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From: KnoxCa@consumer.org

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To: Director - FASB

Subject: Exposure Draft Comments -- File Ref No. 1102-100

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Consumer Federation of America

28, 2004

June





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Financial Accounting Foundation 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 Via email: director@fasb.org

Comments of
Consumers Union
Consumer Federation of America
US Public Interest Research Group
Consumer Action
on
Exposure Draft
File Reference No. 1102-100

We are writing on behalf of Consumers Union, Consumer Federation of America, U.S. Public Interest Research Group, and Consumer Action in support of the Financial Accounting Standards Board's (FASB) proposal to require all public companies to expense stock option compensation costs. Under existing accounting guidelines, firms are not required to report the cost of stock options paid to executives and employees as compensation expenses on their financial statements. By closing this loophole, FASB's proposal would make earnings reports more accurate.

Keeping large and valuable employee stock options off the books has made options an attractive form of executive compensation because, unlike all other forms of compensation, options do not reduce reported earnings. As a result, the volume of stock options paid to executives skyrocketed in the past decade - the 2,000 largest U.S. companies granted \$162 billion in stock options to executives in 2000, up from \$50 billion in 1997. This explosion in stock options has in turn created an incentive to artificially pump up earnings in the short term, possibly without concern for the long-term well-being of the company, lower-level employees, and shareholders. Many people believe that the absence of an expensing requirement helped bring about the anything-goes accounting scandals of the past several years.

Leaving stock option compensation costs off the income statement deprives investors of important information about the true financial status of the companies in which they invest. According to a Bear Stearns analyst, the 2003 reported operating earnings of the 100 largest NASDAQ-traded companies would

have been reduced by 44 percent had they been required to expense stock option compensation. FASB is doing the right thing by acting to tighten accounting rules and to put an end to this kind of investor deception.

As then-Chair of the Senate Consumer Affairs Subcommittee Senator Peter Fitzgerald noted in 2002:

The stock options loophole encourages companies to continue to issue more and more options to their top executives. Excessively large holdings of stock options, in turn, create a dangerous incentive for top executives to goose earnings and cash out when the stock price is high, leaving employees and shareholders holding the bag. We've already seen possible evidence of this pattern at Enron and Global Crossing, where top executives cashed out hundreds of millions of dollars in stock options and left the companies before their houses of cards came crashing down. I am concerned that the special carve-out for employee stock options may be at the heart of the

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corporate abuses we are seeing today.

Federal Reserve Chairman Alan Greenspan echoed these concerns. In February 28, 2002, the *Wall Street Journal* reported that Chairman Greenspan had "blamed the Enron issue in part on the failure of accounting rule makers in the early 1990s to force companies to treat stock options as compensation [2]

expense." That failure to act gave companies an incentive to "game the accounting system in a manner to create the perception of short-term growth, which would be confused with long-term growth."

Similarly, prominent U.S. investor and business leader Warren Buffett has explained why he favors expensing stock options: "When a company gives something of value to its employees in return for their services, it is clearly a compensation expense. And if expenses don't belong in the earnings statement, where in the world do they belong?" We agree with these experts, and believe that stock option compensation costs should be counted as an expense on the financial statements just as all other forms of compensation are.

The arguments being leveled at the proposal by the tech industry and others simply do not hold water. FASB's proposal does nothing to prevent companies from continuing to issue stock options to executives and other employees. It just makes them show the cost. The estimates required to value these options are no more complicated than many other estimates that go into the financial statements. In fact, companies routinely value stock options for tax filings and when they use options for non-employee-compensation purposes.

Finally, contrary to the claims of its critics, FASB has certainly not rushed to judgment on this issue. Indeed, FASB's procedures have been a model of openness and due process. The board has shown itself to be highly responsive to the comments and suggestions of critics of the proposal. In the end, however, the accounting experts at FASB have reached the same conclusion reached by the Big Four accounting firms, the Association for Investment Management Research, Warren Buffett, Paul Volcker, Arthur Levitt, Alan Greenspan, and the over 500 companies that are already expensing stock options voluntarily: stock options are an expense that should have to be reflected in the company's financial statements.

For all of these reasons, we strongly support FASB's proposal for expensing stock options, and, as our comments herein suggest, we would like to see this proposal implemented as soon as possible.

Sincerely,

Sally Greenberg Senior Counsel Consumers Union Barbara Roper
Director of Investor Protection
Consumer Federation of America

Kenneth McEldowney Executive Director Consumer Action

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Sen. Peter G. Fitzgerald News Center archives, "Sen. Fitzgerald: Close stock options loophole," (press release), July 18, 2002, <a href="http://fitzgerald.senate.gov/index.cfm?FuseAction=Issues.View&IssuePosition\_id=24">http://fitzgerald.senate.gov/index.cfm?FuseAction=Issues.View&IssuePosition\_id=24</a> (accessed June 30, 2004).

<sup>&</sup>quot;Interest Rates Won't Climb Soon, Fed Chief Suggests, Amid Little Inflation Risk," Wall Street Journal, 28 February 2002.