lake, Ohio

20. "Bucky" Rulon-Miller, CFA

21. Richard J. Schulte, Brecksville, Ohio

22. Damon A. Silvers, Associate General Counsel, American Federation of Labor and Congress of Industrial Organizations

23. Gregory M. Smith, Director – Operations/Compliance & Fund Accounting, Investment Company Institute

24. Joseph E. Stiglitz, Professor of Economics at Columbia

25. Sarah A. B. Teslik, Executive Director, Council of Institutional Investors