

STOCK-BASED COMPENSATION
Financial Accounting Standards Advisory Council
June 2003



Background

On March 12, 2003, the Board decided to add a project on stock-based compensation to its agenda. The Board added this project to its agenda because of user concerns, concerns about comparability, and the Board's goal of convergence. The objective of this project is to cooperate with the IASB to achieve convergence to a single high-quality accounting standard for stock-based compensation.

Discussion at June Council Meeting

At the June Council meeting, the Board would like to discuss with FASAC the key decisions made to date on the project and key issues to be addressed during the third quarter of 2003.

Key Decisions Made to Date

The Board met on April 22 and May 7, 2003, to make several tentative decisions. Those decisions include the following:

- Recognition. 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.
- Measurement Attribute. The measurement attribute for an exchange involving stock-based compensation is fair value.
- Measurement Objective. 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 equity instruments issued (that is, modified grant date measurement), whichever is more reliably measurable.

- Attribution. Compensation cost should be recognized over the service period using the attribution method in FASB Statement No. 123, *Accounting for Stock-Based Compensation*, rather than by the units-of-service attribution method proposed in IASB Exposure Draft 2, *Share-based Payment*.

IASB Decisions

The IASB began redeliberations of ED 2 in April 2003. In its May 2003 meeting, the IASB decided to use the modified grant-date measurement method and the attribution method used by Statement 123. That means that the IASB and the FASB are converged¹ with respect to accounting for equity-settled employee stock-based compensation transactions.

Key Issues to Be Addressed in the Third Quarter of 2003

The following key issues that the Board expects to address during the third quarter include the following:

Option Valuation. The Option Valuation Group (OVG) was formed to help the Board and the FASB staff understand option valuation issues. The OVG is composed of option-pricing experts from academia, valuation consulting firms, and industry. The FASB staff has had extensive interaction with the OVG, and the Board is scheduled to meet publicly with the OVG on July 8, 2003. After that public meeting, the Board intends to make decisions with respect to Statement 123's option-pricing approach.

Transactions with Nonemployees. The key decisions to date generally have been made in the context of transactions with employees. Important issues related to transactions with nonemployees include determining (1) whether transactions with nonemployees should be treated differently than transactions with employees and (2) the appropriate measurement date to use for such transactions. The Board intends to address transactions with nonemployees beginning in June 2003.

¹ The two Boards are converged in the sense that if the IASB's proposed guidance and the FASB's tentative decisions do not change, the final standards would be converged.

Other Measurement and Attribution Issues. These issues include measurement and attribution of cash-settled stock-based compensation transactions, measurement and attribution of stock-based compensation transactions with multiple-settlement features, and accounting for modifications and settlements.

Income Taxes. The IASB's ED 2 and Statement 123 require different accounting for the tax effects of stock-based compensation transactions. The Board intends to address the issue of whether all or some portion of the tax effects should be recognized in the income statement.

The Board's goal is to issue an Exposure Draft in the fourth quarter of 2003.

DISCUSSION QUESTIONS

1. Certain respondents to the 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*, suggested that the FASB provide more guidance on determining the fair value of employee stock options, whereas other respondents suggested that the FASB require fair value and eliminate all guidance on determining that amount. Based on the Board's tentative decision that employee stock options should be measured at fair value, should the Board provide more guidance than that provided in Statement 123 on determining fair value, less guidance, or no guidance? How can the guidance in Statement 123 be improved?
2. In the third quarter, the Board will consider transactions with nonemployees. The Board wants to consider the impact of its tentative decisions on employee transactions in the context of nonemployee transactions. Are employee and nonemployee transactions similar from an accounting perspective and, therefore, do they warrant similar accounting treatment?