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March 7, 2003

Ms. Kimberly Crook
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH, United Kingdom

Re: Exposure Draft 2 Share-Based Payment

Dear Ms. Crook:

Dell Computer Corporation ("Dell") appreciates the opportunity to respond to the International Accounting Standards Board's ("Board" or "IASB") Exposure Draft published November 7, 2002, entitled *ED 2 Share-Based Payment* ("ED"). Dell supports the IASB's mutual commitment to work with the Financial Accounting Standards Board ("FASB") to develop high-caliber accounting standards that promote comparability of financial statements among cross-border investors and other financial statement users. Because investors rely on credible, transparent, and comparable financial information, high quality and consistently prepared financial statements are important to the efficient functioning of the world's economy and stock markets. Included in Attachment I are our views related to the specific questions set forth in the Board's ED.

As we understand it, the ambitious goal of the international convergence effort would be a single set of high-quality accounting standards that would (a) result in financial statement comparability across all countries and capital markets, (b) improve financial statement transparency, (c) enhance the understandability of financial statements, (d) create a level economic-information playing field among all enterprises, and (e) reduce capital market access costs. In principle we agree with the goals of convergence as in practice they should improve the usefulness of financial information and allow financial statement users to make better economic decisions. However, we are very concerned that the ambitious goals of convergence between the IASB and the FASB to develop a new stock-based compensation standard may not be possible in the short timeframe currently being contemplated by both Boards. We urge the Board to allow for ample time to work with the FASB and other international standard setters to develop a single high-quality standard for stock-based compensation.

Dell believes that present U.S. accounting for stock-based compensation under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), while less than perfect, has served the financial community well. In our view, there currently is not convincing evidence that the expensing of employee stock options ("ESOs") using existing pricing models would improve financial statement reliability, credibility, or transparency. Although there is arguably a compensatory element to the granting of stock options, we strongly support the disclosure-only alternative for stock-based compensation costs as currently allowed by SFAS 123. We believe the IASB should move in this direction to synchronize accounting standards around the globe. Our continued support of disclosure-only is primarily based on the following reasons:

- The value received by an option holder at exercise does not equate to the cost to the issuing corporation. The only "cost" of issuing ESOs is borne by existing shareholders in the form of potential future dilution.

- The debate on fair value is so widespread that it will be impossible to come to agreement on a reliable valuation methodology appropriate for all financial statement preparers. Grant date fair value will always be an imprecise and volatile estimate, regardless of whether the preparer is attempting to estimate the ultimate value, if any, realized by the employee upon exercise, the cost to the issuing corporation, or the value of services received.

- The expensing of stock options further disconnects net income from cash flows; expensing a "hypothetical" fair value could be misleading and confuse the investor as to the relationship between net income and cash flows.

- There is no outflow or consumption of company assets upon the issuance or exercise of stock options; therefore, it would be improper to capitalize, even momentarily, and subsequently expense the services received.

Dell encourages the IASB to implement the disclosure-only alternative by adopting the provisions of SFAS123, APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. For further analysis of Dell's support of the disclosure-only alternative, please refer to Attachment II for a copy of our response to the FASB's Invitation to Comment dated November 18, 2002, entitled 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*.

In addition to our support for the disclosure-only alternative, we feel strongly about the overall conceptual framework around stock option expensing. While both SFAS 123 and the Board's draft International Financial Reporting Standard ("IFRS") measurement objective is the fair value of the equity instrument awarded, the foundation of measurement philosophies of the two pronouncements differs significantly. SFAS 123 recognizes compensation expense based on the fair value of the stock ultimately issued, while the draft IFRS focuses on the value of the services received. We do not support the position of the draft IFRS that compensation must be recognized based on a surrogate valuation of services received. We believe that any accounting standard addressing stock-based compensation must focus on the recognition of the value of stock ultimately issued, and not on the value of services received by the corporation. This is because there is no practical means of measuring the value of services. Despite the fact that we feel strongly that the valuation models that exist for SFAS 123 are inadequate, they are clearly superior to a model that attempts to value the services.

