

Frederic W. Cook & Co., Inc.

New York • Chicago • Los Angeles

August 20, 1999

FASB Begins Redeliberations on Proposed Interpretation of Opinion 25

*Outside Directors are Spared,
but Option Repricingings are Not*

The deadline for public comments has passed, and the Financial Accounting Standards Board (FASB) has begun to redeliberate the issues on the proposed interpretation of APB Opinion No. 25, *Accounting for Stock Issued to Employees* (Opinion 25).¹ To date, the FASB has reached conclusions on three important issues and has decided to further explore alternative approaches to another issue, as briefly summarized below:

Outside Directors -- In a significant reversal, the FASB has decided to permit stock options or awards granted to outside directors to continue to be accounted for under Opinion 25, despite concerns that providing such an exception could lead the FASB down a "slippery slope." The proposed interpretation would have excluded outside directors from the scope of Opinion 25, resulting in a "fair value" earnings charge for stock options under the provisions of Statement 123. Public response to the proposed change was overwhelmingly negative, however, with 90 percent of comment letters responding to the issue opposing the change.

Option Repricing -- The FASB has affirmed its previous decision that variable award accounting would apply to otherwise fixed stock options that are "repriced" or "cancelled and reissued" within 6 months of one another. Interestingly, public opposition to the repricing issue was not as severe as with respect to the outside director issue, with only 45 percent of comment letters responding to the issue at all, and only 67 percent of those responding opposed to the proposed change.

Stock Purchase Plans -- On a nonconfrontational issue, the FASB has affirmed its previous decision that employee stock purchase plans meeting the criteria of IRC Section 423 would retain their status as "noncompensatory," including plans with discounts of up to 15 percent at grant and "look-back" features.

Definition of Employee -- The proposed interpretation would have used a "common law" definition of employee to determine whether a stock option or award recipient would fall within the scope of Opinion 25. The FASB, however, is now considering an alternative two-part

¹ Refer to our letter dated April 27, 1999 for a detailed summary of the Exposure Draft - *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No 25*, released March 31, 1999.

approach that would consist of (1) the 20 criteria used to define employees for federal tax purposes, and (2) a second test for U.S. service providers that would not allow an individual classified as a nonemployee for tax purposes to qualify as an employee for Opinion 25 purposes.

In addition to the open issue dealing with the definition of employee, other important issues that remain to be redeliberated include excess stock-for-tax withholding transactions, award modifications, share repurchase features, and stock option assumptions in business combinations. Perhaps most important, the FASB must redeliberate the proposed interpretation's effective date. As it now stands, the proposed interpretation would become effective upon issuance of a final standard, which is now expected to be in early October of 1999. However, the interpretation would apply on a *prospective* basis to all grants, modifications, and changes to employment status that occur *subsequent to* December 15, 1998.²

The FASB has decided that public hearings would not be necessary in its redeliberation process.

* * * * *

General questions about this letter may be addressed to Thomas Haines in our Chicago office (312-332-0910). Copies of this letter and other published materials are available on our website, www.fwcook.com.

² The provisions in the proposed interpretation dealing with excess stock-for-tax withholding transactions would apply only to grants made *subsequent to* December 31, 1999.