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New York • Chicago • Los Angeles

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**FASB Issues Final Statement
on Accounting for Share-Based Payment**

The Financial Accounting Standards Board (FASB) on December 16, 2004 approved unanimously and issued on schedule its final statement on accounting for equity compensation, referred to as “Statement 123(R), *Share-Based Payment*.” The final statement is substantively similar to the Exposure Draft issued earlier this year, with compensation cost for equity awards generally recognized net-of-tax over the requisite service/vesting period for non-forfeited awards based on “modified grant-date fair value” methodology. The zero cost “intrinsic value” methodology for at-the-money stock options prescribed by APB Opinion No. 25 is repealed. The final statement includes several key differences and similarities when compared to the Exposure Draft, including the following:

- ⇒ Eliminating explicit preference for lattice-based models (Black-Scholes permissible)
- ⇒ Retaining ability to use straight-line cost amortization for awards with graded vesting
- ⇒ Permitting retrospective restatement of financial statements (based on prior footnote disclosures)
- ⇒ Retaining current accounting treatment for income tax effects (greater symmetry)
- ⇒ Permitting minimal purchase discounts (5 percent or less) for Employee Stock Purchase Plans (ESPPs)
- ⇒ Maintaining position that reload stock options must be accounted for as separate grants (as opposed to incorporating into original grant-date fair value)
- ⇒ Retaining extensive footnote disclosures

For public companies (including subsidiaries of public companies), Statement 123(R) becomes effective on a “modified prospective” basis for the first interim or annual reporting period that begins after June 15, 2005 (December 15, 2005 for “small business issuers”). Earlier application of the new rules is encouraged if feasible, and companies are permitted to “retrospectively restate” the initial year of adoption or all reporting periods presented (based on previously estimated grant-date fair values and attribution methods used for recognition or pro forma footnote disclosures under Statement 123). For nonpublic companies not previously adopting the fair value provisions of Statement 123, Statement 123(R) becomes effective on a “prospective” basis for fiscal years beginning after December 15, 2005. The final statement provides several special measurement provisions for nonpublic companies designed to ease implementation, such as the ability to use stock price volatility of an appropriate industry sector index and intrinsic value rather than fair value to measure compensation cost for “liability” awards.

The final statement, which is currently accessible via the FASB’s website at www.fasb.org, is lengthy, complex, and accompanied by further guidance in the form of several “frequently asked questions.” In addition, the Securities and Exchange Commission (SEC) has indicated that they

intend to prepare additional guidance in the area of valuation assumptions and estimates to help companies comply with the new rules.

The FASB intends to consider the “second phase” of its stock compensation project in the first quarter of 2005 dealing with employee stock ownership plans (ESOPs) and equity-based compensation arrangements with nonemployees. Our firm will continue to provide analysis and commentary on the design implications of the new rules as they unfold.

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General questions about this letter may be addressed to Thomas M. Haines in our Chicago office at 312-332-0910 or by e-mail at tmhaines@fwcook.com. Copies of this letter and other related materials are available on our website at www.fwcook.com under the following links:

Date	Title	Website Link
October 20, 2004	FASB Decides on Effective Date for Option Expensing	http://www.fwcook.com/alert_letters/10-20-04%20FASB%20Decides%20on%20Effective%20Date%20for%20Option%20Expensing.pdf
September 3, 2004	FASB Makes Progress on Stock Compensation Redeliberations	http://www.fwcook.com/alert_letters/9-3-04%20FASB%20Makes%20Progress%20On%20Stock%20Compensation%20Redeliber..pdf
July 22, 2004	Update on Close of FASB’s Public Comment Period	http://www.fwcook.com/alert_letters/7-22-04-Update%20on%20Close%20of%20FASBs%20Public%20Comment%20Period.pdf
May 28, 2004	Lattice-Based Stock Option Valuation Models	http://www.fwcook.com/alert_letters/5-28-04%20Lattice-Based%20SO%20Valuation%20Models.pdf
April 13, 2004	FASB Issues Exposure Draft on Share-Based Payment	http://www.fwcook.com/alert_letters/4-13-04-FASB%20Issues%20Exposure%20Draft%20on%20Share-Based%20Payment.pdf
February 26, 2004	IASB Issues Final Standard on Share-Based Payment	http://www.fwcook.com/alert_letters/2-26-04-IASB%20Issues%20Final%20Standard%20on%20Share-based%20Payment.pdf
November 5, 2003	FASB Announces Planned Effective Date and Method of Transition for Stock Option Expensing Mandate and Reaches Further Convergence with IASB	http://www.fwcook.com/alert_letters/11-5-03-FASB%20An%20C9ing%20Mandate.pdf
September 18, 2003	FASB Delays Timetable on Stock Compensation Project but Project Derailment Still Not Likely	http://www.fwcook.com/alert_letters/9-18-03-FASB%20De&ion%20Project.pdf
August 8, 2003	Valuation of Employee Stock Options: Summary of Views from FASB’s Option Valuation Group	http://www.fwcook.com/alert_letters/8-8-03ValuationEmployee.pdf
June 23, 2003	FASB Makes Headway on Stock Compensation Project	http://www.fwcook.com/alert_letters/6-24-03-FASB%20Makes%20Headway%20on%20Stock%20Compensation%20Project.pdf
March 14, 2003	FASB Decides to Add Stock Compensation Project to Agenda	http://www.fwcook.com/alert_letters/3-14-03-FASB%20to%20Add%20Stock%20Comp%20Project%20to%20Agenda.pdf
January 10, 2003	FASB Issues Final Standard on Amendments to Statement 123	http://www.fwcook.com/alert_letters/1-10-03-FASBIssuesFinalStandard.pdf
December 23, 2002	FASB Releases Invitation to Comment on IASB Share-Based Payment Exposure Draft	http://www.fwcook.com/alert_letters/12-02FASBReleaseInvitationTo%5B1%5D....pdf
October 11, 2002	FASB Releases Exposure Draft on Amendments to Statement 123	http://www.fwcook.com/alert_letters/10-11-02FASBReleasesExposure....pdf
March 20, 1996	Compliance with the Footnote Disclosure Requirements of FAS 123	http://www.fwcook.com/032096.html
November 8, 1995	FASB Releases Final Standard on Accounting for Stock-Based Compensation	http://www.fwcook.com/alert_letters/11895TMH.pdf