Additionally, Dell believes that the SFAS 123 concept of issuance is of significant importance in the design of an accounting standard on stock-based compensation. In accordance with this concept, equity instruments are not issued until the issuer has received valuable consideration in exchange for the equity instruments. Issuance occurs only when an employee actually exercises an option. The notion of issuance supports SFAS 123's conceptual basis to account for forfeited awards and Dell agrees with SFAS 123's approach to accounting for forfeitures. Under SFAS 123, measurement of estimated fair value at grant date is not adjusted for the effect of forfeitures, because forfeitures do not affect the value of an individual option. Rather, the effect of forfeitures should be addressed through the notion of issuance by either (1) estimating the amount of expected forfeitures and adjusting that estimate to actual forfeitures or (2) recognizing forfeitures as they occur. Under either approach, forfeitures are accounted for as an adjustment to the quantity of equity instruments ultimately issued. If shares are not issued due to an optionee's failure to perform, then equity has not been exchanged for valuable consideration and companies should not record compensation expense.

Recording an expense for unissued shares would also be contrary to the principles of FASB Concepts Statement No. 6, *Elements of Financial Statements* ("CON 6"), as there is no outflow or consumption of company assets. The accounting for forfeitures allowed by SFAS 123 mitigates the risk of incorrectly estimating in advance the potential valuable benefit an employee forfeited due to failure to meet vesting requirements or performance conditions. The accounting required by the units of service method in the draft IFRS, by contrast, leads to incorrectly considering the value of forfeitures in the grant date fair value of the option.

If the Board insists on moving forward with expensing ESOs at the time of grant, in addition to reconsidering both the treatment of forfeitures and the valuation of the equity instrument issued instead of the services received, Dell believes the Board's efforts would be best served to first develop improved option-pricing models for ESOs. We are concerned with the current models' shortcomings and inability to produce reliable measurements of fair value. The option pricing models currently available rely on six basic assumptions, and they were not initially designed to evaluate non-transferable, long-lived equity instruments. Therefore, the fair value generated by existing models fails to appropriately reflect the true nature of stock transactions with employees, as the calculated fair value rarely approximates the actual value realized by the employee upon exercise. Specifically, existing models fail to fully reflect a discount for the fact that ESOs cannot be transferred to other individuals. Therefore, a liquidity adjustment should be considered in calculating fair value since ESOs are not publicly traded, cannot be sold and represent a transaction only between the employee and issuing company. Additionally, the models should permit volatility to be significantly adjusted to reflect the fact that employees do not benefit from (and therefore are not compensated for) the volatility of underlying stock while the option is outstanding. These improved models would provide more consistent and comparable results across companies and industry sectors. We believe that it would be imprudent to impose a standard requiring the expensing of ESOs prior to the development of sound valuation models. We feel that until such time as option-pricing models are developed that reasonably reflect the fair value of long-lived, nontransferable ESOs, any expense required to be recognized under an accounting standard would be arbitrary and imprecise.

In closing, as Dell has encouraged the FASB, we encourage the IASB to consider the potential unintended consequences to the global economy and capital markets if it rules to expense stock options. A new expensing standard could lead to volatile stock prices, increases in the cost of capital, and reduced economic growth rates. Employee stock options are issued to increase productivity, improve employee retention, and encourage company ownership. Without providing employees with the opportunity to participate in a company's future growth, the best people will not be attracted or retained, and productivity in the global economy will most likely be adversely affected. These potential consequences to the world economy are contrary to the basic principles underlying employee stock option programs.

Thank you for the opportunity to comment on this important matter. If you have any questions regarding our comments, please contact me at (512) 728-4283.

Sincerely,

Robert W. Davis
Vice President, Chief Accounting Officer

ATTACHMENT I

Question 1: **Paragraphs 1-3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS. Is the proposed scope appropriate? If not, which transactions should be excluded and why?**

No, the proposed scope of the draft IFRS is not appropriate. Employee Stock Ownership Plans ("ESOPs") and certain Employee Stock Purchase Plans ("ESPPs") should be excluded from the scope of an accounting standard addressing share-based payments. These types of plans are fundamentally different from employee stock options in that the time value is minimal and the awards are purchased at fundamentally current stock prices. In addition, the intent of these broad-based plans is generally to raise capital or to obtain more widespread ownership of stock among employees rather than serve as compensation to the employee. ESOPs and ESPPs are established primarily to meet these objectives, and historically these objectives have been met successfully. Therefore, the associated cost should not be accounted for as a charge to operations.

