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Letter of Comment No: 5 808 File Reference: 1102-100

From: Eric Behrns@amat.com

Sent: Wednesday, June 30, 2004 3:27 PM

To: Director - FASB

Subject: File Reference 1102-100: Accounting for Stock Options and ESPPs

Mr. Robert H. Herz Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

RE: File Reference No. 1102-100

Dear Chairman Herz:

I am writing to express my strong disagreement with the Exposure Draft FASB released on March 31, 2004, with regards to accounting for share-based payments relative to FAS 95 and 123.

There are numerous reasons for my disagreement with your endeavor to change accounting standards for stock options and Employee Stock Purchase Plans (ESPPs). While my company offers both types of incentives, I write of my own accord. It is of note that there is real irony attached to this process as I prepare to file my comments to FASB using technologies created by individuals incentivized with stock options and ESPPs.

When an "independent" body such as FASB decides to shift directions and issue a new standard on a matter that has been considered previously, it is prudent to ponder the impetuses preceding the new conventional wisdom. In this vein, it appears that there are both public and private reasons for FASB's actions on this matter.

On the public level, it has been stated that the primary reason for the resuscitation of this matter—a decade after it was last considered—is that recent history has shown that stock options create a perverse incentive for corporate managers to skew financial results and reap personal gain. Since accounting rules do not require a "cost" to be listed on the P&L Statement, this creates an easy way to game both the financial system and investors while enriching a few fat cat executives in the process. This idea has been anecdotally credited—without factual substantiation—as the causal factor of the fraud discovered at a handful of American companies.

If one was to perform a serious evaluation of the crimes committed at Enron, WorldCom, Adelphia, and others, they would not be able to prove any direct linkages between stock options and the laws broken by managers at these companies. Since a variety of other "creative" accounting features were directly to blame in these incidents—such as Special Purpose Entities—stock options can only be implicated indirectly and investors could not reasonably expect that these scandals would have been averted if "expensing" had been required.

Since we know with certainty that accounting features other than those relating to share-based payments were utilized by accounting firms and investment banks to perpetuate fraud, we must ask why stock options have been cited repeatedly and publicly as fraud's causal effect. Further, if we accept the premise that stock options create a perverse incentive for corporate managers writ large—not just those with significant moral failings—we must then determine whether an accounting standards setting body is the proper venue for solving a corporate governance matter.

Leaving aside this question, Congress clearly declined to implicate stock options as a contributing factor in the recent corporate fraud during the legislative activities that led to the passage of the historic Sarbanes-Oxley legislation. Unquestionably, Congress found other factors, structures, and institutions that were the enabling mechanisms of corporate fraud. Even after the Invisible Hand worked its will and the stock exchanges added rules requiring shareholder approval of stock incentive plans, a number of groups were left wanting more, largely out of non-enlightened self-interest.

The proponents of the Exposure Draft generally fall into four camps. First, there are those who wish to deflect attention from their own legal chicanery and deception of both the investing public and employees at the afflicted companies. In this corner we have the accounting firms who created Special Purpose Entities and other unusual arrangements that were complex enough to evade popular comprehension. Also in this camp are the investment banks that compromised the integrity of their "research" in order to win lucrative M&A contracts from the firms in question. This particularly sophisticated group realized that the only scapegoat they could plausibly market would be the proverbial "fat cat executive." When you've profited from screwing the little guy, and are at risk of taking the blame, what better form of deflection than assuming the mantle of populism? What better target of blame in an economic downturn, (following upon the heels of a global economic boom), than the "over-compensated" corporate executive? It is mind-boggling that so many fell for the sophistry of those most responsible for enabling these scandals. Tangential membership in this group goes to corporations who, having used stock options primarily to incentivize their executives, chose to "expense" options so as to erect a thin veneer of good corporate governance in the face of their top-heavy schemes.

