

ikon

Letter of Comment No: 2823
File Reference: 1102-100

From: Mike Cranor [mikecranor@austin.rr.com]
Sent: Friday, May 28, 2004 1:32 PM
To: Director - FASB
Cc: Mike Cranor
Subject: Proposed Expensing for Employee Stock Purchase Plans

To: Suzanne Bielstein

From: Mike Cranor

Regarding: Proposed Expensing of Options for Employee Stock Purchase Plans

Date: 5/28/2004

Suzanne,

As a former stock plan administrator at a Fortune 500 company, I would like you to know that I along with many other employees of companies which offer ESPP programs am in favor of an exemption to the stock option expensing requirement for ESPP plan discounts. Here are a few reasons:

1. Companies will likely eliminate purchase discounts or eliminate ESPP plans entirely for rank and file employees.
2. Rank and file employees should not be penalized in the current climate of cracking down on corporate abuses. After all, it was rank and file employees, along with outside shareholders, who have been hurt most by corporate abuses from the top.
3. ESPP plans (along with ESOP plans) provide a valuable incentive for employees to work for the mutual benefit of themselves and their companies.
4. Due to short swing requirements and the \$25,000 annual value limitation, most top executives don't participate in ESPP plans anyway.
5. Many people who have achieved financial security at retirement were afforded this security as a result of regular savings put into their employers' stock.

If FASB wants to have an impact in this area, maintain an exemption for 423 plans for rank and file employees. Carve out the executives if you wish to designate their shares for an accounting chargeback and most companies would simply eliminate them from the stock purchase plan.

Unlike option plans which create overhang situations that can last for many years, ESPP plans actually distribute the shares over relatively short timeframes. Most plans are quarterly or semi-annual in nature. The "expense" of running these plans is quickly reflected in earnings per share and I generally support broad-based ESPP plans when I vote my proxies for my IRA stock holdings. I am currently job searching since my current position is being eliminated within the next few months. I will be searching for a company that offers an ESOP or ESPP to employees.

Though probably useless to argue in the current political environment, I will go on to say that I believe expensing options other than in a standardized pro-forma fashion results in double expense counting in EPS terms. The impact to EPS is now improperly reflected twice, once when the option expense begins to be amortized against currently outstanding shares (which can span several years for the vesting) and again in terms of share dilution when the option has been exercised. The expense taken against past EPS is also never reversed, resulting in a reduction of past earnings when current outstanding shares are taken into account. This skews a company's earnings history. Instead, I favor the following transparent disclosure in case FASB is still open to good suggestions on this point:

1. No direct expensing of options.
2. Instead, forcing companies to publicly and transparently report EPS for only dilutive shares and again for fully diluted EPS, eliminating all public reporting of primary EPS. My idea proposes that the company also report in a table format the cash consideration that would be received on a year by year basis for all forms of stock and derivatives and how much cash would be raised on a fully diluted per share basis. This puts stock

options, which can be a favorable incentive, back on an equal footing with restricted stock. Other than the cash impact, which is very important to a company, the dilutive nature of the options is all that really matters going into the future. An investor should know the full potential impact of option and other forms of stock dilution, rather than being shown lower earnings. By treating all derivatives as fully outstanding shares, a consistent comparison can be made when taking the expected cash receipts into account. This approach forces all companies to properly deal with dilution and overhang in all its forms, eliminates dual impacts to EPS, and makes company to company comparisons an apples to apples comparison for investors. It does away with all the issues related to how companies come up with their accounting assumptions, and other ways to play the system. Each share or option granted is also properly represented in the EPS formula.

Regardless of FASB's decision on overall stock option expense rules (and the course seems firmly set), I hope you will consider my position on ESPP plans. I know it would be shared by many employees across the country if this issue were brought to their attention. I believe, however, that the public at large is not informed on this very important issue.

Thank you,
Michael Cranor