Question 2: **Paragraphs 4-6 of the draft IFRS propose requirements for the recognition of share- based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed. Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?**

No, we do not believe that the recognition requirements proposed under the draft IFRS are appropriate. Fundamentally, we believe that the equity instruments, not the goods or services received, should be the focus of the measurement of fair value. Therefore, Dell prefers SFAS 123's conceptual framework based on valuing the equity instrument.

Question 3: **For an equity- settled share- based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities. Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?**

No, the measurement principle proposed in the draft IFRS is not appropriate. Please refer to our response to Question 2.

Question 4: **If the fair value of the goods or services received in an equity- settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8). Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?**

As stated above in Question 2, Dell believes that the fair value of the equity instruments issued should be measured and recorded directly, not the fair value of the goods or services received. Dell agrees that the grant date serves as the most appropriate time to initially measure the fair value of the equity instruments granted. However, compensation expense should be limited to the fair value of awards actually issued (i.e., vested options).

Question 5: **If the fair value of the goods or services received in an equity- settled share-based payment transaction is measured by reference to the fair value of the equity**

instruments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8). Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

Yes, Dell believes that the grant date is the appropriate date at which to measure the fair value of the equity instruments.

Question 6: **For equity- settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10). Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?**

Dell believes that the fair value of the goods or services received from a nonemployee is more readily determinable.

Question 7: **For equity- settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12). Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?**

Yes, Dell agrees that the fair value of the equity instruments granted is more readily determinable.

Question 8: **Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the counterparty is required to complete a specified period of service before the equity instruments vest. Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?**

Yes, it is reasonable to presume that the services rendered are received during the vesting period, because the equity instrument is deemed to be earned throughout the vesting period (the period in which the employee provides service to earn the related benefit, if any). Accordingly, the fair value of the awards ultimately issued should be recognized ratably over the equity instruments' vesting period.

Question 9: **If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15). Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount to attribute to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative method do you propose?**

No, Dell does not agree that the fair value of the equity instruments should serve as a surrogate for the fair value of the services received. Dell reiterates its preference for SFAS 123's conceptual framework based on valuing the equity instrument rather than determining the fair value of an employee's service. Dell does not support the unit of service method approach to account for forfeited stock options.

Dell also emphasizes the importance of ensuring that financial statement preparers are allowed the ability to reverse compensation if stock options are forfeited, regardless of whether the instruments were awarded to employees or nonemployees. Dell believes that issuance is of significant importance in the design of an accounting standard on stock-based compensation. If shares are not issued (equity is not exchanged for valuable consideration) due to an optionee's failure to perform, companies should not record any expense. Recording an expense for unissued shares would also be contrary to the principles of FASB Concepts Statement No. 6, *Elements of Financial Statements* ("CON 6"), as there is no outflow or consumption of company assets. The accounting for forfeitures allowed by SFAS 123 leads to less consequence of incorrectly estimating in advance the potential valuable benefit an employee forfeited due to failure to meet vesting requirements or performance conditions. Whereas the accounting required by the units of service method in the draft IFRS leads to incorrectly considering the value of forfeitures in the grant date fair value of the option.

Measurement of fair value should be based on equity instruments actually issued (that is, the total options awarded less forfeitures).

Question 10: **In an equity- settled share- based payment transaction, the draft IFRS proposes that having recognised the services received, and a corresponding increase in equity, the entity should make no subsequent adjustment to total equity, even if the equity instruments granted do not vest or, in the case of options, the options are not exercised (paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another. Do you agree with this proposed requirement? If not, in what circumstances should an adjustment be made to total equity and why?**

No, we do not agree with the draft IFRS position that there should be no adjustments to total equity if the equity instruments do not vest and are not issued. As stated in our response to Question 9, we believe that the measurement of fair value should be based on the stock that is ultimately issued, net of forfeitures. Financial statement preparers should be allowed the ability to reverse compensation expense if stock options are forfeited.

