Equity Risk Sciences, Inc

Institutional Investment Data Analytics

Mr. Mullaney's Reports to the Securities Exchange Commission in September of 2000 Regarding Irregularities in the Accounting Statements of Cisco and GE

December 31, 2023

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In 2000, Wall Street "Experts" Urged Investors to Buy Cisco and GE at a Cost of $1 Trillion

At their highs in 2000, GE and Cisco had a combined market cap exceeding $1 trillion.
As of 12/31/23, GE & Cisco were worth $344 billion.
Wall Street "experts" LOST investors $676 billion on just 2 stocks!
In 2000, Mullaney wrote reports to the SEC, accusing GE and Cisco of "producing misleading earnings" and potential fraud.

24 years ago, GE's stock traded at $374.56.
Wall Street's analysts urged investors
to buy GE when its market value was $463 billion.
Today (12/31/23), its price is $127.63
and its market value is $139 billion.
The analysts lost investors $324 billion!

24 years ago, Cisco's price was $80.25.
Wall Street's analysts urged investors
to buy CSCO when its market value was $557 billion.
Today (12/31/23), its price is $50.52
and its market value is $205 billion.
The analysts lost investors $352 billion!

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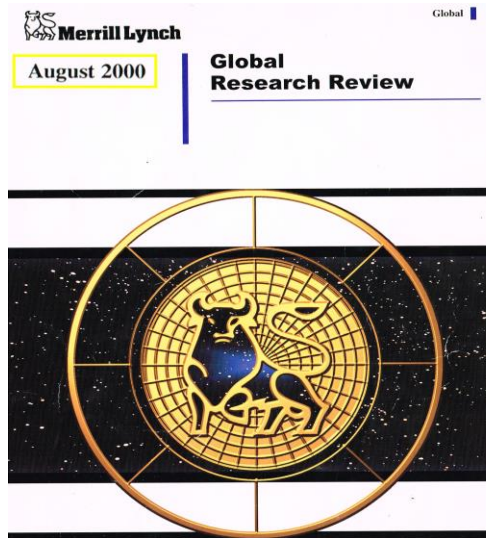
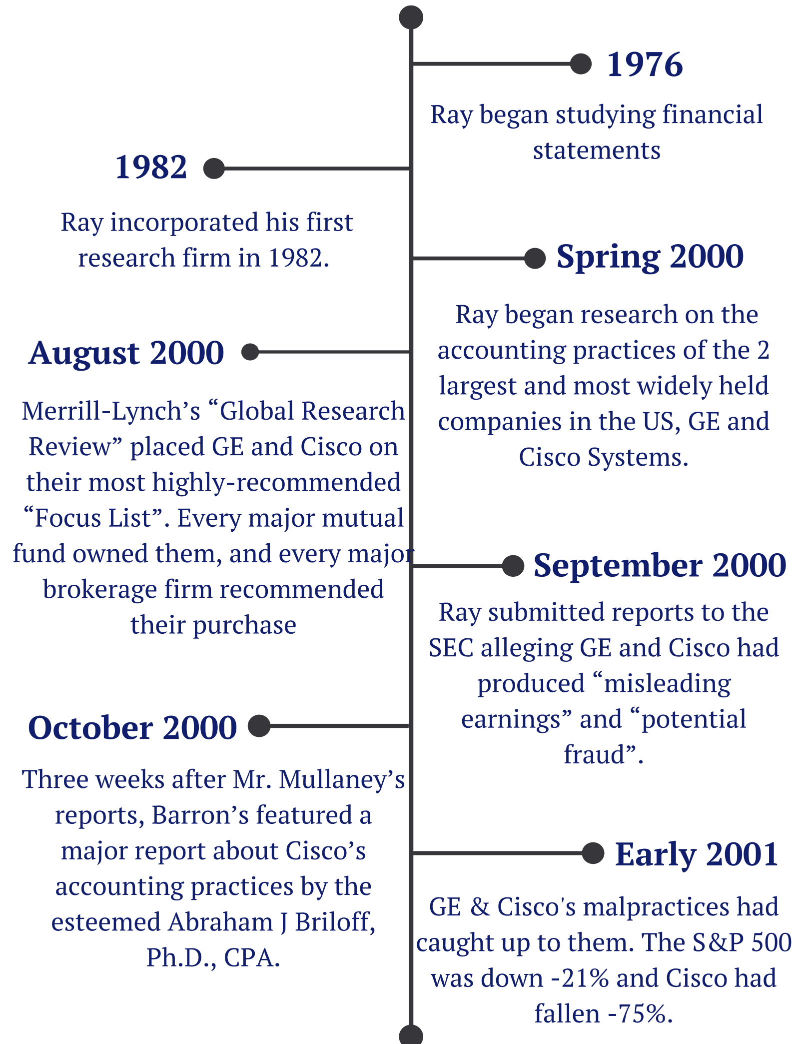
Predicting GE and Cisco's Price Collapse in 2000





1976

Ray began studying financial statements

1982

Ray incorporated his first research firm in 1982.