The second group is primarily composed of institutional investors concerned about the dilution of their ownership levels. This is a group that invests in large quantities and doesn't like to see its voice dimmed within the ranks of corporate management at the "expense" of a bunch of uppity employees with different priorities. After all, it doesn't behoove fund managers to allow groups with divergent interests to become a potentially strong and oppositional voting block at proxy time. It is worth noting that this group is easily bought off. As companies seek shareholder approval for their share-based payment plans, institutional investors ostensibly opposed to the accounting of stock options and ESPPs have voted to approve stock plans accompanied by share buyback programs. The true concern of these expensing proponents is not really the accounting—despite the straw men of clarity, transparency, and accuracy that are often exalted to the press—it is quite simply a matter of profit and control. In fact, many members of this group understand that the economic value proposition that accompanies an alignment of the interests of employees and investors is in an increased stock price. Quite simply, they wish to retain control when proxy time rolls around.

The third group is equally pernicious in its motives. It does not take a doctorate in chemical engineering, (an all-too-rare skill-set for which share-based payments are a primary method of attraction and retention), to understand the utter failure of unions to penetrate America's high-tech workforce. It is not an accident that employees with stock options do not look kindly on attempts to unionize their workforce. The model that has come to define management-employee relations in the unionized American workforce exhibits a level of animosity and distrust not found when employees and managers unite towards a shared goal that benefits both – raising the stock price. Although broad-based employee stock plans are an unmatched response to the concerns raised by Marx and Engels regarding ownership of the means of production, unions have largely failed to embrace these tools. If the proletariat, (i.e. the rank-and-file worker), is offered a stake in the ownership society, they can't help but to think more like an owner and less like an meaningless cog in a Kafka-esque machine of corporate drudgery. So if unions seek to represent the best interest of workers, why would they oppose a fundamental improvement in the management-worker relationship? Could it be that union leaders generally failed to recognize this opportunity and as such have miserably failed to represent the best interests of their membership? Could it also be that a workforce that does not revile management as the enemy would not require a bureaucracy to fight with management on its behalf? It cannot be an accident that the few unions who negotiated stock options into their contracts do not seek a change in accounting standards which would inevitably result in an elimination of a benefit their membership currently enjoys.

The fourth group is largely composed of those who reside within self-perpetuating bureaucracies, and as such, seek to justify their existence and their turf in perpetuity. We see many of this genre within the ranks of government, and FASB and other similar institutions are certainly not immune from this gravity. It is this mindset that has helped create an obtuse federal tax code that requires the average person to hire an accountant to simply pay their taxes. It is the bureaucratic need to appear to be "doing something" that has created excessively complex corporate financial reports that leave the average investor bamboozled as to which numbers and metrics are the best measures of economic value. As financial statements become increasingly complex, they have also become increasingly incoherent.

It seems that FASB has ascribed to a variant of the Nitzchean tenet that "If there was not a God, one would have to be created." If there was not a constant stream of FAS pronouncements, from where would one gather comfort within our financial system? It is my contention that FASB does not need to offer up many of its pronouncements, but instead, should take a hard look at achieving the actual goals of accounting: presenting the public with a clear and precise snapshot of corporate finances. Like the Federal tax code, a constant stream of new regulations and detailed prescriptions designed around problems rather than seeking to increase clarity and transparency create (1) an increased ability for the unethical to game the system, and, (2) a waterfall of information that loses clarity as its deluge gathers force and becomes opaque. What is the point of the P&L statement if the average investor must individually decipher and separate out numbers that no longer reflect a company's economic reality?

Much has been said—particularly by FASB and its lobbyists—about the need to preserve the independence of FASB's pronouncements. On its face, this is a reasonable claim. Once one considers it closely, however, this argument is revealed as a red herring. Our society loves to elevate those who consider themselves "independent" or "objective." We peons of society are told to accept pronouncements from these sorts of institutions and people without critical thought because they have been made without consideration of the beliefs of one side or another. How anathema would our founding fathers find this ideology? The most famous institution of this sort is the "free press," which academic studies have shown to be notably less objective it claims to

be. FASB, while it professes objectivity and cries out to be allowed to work its will unfettered by oversight, has compromised its own independence. It is clear through the statements of various FASB members that this ED is pursuant to IASB intentions. If FASB is independent, why is it blindly following the lead of a European standards setter?

FASB also declines to acknowledge that all manners of independence granted by our society are pursuant to a code of conduct by which one earns the right to continue acting "independently." Take for example an automobile driver who, through their own independent action, causes injurious harm to others in society. We do not allow this person to continue driving without penalty. Instead, we act to mitigate the driver's independence so as to preserve the safety and well-being of the greater good. When we enter into a contract with the state that grants us license to drive, we receive the independence to act within reason. Once we act outside of these boundaries, it is entirely appropriate for the government to step in and preserve the greater good. In the same way, it is entirely appropriate for outside entities—including the SEC and Congress— to exercise oversight authority over FASB when it embarks upon a path with substantial micro- and macro-level economic impacts.