Question 11: **The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk- free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends. Do you agree that an option pricing model should be applied to estimate the fair value of options granted? If not, by what other means should the fair value of the options be estimated? Are there circumstances in which it would be inappropriate or impracticable to take into account any of the factors listed above in applying an option pricing model?**

Yes, if options are expensed, an option pricing model should be applied to initially estimate the fair value of the options granted. However, current valuation methodologies, without modification, yield arbitrary and imprecise results due to the significance of subjective and complex estimates. The use of such models without modification could potentially provide investors with a false sense that share-based payments have been appropriately and consistently determined, when in fact the underlying estimates are imprecise due to the models' failure to consider some of the important, unique aspects of employee stock options ("ESOs").

We are concerned with the current models' shortcomings and inability to produce reliable measurements of fair value. The option pricing models currently available rely on six basic assumptions and were not initially designed to evaluate non-transferable, long-lived equity instruments. Therefore, the fair value generated by existing models fails to appropriately reflect the true nature of stock transactions with employees, as the calculated fair value rarely approximates the actual value realized by the employee upon exercise.

Specifically, existing models fail to reflect a discount for the fact that ESOs cannot be transferred to other individuals. Therefore, a liquidity adjustment should be considered in calculating fair value since ESOs are not publicly traded, cannot be sold and represent a transaction only between the employee and issuing company. To illustrate, investors apply substantial discounts to unregistered shares of stock that are sold in private placements. A discount recognizes that during the vesting life of an ESO, there are significant risks associated with holding a nontransferable award. Additionally, the models should permit volatility to be significantly adjusted to reflect the fact that employees do not benefit from (and therefore are not compensated for) the volatility of underlying stock while the option is outstanding. Rather, an employee's real benefit is limited to the cumulative appreciation of the stock price, if any, as of the date of exercise.

Question 12: **If an option is non- transferable, the draft IFRS proposes that the expected life of an option rather than its contracted life should be used in applying an option pricing model (paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22). Do you agree that replacing an option's contracted life with its expected life when applying an option pricing model is an appropriate means of adjusting the option's fair value for the effects of non- transferability? If not, do you have an alternative suggestion? Is the proposed requirement for taking into account the inability to exercise an option during the vesting period appropriate?**

Yes, Dell agrees that the expected life of a non-transferable option is preferable. This is but one of the shortcomings of existing option pricing models which were designed to value short-term transferable options. Current models tend to overstate the fair value of ESOs because they disregard the unique, restrictive aspects of ESOs, such as non-transferability and inability to benefit from stock volatility during the vesting period.

Question 13: **If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24). Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?**

We do not believe that the fair value of the options should be adjusted to reflect potential forfeitures due to failure to meet vesting conditions. Instead, the effect of forfeitures should be addressed with an adjustment to the quantity of options ultimately issued. If an option grant is conditional upon satisfying certain vesting conditions and those shares are ultimately not issued because the vesting criteria have not been met, then no expense should be recognized.

Question 14: **For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25). Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?**

While Dell believes that a reload feature ideally would be taken into account when measuring the grant date fair value of the option, we agree with the FASB's prior conclusion that no reasonable method exists to estimate the value of such a feature.

Question 15: **The draft IFRS proposes requirements for taking into account various features common to employee share options, such as non-transferability, inability to exercise the option during the vesting period, and vesting conditions (paragraphs 21-25). Are there other common features of employee share options for which the IFRS should specify requirements?**

Dell agrees that non-transferability, inability to exercise during the vesting period, and the vesting conditions are important considerations to consider when developing an option pricing model for share-based payments. Additionally, as stated in our response to Question 12, current option pricing models were designed to value short-term transferable options and were not designed to value long term ESOs.

Question 16: **The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles based standards and to allow for future developments in valuation methodologies. Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?**

No, in this case Dell does not agree with the draft IFRS approach of issuing a principle based standard. Due to the technical nature of the topic, and given the IASB's stated goal of developing a standard that provides for more consistent and comparable financial statements, Dell believes that the IASB should issue a technical, application-based standard as opposed to a principle-based standard. Dell believes that a number of improved option pricing models need to be prescribed by a new standard, especially if the disclosure-only alternative as allowed for by SFAS 123 is no longer an alternative.

