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Accountability \* Integrity \* Reliability

Comptroller General  
of the United States

United States General Accounting Office  
Washington, DC 20548

June 28, 2004

The Honorable Richard C. Shelby  
Chairman  
The Honorable Paul S. Sarbanes  
Ranking Minority Member  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate

Subject: *Independent Standard-Setting Process for Establishing Accounting Standards for Private-Sector Entities*

This letter provides our views, which we recently discussed with your staffs, on the existing independent standard-setting process for establishing accounting standards for private-sector entities.

On March 31, 2004, the Financial Accounting Standards Board (FASB) issued an exposure document on a proposed Statement, *Share-Based Payment, an Amendment of FASB Statements No. 123 and 95*, which addresses the accounting for compensation to employees in the form of equity shares, including stock options. Our comments to FASB on its exposure document on share-based payment are enclosed. We recognize that this is a complex and controversial issue on which reasonable people can and do disagree. In light of the above, there has been a renewed interest for the Congress to legislate accounting rules for stock options.

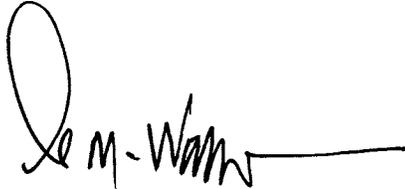
Notwithstanding our and others' views on the merits of various accounting methods for stock options, we believe that the principle of independence, both in fact and in appearance, is essential to the credibility of and confidence in any authoritative standard-setting processes. With respect to the role of FASB in this and other areas, we support its efforts, as the Securities and Exchange Commission's (SEC) designated independent private-sector standard-setting body, to identify issues for consideration, prepare exposure documents, conduct outreach efforts and solicit comments on exposure documents, and consider the resulting comments in finalizing and issuing new accounting standards. This time-tested and proven deliberative process has served to strengthen financial reporting and ensure general acceptance

of the nation's accounting standards. This process is especially important given the complexity and controversial nature of some accounting standards, including the accounting for share-based payments.

We note that FASB has an established process in place to obtain feedback from its constituent groups, including financial statement preparers, auditors, and users such as individual investors, institutional investors, lenders, creditors, professional analysts, and various other parties. These processes were established in order to balance the competing interests and demands of the various groups while providing standards that promote transparent, credible, and comparable financial information.

We believe it is critical that FASB complete its analysis of comments received on its exposure document on share-based payment and finalize its proposed Statement in accordance with its established independent standard-setting process. As a safeguard, the Congress has provided the SEC with oversight responsibility for FASB standard-setting activities. In enacting the Sarbanes-Oxley Act of 2002, the Congress recognized the importance of having an independent standard-setting process that facilitates accurate and effective financial reporting and protects investors. The Act specified criteria for the SEC to use for determining whether a private-sector accounting standard setter's principles will be considered as generally accepted. The SEC determined that FASB met the statutory criteria established in the Sarbanes-Oxley Act of 2002. In our opinion, the FASB's independent standard-setting process, subject to SEC oversight, should be allowed to proceed in its consideration of accounting for stock options.

We are available to discuss these matters further with you or with your staff.

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David M. Walker  
Comptroller General  
of the United States

Enclosure

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Director of Major Projects  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 1102-100

Subject: *Financial Accounting Standards Board's Proposed Statement on Share-Based Payment*

This letter is in response to the Financial Accounting Standards Board's (FASB) March 31, 2004, exposure document on a proposed Statement, *Share-Based Payment, an Amendment of FASB Statements No. 123 and 95*, which addresses the accounting for compensation to employees in the form of equity shares, including stock options. The FASB's proposed Statement would generally eliminate the ability to account for share-based services using the intrinsic method and would require instead the use of a fair-value-based method, which would generally result in companies treating stock options granted to employees as an expense.

We support the concepts behind FASB's current proposed Statement requiring companies to record share-based payment as an expense. In our view, stock options and other forms of share-based payment have economic value and represent a form of compensation expense. Therefore, we believe that the economic substance of such transactions should be reflected as compensation expense in the calculation of a company's net income to accurately portray its financial results. The current standard, which permits companies to choose between two methods, allows companies to select the impact on net income. It also creates a barrier to comparable financial information, both domestically and internationally, because the choice of methods used will result in differences in reported amounts across companies due to the different methods of accounting. We believe that a requirement to expense stock options and other share-based payment will provide additional transparency, clarity, and comparability in financial reporting.

We also support the four principal reasons FASB cited for issuing the new proposal: (1) addressing concerns of users and others that the use of the intrinsic value method results in financial statements that do not faithfully represent economic transactions, which can distort the financial condition and operations of the issuer; (2) improving the comparability of reported financial information through the elimination of alternative accounting methods; (3) simplifying U.S. generally accepted accounting principles by requiring the use of a single method of accounting for share-based payment; and (4) enabling international convergence and greater international comparability in the accounting for share-based payment.

We appreciate your consideration of our comments and would be pleased to further discuss these issues at your convenience.

A handwritten signature in black ink, appearing to read "D. M. Walker", followed by a horizontal line extending to the right.

David M. Walker  
Comptroller General  
of the United States