

Stacey Sutay

Letter of Comment No: 2139
File Reference: 1102-100

Subject: FW: FROM FRANK DODGE (thank you, Sue)

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

From: EbbetsF@aol.com [mailto:EbbetsF@aol.com]

Sent: Monday, May 03, 2004 4:01 PM

To: Sue Bielstein

Subject: FROM FRANK DODGE (thank you, Sue)

478 Valencia Drive
Los Altos 94022
Phone: 650-949-0365
Fax: 650-949-1434
e-mail: EbbetsF@aol.com

17 Apr 04

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

Re: File reference 1102-100

Dear Mr. Herz:

Your reputation alone makes you a good man for this job. You of course have to delegate to "The Director of Major Projects" and others, but ultimately the buck stops with you. This is most important, because I am writing in behalf of the CPA profession. My qualifications are a B.S. in accounting from San Jose State College (as it was called in those days), an M.A. in finance from SJSC, and an MBA in taxation from Golden Gate University. I was either a sole proprietor or partner in local firms in San Francisco for over twenty five years. During those years I was continuously active in several sections (committees)

of our profession in San Francisco and at the State level. One of the sections was taxation, where I worked with Dom Tarantino and Mark Larkin of your firm, two of my public accounting heroes! I also served as chairman of the ethics section. In those days the accounting profession tended to "face Chicago and bow three times a day," but now I think the profession is primarily looking to your firm for guidance in excellence. I trust you understand that I am submitting this "walk down memory lane" because

Page two

5/3/2004

I am attempting to convey to you that this letter is objective. I have no ax to grind. No family members have ever received or are likely to be granted stock options. I will attempt to ethically set forth only observations with which I am comfortable in my knowledge of the subject. For example, I decline to comment on issues such as option volatility (letter #63) and the Black-Scholes model (letter #8): the math is too difficult for me, especially at my retirement age of 67.

AND NOW, MY "COMMENT LETTER."

The proposed standard, I'm afraid, is a rush to judgment in order to quiet those angry about past losses and who are therefore looking for a scapegoat. I understand the pressure you feel. But Mr. Herz, this proposed standard, if left unchanged, will bring about huge damage to the *double-entry system of accounting*. 123 unequivocally reverts double entry accounting to *single entry bookkeeping*. First, to my knowledge, there is no authority in GAAP for booking a transaction before it happens. And then, digging our profession into a deeper hole, 123 proposes a debit for which there is no possible logical credit. Nothing happens when an option is granted (e.g., suppose HJ Heinz is trading at 35, and someone in Mexico is granted an option to buy 500 shares at 35). But 123 proposes a debit to "option expense": this is a one-sided entry. If you stay with me on this, the only possible credit is to the equity side. There would be no point in crediting equity, because when the books are closed out, book value would be unchanged!!!! Please. Do you see my point? When Heinz tells the man in Mexico that he now has an option to buy 500 shares, no balance sheet asset has been created or affected. And no balance sheet liability has been created or otherwise affected. This a real burr under my saddle, because I date back to the days when I was ordered to balance manual general ledgers with pen and ink, pull off a working trial

Page three

balance, tie down every single asset and liability, and prepare financial statements from the perfectly balanced working trial balance. Sorry, not possible when even one entry in the ledger is one-sided.

Because of the foregoing, FASB should not finalize 123 until my observation has been addressed. I don't know, maybe consider a rule that SOMETHING has to be booked when an option is exercised; i.e., when something actually happens.

RELATED COMMENT LETTER TOPICS

History of the double-entry system of accounting. After studying business methods in Venice. Fr. Luca Pacioli "codified" the double

entry system of accounting. This was in 1494. A picture of this Franciscan monk hung in my office for many years. Again, please, don't cause Fr. Pacioli to turn over in his grave because you permit single entry bookkeeping to replace a system that has worked so well for over 500 years! The double-entry system of accounting ain't broken; please don't try to "fix" it.

Bob Newhart Although Newhart once worked for a public accounting firm, he never became a CPA. Maybe he couldn't balance the books. ("Seriously Funny" Gerald Nachman, Pantheon Books, 2003, page 371) But I would hate to see FASB give Newhart the idea that the CPA profession has gone back to single entry bookkeeping. Or, let Bob suggest the idea to Dave Letterman or Jay Leno! Our profession has suffered enough.