Question 17: **If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, ie additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that example, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period. Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?**

Conceptually, Dell agrees with the IASB and believes an award modification is, in effect, a change in the terms and conditions of the original award. Therefore, Dell supports calculating the fair value of the original award at the modification date by using the remaining expected life of the original award. Dell also agrees that the incremental fair value of a modified award, as compared to the fair value of the original award at the modification date, should be measured and recognized over the remaining vesting period of the modified award.

Question 18: **If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments. Are the proposed requirements appropriate? If not, please explain why not and provide details of your suggested alternative approach.**

No, we do not agree that an entity should continue to recognize expense after the cancellation of an option grant. If a company settles outstanding stock options through a cancellation or repurchase, the awards are no longer outstanding and no future benefit can be derived by the former option holder. The grantee can no longer reap benefits from the equity instruments subsequent to settlement. Although the option grantee may perform services subsequent to settlement, the cancelled equity instruments do not serve to compensate the individual in any way. Therefore, it appears unreasonable to continue to recognize expense subsequent to the equity awards' cancellation. Our view is consistent with the viewpoint that measurement of equity awards is more reliably determinable than measurement of the related goods or services.

Question 19: **For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statement. Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.**

No, we do not agree with the proposed requirements for measuring cash-settled share-based payments. Cash-settled share-based payments, including stock appreciation rights ("SARs"), should be measured at intrinsic value rather than the fair value obtained from an option-pricing model because the results yielded by existing pricing models are not reliable. For example, SARs obligate a company to pay cash at a future date based on a company's stock price; therefore, intrinsic value measurement is most closely aligned with the true compensation expense to an entity.

Question 20: **For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle. Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.**

Yes, the proposed requirements are appropriate. However, if adopted, the draft IFRS would establish additional criteria for companies in evaluating how an entity should account for certain contracts that can be settled in cash or equity at the entity's option. The FASB Emerging Issues Task Force ("EITF") Issue No. 00-19 presumes that companies will prefer to issue equity securities to avoid consumption of assets; however, this presumption may not be accurate. Accordingly, the accounting for such arrangements should reflect the terms as understood by the employer and employee. While the written option plan generally provides the best evidence of such terms, an employer's past practices may indicate substantive terms that differ from written terms.

Therefore, the draft IFRS appears to set forth reasonable criteria in overcoming the presumption set forth in EITF Issue No. 00-19.

Question 21: **The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand: (a) the nature and extent of share-based payment arrangements that existed during the period, (b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and (c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss. Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?**

Yes, Dell agrees that the draft IFRS disclosure requirements are appropriate. If the disclosure-only alternative of SFAS 123 is no longer allowed and companies are required to expense share-based payments, we agree that additional disclosures should be included to allow users of financial statements to fully understand the nature and calculation of the expenses.

Included in the disclosures required under *(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined*, the following paragraphs summarize our viewpoints regarding certain disclosure requirements included in the draft IFRS that are beyond the current disclosure requirements of SFAS 123.

- *Draft IFRS paragraph 48(a)(ii), comparison of historical and expected volatility*

  Because volatility significantly influences current option-pricing models' estimation of fair value, an explanation of historical and expected volatility will likely enhance information available to investors. Historical volatility is not always indicative of a company's expected volatility due to various factors, including: limited corporate life cycle, disposal of a significant line of business, or isolated incidents that may not be representative of future stock performance. This is particularly true given recent significant declines in the stock market over the past several years which will result in abnormally high volatility. Therefore, Dell supports the draft IFRS's proposed disclosure requirements.

- *Draft IFRS paragraph 48(a)(iv), assumptions of vesting conditions and draft IFRS paragraph 48(e), comparison of estimated and actual equity instruments vested*

  Dell agrees that disclosure of the assumptions made with regard to vesting conditions (i.e., estimated forfeitures) and a comparison of estimated and actual forfeitures will serve as beneficial information to investors and will improve the transparency of reported financial statements. Companies should also be allowed to disclose whether significant unforeseen events have occurred which impact original estimates (i.e., layoffs, consolidations, restructurings, etc.). Additionally, Dell reiterates its support for the SFAS 123 position of valuing the equity instruments actually issued, and we do not support the draft IFRS measurement objective of measuring the goods or services received by the company. A company does not receive valuable consideration for a forfeited equity instrument, and thus the company should be allowed to reverse compensation if stock options are forfeited, regardless of whether the instruments were awarded to employees or nonemployees.