FASB emphasizes that it is only tasked with one goal—setting accounting standards—and that it is thus inappropriate to examine the environment in which its pronouncements take place. FASB does not concern itself with foreign competition for scare resources (i.e. highly-skilled and educated employees), or the economic butchery visited upon start-up companies, or even the budgetary impact on states (California received approximately 15% of its revenues from the exercise of stock options during the boom). Instead, FASB has adhered to the bureaucratic tenet advanced by Charles Goodsell that holds that where one sits determines one's stance. How else could we explain the fact that Chairman Herz has apparently reversed his position on expensing since working for a large accountancy, where he was expected to help woo clients?

FASB appears to see no problem with proceeding with the same attitude (*I focus strictly on my task and deny any sort of responsibility for the greater consequences*) employed by Adolf Eichmann. While FASB's actions will not lead to the sort of carnage that Eichmann's efficient trains resulted in, it can certainly be postulated that ignoring the big picture will have disastrous results for America's economic and technological prowess in our increasingly competitive world.

Of course, none of this is relevant to you, is it? After all, your theoretically pure view of comparative advantage is one that allows you to say, "We are just accounting gurus. We retain agnosticism on questions not directly related to accounting." Comparative advantage is a wonderful thing, but do not allow yourselves to abdicate critical judgment about how your function relates to American society at large. In abdicating this judgment, please acknowledge your membership in a Banality of Bureaucracy.

The premise that "expensing" is necessary and essential to provide investors with the information needed to make an accurate assessment of a company's economic value is beyond ridiculous. Millions of shares are traded publicly each day by investors who are well aware that the companies they are buying and selling offer their employees stock incentive programs. Those who choose a higher state of awareness are already able to find detailed data within the footnotes that accompany each company's SEC filings. Surely, if the location of this data had caused a crisis of confidence, investors would not continue to buy and sell these stocks! Surely, if institutional investors felt that the true state of a company's financials were being shrouded by accounting gimmicks with regards to stock incentives, they would not stay invested in companies that choose not to "expense" these instruments. It is clear that the pension funds bringing shareholder resolutions at companies with broad-based stock programs are not responding to their preference for expensing by liquidating their holdings.

In short, what need are you filling with this ED? Do investors really need a more complicated balance sheet that includes a guesstimate in the calculation of the bottom line? Will clarity truly be improved, or will this cause further confusion and cause investors to seek out pro forma numbers for a more accurate picture of the company's financial position? Are investors better served by the insertion of new numbers onto the P&L derived from a valuation mechanism whose own inventor disavows its usage for these purposes? Will investors understand the arcane tax implications of this standard, or is it simply a method for further enhancing the bottom line of the accountancies who will inevitably be hired to digest this added complexity?

I urge you to adopt a variant of the Hippocratic Oath and first determine to "do no harm." Please don't make financial statements less coherent, less clear, and less comparable. Please don't advocate valuation models that are not intended for the goals you seek to achieve. Please don't violate your own concepts on realizable revenue and gain by assigning cash values to instruments that are not readily convertible. Please don't impair the ability of highly cyclical industries—like the semiconductor industry—to retain valuable employees when times turn tough. Please don't reduce the NASDAQ 100's profits by approximately 40% and potentially cause investor panic. Please don't adopt a new standard that ironically assists those most culpable in the recent corporate scandals. Please don't create a standard that results in stock incentives only being granted to executives at the "expense" of rank-and-file workers.

Should FASB standardize the disclosure mechanisms of corporate financial reporting? Absolutely! Should it add a guesstimate to the P&L with variable methods of computation? I may not be a certified public accountant, but as a user of accounting statements I would hope that FASB would not entertain "standards" that fail to meet any definition of the term. I do not wish to attempt analysis of financial statements that are cloaked in Vanessa Huxtable's "New Math." Please shelve your ED entirely, or,

if you refuse to countenance total defeat yet again on this matter, attempt to rework it so that it makes at least a modicum of sense.

Sincerely -

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