

Letter of Comment No: 112  
File Reference: 1101-SCU  
Date Received: 10/09/03

**Stacey Sutay**

**Subject:** FW: FASB 123 (Stock Option abuse)

-----Original Message-----

**From:** R.W. Glenn [mailto:rwglenn@netzero.com]

**Sent:** Thursday, October 09, 2003 2:04 PM

**To:** Michael Tovey

**Cc:** chairman@sec.gov

**Subject:** FASB 123 (Stock Option abuse)

Dear Mr. Tovey,

I am writing a book on why individual investors should **not** be investing in the stock market. The primary reason is what I refer to as "stock option abuse". I have read the FASB's 9/17/03 decisions and those tentative prior decisions but need some help in determining whether or not any **specific** consideration has been given or will be given to my comments in item 6. of my Invitation to Comment letter to the FASB dated January 30, 2003:

"6. Measuring the fair value of the equity instrument at grant date is, no doubt, more readily determinable but it ignores the difference (or gain) between the value of the equity instrument at exercise date (intrinsic value). At first thought, one may think, the gain to the employee, or the difference between the grant price and the market price of the stock the day the option is exercised has nothing to do with the company's financial statements. One may think, this gain to the employee represents the fruits of his labor for a job well done during the vesting period and is "unrecognized" compensation in that it doesn't appear anywhere in a company's financial statement. It does and it does so significantly. When options are exercised, shares outstanding increase diluting earnings per share. To offset this dilution of earnings because of the increase in the number of shares outstanding, shares are repurchased in the market to reduce or offset this increase. If the number of shares repurchased are the same as the number of shares exercised, there is a decrease in book value (shareholder's equity). This difference in book value is the difference between the grant price and the market value of the shares repurchased. So the "unrecognized" gain going to employees results in a decrease in shareholder's equity when the number of shares repurchased equals the number of shares exercised. For the "TOP TEN" companies noted in 5 B above this is what happened over the three years ending 2001. The outstanding shares remained basically the same (decreased by 190 million shares from 48,741 to 48,551 billion shares) yet the companies purchased approximately 1.641 billion shares for \$69.7 billion (or 29% of their net income) in their "share-purchase" programs. **Thus, determining the fair value of stock option compensation expense at the date of grant (use of Black-Scholes et al) ignores this huge "hidden" loss of equity on the part of shareholders which has accrued to the benefit of those employees receiving those stock options whose value was determined at grant date rather than exercise date.** The preceding scenario is magnified when one company acquires another for stock and all of the outstanding options of the acquired company become immediately exercisable. Stock repurchases increase significantly to offset the dilution in earnings resulting from sudden increase in options exercised. Pfizer Inc spent \$2.4 billion per year or 44% of their net income for their "share-purchase" programs for the period 1999-2001. However, as a result of the Warner-Lambert acquisition, for just the nine months ended 9/29/2002 Pfizer has spent \$4.7 billion or **75% of net income** to buy back shares with shares outstanding only dropping slightly from 6.361 to 6.202 billion shares. The stock option expense recognized was only a fraction of this."

I believe the analogous relationship between stock options and stock buy-back programs and how management is using these programs to **blilk billions from the investing public** is of critical importance and must be addressed.

**Proper accounting for stock-based compensation must recognize the direct connection between stock options exercised and "share-purchase" or stock buy-back programs. Ignoring this relationship passes over the reality of what corporations are doing with substantial amounts of their cash. They are using this cash with no significant effect on earnings to offset the dilutive effect of the increase in the number of shares outstanding resulting from the number of shares exercised under their stock option programs. It is truly a license to drain the corporate coffers with minimal effect on earnings. Uncontrolled as it is, this infectious greed completely destroys the incentive for investor's to invest because significant amounts of cash are being siphoned to management with minimal effect on earnings.**

The investing public is being scammed by stock options. Enron, WorldCom, *et al* is peanuts when compared to the billions the corporate elite are robbing from their shareholders through stock options. **This grand theft is legal and complies with accounting guidelines.** In addition to the billions going from corporate coffers into the pockets of their management, corporate earnings are being grossly overstated making financial statements meaningless.

The scam is simple.

(1) the Board of Directors approves a **share buy-back program** under the pretext of reducing the number of share outstanding. (fewer shares means higher earnings per share given the same net income.) There is no mention of the company's stock option program.

(2) In the meantime, employees **exercise** their stock options which increases the company's shares outstanding. More shares outstanding means lower earnings per share given the same income.

(3) But as long as the cash used to **buy back** shares equals the shares **exercised**, according to current accounting standards, there is no change in net earnings and the massive transfer of cash from the corporate coffers to management pockets goes unnoticed.

For the 3 years 1999-2001, the "Top Ten" S&P 500 Companies in addition to their salaries, bonuses, and benefits put \$69.7 billion (or 29% of their net income) in the pockets of their executives through this scam while only recording 6% of net income as a *pro forma* compensation expense! Over the 3 years there was no significant decrease in shares outstanding thus no improvement in the company's earnings per share as a result of this \$69.7 billion cash expenditure which is not shown on the company's income statement. Those few select employees, however, received 1.451 billion shares of stock worth \$69.7 billion! As a matter of comparison, dividends paid to all stockholders for the same period was \$67.7 billion.

This scam, the quintessence of infectious greed, is systemically destroying the incentive to own stock. Not only do shareholders lose but management, board members, employees, and even customers lose. It's a lose-lose situation for all concerned. The accounting standards must change to stop this scam. Compensation expense must be properly recognized in order to restore credibility and investor confidence. As Mr. Robert H. Herz, Chairman of the Financial Accounting Standards Board" most aptly stated in his opening statement to the roundtable participants on May 8, 2003, "Our capital markets, and the investors who participate in those markets, are demanding and deserve sound, transparent, and unbiased financial information."

Thank you and may God bless you in your efforts to resolve this grand theft of the American public. I look forward to hearing from you. I sincerely believe that your efforts and those of the board regarding this matter are of the greatest significance to America.

Sincerely,

R. W. Glenn, 6 Woodstock Court, Greensboro, NC 27408; (336) 288-8429