- *Draft IFRS paragraph 48(f), comparison of estimated and actual option life*

  Requiring companies to disclose a comparison of actual option life and the grant-date estimate of expected option life will enhance investors' ability to evaluate the quality of estimates underlying reported financial statements. As previously mentioned, additional disclosures should be permitted to explain significant differences between estimated and actual option lives due to unforeseen circumstances or significant events.

Question 22: **The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (ie the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured). Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.**

No, Dell does not believe that the implementation guidance in the draft IFRS is appropriate. We believe that if the combined Boards move forward with developing a standard that requires expensing of share-based payments, and no longer allows for the disclosure-only alternative of SFAS 123, then a prospective implementation approach should be allowed from the required implementation date of the final standard. Dell believes that all options outstanding (vested and unvested) prior to the date of implementation of a new standard should be exempt from expensing. Furthermore, a new share-based payment standard requiring the expensing of stock options will negatively affect a company's willingness to issue stock options. A prospective implementation approach would allow companies to fully consider the financial impact of issuing options and to make decisions most appropriate for their business.

Question 23: **The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) *Income Taxes* to add an example to that standard illustrating how to account for the tax effects of share-based payment transactions. As shown in that example, it is proposed that all tax effects of share-based payment transactions should be recognised in the income statement. Are the proposed requirements appropriate?**

No, we do not believe that the proposed requirements are appropriate. Income taxes should be recognized based upon the amount recorded as compensation expense. Any difference between benefits assumed based on grant-date fair values and actual benefits received should be recorded as equity. We support the SFAS 123 methodology, which is less complex to apply, produces less income statement volatility and is consistent with the current tax treatment of equity awards accounted for using the grant-date intrinsic value method.

Question 24a: **In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 *Accounting for Stock-Based Compensation*, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following.**

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:

- **employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;**
- **SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in**

Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (paragraphs BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); and

- **unlisted (non-public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75-BC78 in the Basis for Conclusions give an explanation of minimum value**

Dell agrees with the position of SFAS 123 and believes that the Board should exclude ESOPs and certain ESPPs from the scope of an accounting standard addressing stock-based compensation. The intent of these broad-based plans is generally to raise capital or to obtain more widespread ownership of stock among employees rather than serve as compensation to the employee. Because ESOPs are put in place primarily to meet these objectives, the associated cost should not be accounted for as a charge to operations.

We strongly agree with the fair value disclosure only alternative allowed for by SFAS 123. We believe that until such time as option pricing models are developed that accurately reflect the fair value of ESOs, the intrinsic value measurement under APB No. 25 is a more reliable calculation of the expense to be recorded by the issuing corporation.

No comment regarding the calculations of fair value for unlisted entities.

Question 24b: **For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However: under SFAS 123, the estimate of the fair value of an equity instrument at grant date is not reduced for the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas the draft IFRS proposes that the possibility of forfeiture should be taken into account in making such an estimate. Under SFAS 123, the transaction is measured at the fair value of the equity instruments issued. Because equity instruments are not regarded as issued until any specified vesting conditions have been satisfied, the transaction amount is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted are forfeited. Under the draft IFRS, the transaction is measured at the deemed fair value of the employee services received. The fair value of the equity instruments granted is used as a surrogate measure, to determine the deemed fair value of each unit of employee service received. The transaction amount is ultimately measured at the number of units of service received during the vesting period multiplied by the deemed fair value per unit of service. Hence, any amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.**

Dell supports the position of the IASB and SFAS 123 that the measurement of expense should be based on the fair value of the equity instruments at grant date. However, as detailed in our response to Question 9, we do not support the units of service method of accounting for forfeited instruments as proposed in the draft IFRS. Dell strongly supports SFAS 123's current accounting for forfeited equity instruments and its focus on the measurement of the fair value of equity instruments ultimately issued. Forfeited equity instruments are never issued and thus provide no valuable benefit to the option holder. A company does not receive valuable consideration for a forfeited equity instrument and thus the company should be allowed to reverse compensation if stock options are forfeited, regardless of whether the instruments were awarded to employees or nonemployees.

