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From: Ram Varadarajan [Ram@arcot.com]
Sent: Friday, May 28, 2004 8:02 PM
To: Director - FASB
Cc: jcdowling@nvca.org
Subject: Expensing Stock Options

To Whom It May Concern:

I am the President and CEO of a pre-public, venture funded startup company. I am writing to inform you my disagreement with the concept of expensing stock options in the body of financial statements, rather than in the footnote disclosure.

I believe that there are other methods for addressing the issue of excesses that have taken place in executive compensation. To drastically change the option granting process across the industry is not prudent, in my view. I urge you to consider the problems that may arise out of the FASB proposal, as some of my startup colleagues have passionately argued:

1. It will obscure financial disclosure -Google filing: As soon as the financial analysts had their first look at their heretofore-secret financial statements, they all rushed to subtract out the theoretical, non-cash accounting charge for stock option expenses so they could understand the cash flows and expenses of the operating business. This is an extremely accurate foreshadowing of what will happen on a gross basis if this nonsensical rule goes into effect. There will be mass confusion and a greater proliferation of proforma results and reconciliation's. The FASB should have a goal of proposing accounting rules that are useful to investors and generate GAAP financial statements that can be used without having theoretical non-cash opportunity cost charges included.

2. It's bad accounting - Why do the exposure drafts consider it as an expense? The option is granted at the market price, a price available to any member of the public who would like the purchase the stock on that same day. The employee has to buy the stock at that price when he exercises the option. I think the general public and our politicians think that the stock is free to the employee. Of course, the cash-free and risk-free ability to hold the stock has value, but the profit that is realized (if any) is paid to the employee by the capital markets, not by the company. Over the years, I have received options from Motorola, Hewlett Packard, Oracle and Sybase, all successful businesses. Nonetheless, many of those options expired unexercised and out of the money. What should the expense have been on the financial statements? The current method of accounting works extremely well here. The option count is included in the calculation of earnings per share, so the dilution of capital caused by options is properly reflected and disclosed. The footnote disclosure is available to those who like to ruminate on the theoretical implications on expense using strange and arcane formulas. GAAP still excludes even more important items, like marking real estate and capital assets to market. Why focus on this area of options if you want to improve the transparency of financial statements?

3. It's bad for the economy - True economic risk is experienced by those who fuel the engine of new company formation and growth, often sacrificing job and financial security and giving up higher pay and benefits to do something new, but risky. For investors and entrepreneurs to attract the human capital to advance job growth and the economy and give the US an edge in a world of cheaper labor, granting equity is very important. On a day to day basis, the broader sharing of wealth that options have fostered, have supported both savings and consumption on a much vaster scale than has been seen before, benefiting the entire economy. Accounting rules that chill this process are a death wish for the economic status of this country.

4. It's counter to established public policy - Encouraging employee ownership of the equity of corporations has been a mainstay of government policy for decades, at both the Federal and State levels. The favorable tax treatment of ISO's, the provision for ESOP are two concrete examples. Where the company's revenue is derived from either intellectual property or from the provision of services, those spring only from the humans who populate the company and a sharing of the value of the company they create is most equitable. In old time America, all the equity was held by just wealthy shareholders and a very few executives at the top. That's the approach that made people like Warren Buffet one of the richest men in the world, where all the equity is held and never shared. That's the world they love and why people of his vintage oppose sharing equity with the employee base.

I appreciate the opportunity to share my view with you. Please give it your utmost consideration.

Thank You,

Ram Varadarajan
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