Karen Salmansohn

From:
Sent:
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Subject:

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----Original Message----

From: Ross A. McLaurin [mailto:ross@lincolnhouston.com]

Sent: Thursday, January 30, 2003 5:20 PM

To: letters.editor@ft.com; Director - FASB

Subject: stock option accounting-fasb file ref #1102-001

Gentlemen-

The current method of accounting for compensation related stock options violates a fundamental principal of accounting and leads to a misallocation of resources. Costs are recognized as charges against profits in accordance with how these resources are utilized in a business. For example, a company making a capital expenditure on a plant that is expected to benefit the business many years will reduce the profits from that plant by the amortization of the capital expense over the expected life of the plant, even though the monies are spent up front. Labor and management are current expenses and the costs should be recognized as reducing current profits. Paying employees with equity in a company via stock options is in essence trading an interest in a perpetual income stream for current services. The effect is to charge earnings in perpetuity by an amount equal to the current cost of labor divided by the price to earnings ratio of the stock. A firm with a high price to earnings ratio can show a current charge for labor and management equal to only a few percent of the actual value of the services rendered - when in fact they may consume a very large portion of the firms revenues. This gives the illusion of a higher level of profitability than really exists. The reduction of current earnings by expensing stock options along with the dilution of earnings due to increased stock outstanding is claimed to be double counting. However, this can be remedied by buying back all the stock exercised so that dilution does not occur (which is what is practiced by many firms anyway). It is claimed that innovation would be stifled by requiring the expensing of stock options. A critical function of any properly functioning economic system is to allocate resources so that they are most efficiently used. The use of resources without a proper examination of the benefits that their use brings leads to the misallocation of resources. The stock market bubble was a gigantic misallocation of resources that will dog our economic progress for sometime. Stock options and the incentive they supplied to managements to obfuscate accounting were largely responsible for creating the illusion of profits that were in fact not there, helping to create the bubble.

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