Question 24c: **If, during the vesting period, an entity settles in cash a grant of equity instruments, under SFAS 123 those equity instruments are regarded as having**

immediately vested, and therefore the amount of compensation expense measured at grant date but not yet recognised is recognized immediately at the date of settlement. The draft IFRS does not require immediate recognition of an expense but instead proposes that the entity should continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

We agree with the treatment of cash-settled options as outlined in SFAS 123. If a company settles outstanding stock options due to cancellation or repurchase, the awards are no longer outstanding and no future benefit can be derived for the former option holder. The employee or nonemployee can no longer reap benefits from the equity instruments subsequent to settlement. Although the option grantee may perform services subsequent to settlement, the cancelled equity instruments do not serve to compensate the individual in any way. Therefore, it appears unreasonable to continue to recognize expense subsequent to the equity awards' cancellation. This approach is consistent with the viewpoint that measurement of equity awards is more reliably determinable than measurement of the related goods or services.

Question 24d: **SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96-18 *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* requires the fair value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.**

If options are expensed, we believe that fair value should be measured at grant date for options granted to nonemployees. We also reemphasize that compensation expense should not be recorded for option grants that are forfeited and not ultimately issued. Dell supports SFAS 123's current approach to accounting for forfeited equity instruments and not considering forfeitures in the initial estimate of grant date fair value.

Question 24e: **SFAS 123 requires liabilities for cash-settled share appreciation rights (SARs) to be measured using an intrinsic value measurement method. The draft IFRS proposes that such liabilities should be measured using a fair value measurement method, which includes the time value of the SARs, in the same way that options have time value (refer to paragraphs BC70-BC81 of the Basis for Conclusions for a discussion of intrinsic value, time value and fair value).**

Refer to our response to Question 19.

Question 24f: **For a share-based payment transaction in which equity instruments are granted, SFAS 123 requires realised tax benefits to be credited direct to equity as additional paid-in capital, to the extent that those tax benefits exceed the tax benefits on the total amount of compensation expense recognised in respect of that grant of equity instruments. The draft IFRS, in a consequential amendment to IAS 12 (revised 2000) *Income Taxes*, proposes that all tax effects of share-based payment transactions should be recognised in profit or loss, as part of tax expense. For each of the above differences, which treatment is the most appropriate? Why? If you regard neither treatment as appropriate, please provide details of your preferred treatment. (Respondents may wish to note that further details of the differences between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment.)**

Refer to our response to Question 23.

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January 31, 2003

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
File Reference No. 1102-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: 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*

Dear Ms. Bielstein:

Dell Computer Corporation ("Dell") appreciates the opportunity to respond to the Financial Accounting Standards Board's ("Board") Invitation to Comment dated November 18, 2002, entitled *Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123, Accounting for Stock-Based Compensation, and Its Related Interpretations, and International Accounting Standards Board ("IASB") Proposed IFRS, Share-based Payment*. Because investors rely on credible, transparent, and comparable financial information, high caliber accounting standards are vital to the efficient functioning of the world's economy. Dell fully appreciates the Board's due process in giving us ample opportunity to comment on the projects the Board is considering.

We feel strongly about the conceptual framework around stock option expensing. Although there is arguably a compensatory element to the granting of stock options, we are strong proponents of the disclosure-only alternative provided for under Statement No. 123 until such time as option-pricing models are developed or refined that reasonably reflect the fair value of long-lived, nontransferable employee stock options ("ESOs"). We also prefer this alternative until the Board develops a more reasonable approach for handling post-grant events, such as forfeitures, which have a significant impact on the expense associated with ESOs. We believe there are salient points to support our position as discussed more fully below.

Dell believes that present US accounting for stock-based compensation, while less than perfect, has served the financial community well. In our view, there currently is not convincing evidence that the expensing of ESOs using existing pricing models would improve financial statement reliability, comparability, or transparency. Although we do recognize that the Board is not seeking comments on whether stock options should be expensed, we strongly support the continued disclosure-only alternative for stock-based compensation costs. Our support of disclosure is based on the following reasons:

- The value received by an option holder at exercise does not equate to the cost to the issuing corporation.