FASB need not be intimidated by what FASB has previously pronounced. FASB should not put pressure on *itself*. FASB has enough outside pressure. Some of the very close votes on earlier Standards indicate some folks were pushing
Page four

hard for what was in their best interest. For example, during this lengthy "option expensing cold war," FASB may have said a level grant (like the above example of a grant to exercise at 35 when the stock is trading at 35) is a transaction. I am arguing in behalf of Fr. Pacioli that a level grant is NOT a transaction; there is still time for you to get it right. You are not locked in to some remark you may have made in a stressful meeting sometime at 1 AM. Simply say "I have revisited this question, I have listened to fellow CPAs concerned only about the integrity of the numbers on which they sign off (please don't get me started on what "standards overload" has done to the accounting profession), and now I see it differently." You have the power.

How can FASB respond to the pressure it now faces? I have read all of the comment letters though #68. #8 and #63 stand out for their accuracy, and good quality. Another 1/2 dozen or so offer well-written good points on both sides of your issue. The remainder (my take), is "my ox is getting gored", regardless whether writers advocate or disdain option expensing. Very few of the writers seem to demonstrate any knowledge of double entry accounting. What you of course need to do is focus on letters in which the writer shares his or her *reasoning* for a position. For example, some writers say "I need my options to pay for the kids' college." Well, that is hardly relevant to GAAP. Others say "someone has to be punished for surprising investors with 'under the table' income." But FASB can not punish the corporate fraud and greed of the eighties and nineties. That is more the job of the SEC and even the state attorneys general. The AG of New York has been doing a good job of pursuing investment bankers, their "analysts", and their bogus Chinese Walls

-- in my judgment these *investment banking firms are the real culprits behind the overly inflated P/E ratios of the nineties*. It is these investment bankers who misled the small investors and obviously burned a number of
Page five

embarrassed Certified Financial Analysts (CFAs). Please be wary that you don't buy into the rhetoric of the investment bankers. On 12 Apr 04, the WSJ published bonuses paid to execs in the financial services arena. The bonuses paid to execs at Citicorp, Merrill, Goldman, and Bear Stearns were staggering. The financial services firms can make e.p.s. anything they want to, simply by announcing arbitrary bonuses. Talk about surprises! The point is, FASB should not try to "punish" firms who follow GAAP.

One must also weed out those who take a position for no apparent reason at all. Jesse Eisenger writes a very good column for the Journal, "Ahead of the Tape". I read it almost daily. But in about the second week of November 2003, he wrote a very sarcastic piece about stock options. There was no logic to his piece. He may have quoted Warren Buffett, I don't recall. I e-mailed him, stating he should apologize to those people who receive options. He sent me a return e-mail stating in substance "I don't like stock options. Period." As for Warren Buffett, CAL-PERS is trying to kick Mr. Buffett off the Coca-Cola Board. Perhaps Mr. Buffett has also done some other things that were not based on sound reasoning. Several comment letters quote Mr. Buffett as if he were at your level of accounting knowledge. Mr. Buffett's clever quote is cited (letter #41, e.g.) which in substance says "Options are compensation". But Mr. Buffett needs to distinguish between a *grant* (no transaction has yet occurred) and an *exercise* (the time that a transaction occurs, and compensation does become an issue). By commingling grant and exercise, Mr. Buffett muddies the waters. Maybe this is his intent; I wonder why.

MAY I OFFER A TENTATIVE CONCLUSION?

FASB is charged with the duty to maintain the integrity of our beautiful double-entry system of accounting.
Page six

Therefore, let us not desecrate Fr. Pacioli's *very foundation* of the double entry system of accounting: the timing of recognition of revenue and expense. Fellow CPA, I submit we need to go back and take another look at this. Carefully study comment letters 8 and 63, both of which appear thorough and objective.

Right now, FASB's timing is quite a bit off.

Pun intended.

Respectfully submitted,

A. Frank Dodge

PS -- You probably know that we've lost Mark Larkin, but I've heard no news about Dom.

August Franklin Dodge (aka A. Frank Dodge)
478 Valencia Drive
Los Altos CA 94022
650.949.0365
24/7 fax -- 650.949.1434
ebbetsf@aol.com