- The debate on fair value is so widespread that it will be impossible to come to agreement on a reliable methodology applicable to all financial statement preparers because grant date fair value will always be an imprecise and volatile estimate of the ultimate value, if any, realized by the employee upon exercise.

- The expensing of stock options further disconnects net income from cash flows; expensing a "hypothetical" fair value could be misleading and confuse the investor as to the relationship between net income and cash flows.

Although stock options can provide the employee with a valuable benefit, the only value an employee ultimately realizes from a stock option grant is the intrinsic value recognized upon exercise of the vested option. However, the value realized by the employee upon exercise is irrelevant to the cost incurred by the issuing company. The value of an ESO to the employee (however calculated) does not equate to the cost to the issuing corporation. The issuance of stock options does not result in a cost that affects net income. The only true cost of an employee stock option to the issuing corporation is in the form of potential dilution to shareholders, which is measured in the EPS calculation. With respect to the compensatory element, not only is the value not reliably measurable at the time of grant, it may bear no resemblance to the value, if any, ultimately realized by the employee. For instance, Dell ESOs that have realized by far the most intrinsic value are those that were granted in the mid-1990s and prior. The application of the Black-Scholes valuation model to those ESOs resulted in insignificant fair values at the time of grant compared to their realized intrinsic values. Conversely, Dell ESOs granted during our fiscal 2000 and 2001 fiscal years resulted in enormous fair values while the actual grants are now significantly under water. It does not seem logical to require recognition of compensation expense in the basic financial statements when the actual outcomes can be so significantly disconnected from the theoretical fair value.

In addition to the disconnect described above, we are concerned that current pricing models (irrespective of their level of sophistication) do not generate a reliable fair value of an ESO. The current models tend to overstate the fair value of a nontransferable ESO, and these models require the input of highly subjective assumptions. Current option pricing models yield varying and misleading results because they disregard the unique, restrictive aspects of ESOs, such as nontransferability and inability to benefit from stock volatility during the vesting period. And as we alluded to above, the fair value of an ESO at grant date is not adjusted for declining stock prices; however, such declines significantly affect an employee's decision about whether or not to exercise an ESO. It is counterintuitive that a company would incur an expense at any time for options that expire out-of-the-money. If the Board insists on moving forward on expensing ESOs at the time of grant, Dell believes the Board's efforts would be best served to develop improved option-pricing models for ESOs that, although perhaps still imperfect and imprecise, would provide more consistent and comparable results across companies and industry sectors.

We also believe that the Board should consider how expensing of ESOs will cause a further disconnect between net income and operating cash flow. Investors tend to keenly focus on cash flows generated by a company's on-going operations and their respective claim to such amount because cash flows are not subject to estimation or manipulation. Employee stock options are very attractive in aligning the interests of management, employees and shareholders. Issuing ESOs serves to protect shareholder interests as it minimizes the impact to corporate cash flow while still creating equity capital. Moreover, when options are granted, less compensation is typically incurred and less cash is paid to recruit and retain an employee. We are concerned that recording a hypothetical fair value as an expense using current pricing models could be misleading and confuse investors as to the relationship between net income and cash flows. Disclosure of the pro forma impact under the existing rules adequately allows users to consider, at their discretion, whether or not to include hypothetical fair value information in their analysis of a company's financial results.

In closing, Dell encourages the Board to consider the potential unintended consequences to the economy if it rules to expense stock options. A new expensing standard could lead to depressed US stock prices, increases in the cost of capital, and reduced US economic growth rates.

Employee stock options are issued to increase productivity, retain employee service, and encourage company ownership. In high-growth, high-risk, and youthful companies with limited resources, ESOs are a significant part of attracting and retaining talented people. Expensing of ESOs would undoubtedly affect a company's willingness to issue ESOs. Without providing employees with the opportunity to participate in a company's future growth, the best people will not be attracted or retained and productivity in the US economy will most likely be adversely affected. These potential unintended consequences to the economy are contrary to the basic principles underlying employee stock option programs.

Thank you for the opportunity to comment on this important matter. If you have any questions regarding our comments, please contact me at (512) 728-4283.

Sincerely,

Robert W. Davis
Vice President, Chief Accounting Officer