Spring 2000

Ray began research on the accounting practices of the 2 largest and most widely held companies in the US, GE and Cisco Systems.

August 2000

Merrill-Lynch's "Global Research Review" placed GE and Cisco on their most highly-recommended "Focus List". Every major mutual fund owned them, and every major brokerage firm recommended their purchase

September 2000

Ray submitted reports to the SEC alleging GE and Cisco had produced "misleading earnings" and "potential fraud".

October 2000

Three weeks after Mr. Mullaney's reports, Barron's featured a major report about Cisco's accounting practices by the esteemed Abraham J Briloff, Ph.D., CPA.

Early 2001

GE & Cisco's malpractices had caught up to them. The S&P 500 was down -21% and Cisco had fallen -75%.

When GE & CISCO Were the Hottest Stocks on Wall Street Mr. Mullaney Provided Reports to the Securities Exchange Commission Alleging GE and Cisco Manipulated Earnings

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
450 Fifth Street, N.W
Washington, D.C 20549

DIVISION OF ENFORCEMENT

Mr. Roy Mullaney
Fax No. 410-280-2029

Dear Mr. Mullaney:

I am writing to confirm our phone conversation yesterday and to acknowledge receipt of your September 29 and October 4, 2000 faxes relating to Cisco Systems. In our conversation you provided information relating to potentially misleading earnings statements by Cisco Systems and transfers of large dollar amounts from insurance subsidiaries of General Electric to G.E. Capital. The Securities and Exchange Commission ("Commission") appreciates receiving information from members of the public concerning possible violations of the federal securities laws and will give serious consideration to the information you have provided.

However, as I informed you, the Commission conducts investigations into allegations of violations of the federal securities laws on a confidential basis. Therefore, the staff does not comment on whether the informanon provided to the Commission relates to an ongoing investigation or provide assurances that an investigation will be initiated.

Let me know if I can be of further assistance.

Sincerely,

Susan A. Mathews
Senior Counsel

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On October 23, 2000, Abraham J. Briloff Wrote a Feature Article Called "Pooling and Fooling" Which Outlined His Concerns On Their Accounting Methods

BARRON'S

Cisco's accountings for its fiscal years ended July 1999 and 2000 furnish vivid demonstration of the causes of my concern....

By my reckoning, in the two fiscal years ended July 2000, Cisco has suppressed a grand total of $18.2 billion of costs by using pooling in accounting for its acquisitions. Even in today's wondrous financial world, when billions are commonplace, $18 billion of costs not taken is mindboggling. Manifestly, the handmaiden of pooling is fooling.

But pooling is not the only accounting device that Wall Street's favorite company uses to enhance its operating results. Another, equally egregious, involves stock options and the way Cisco accounts for them.

How to account for options has been the subject of agonizing reappraisals in board rooms, among scholars in academe, at the FASB and even in Congress. The crucial questions are: Can options be valued and, if so, should they be entered into a company's accounts and when? Further, if they were to be recorded, should it be as a cost of doing business or merely a capital transaction?

The correct answer to the first question is yes, they should be entered into accounts and, to the second, as a cost of doing business. Let me elaborate, using Cisco as a prime exhibit.

In the statement of shareholders' equity in Cisco's 1999 10K, there's an entry described as "tax benefit from employee stock option plans." This item added $837 million to the capital stock and additional paid-in capital and shareholders' equity columns. The implications of that apparently innocuous entry are, in fact, far from innocuous.

When the employee exercises his or her options, the resultant gain is deemed to be compensatory income, i.e., salaries or wages to the employee and, accordingly, subject to tax. Correspondingly -- and this is the critical side of the relationship -- Cisco was presumed to have paid wages or salaries equal to the income earned by the employee and thus the company is entitled to a tax deduction (all spelled out in Section 83 of the Internal Revenue Code).

Now then, that $837 million tax benefit means that at an assumed 33% tax rate, the related deduction for Cisco's tax return would have been $2.5 billion in the fiscal year ended July 31, 1999. If $2.5 billion is a cost for tax purposes, logic dictates that it is also a cost for determining Cisco's operating results.

More specifically, for fiscal '99, Cisco's pretax income should be reduced by $2.5 billion; its income tax cost would be cut by $837 million. Net income, accordingly, would be slashed by a whopping $1.6 billion, or by nearly 80% from the reported figure of $2.02 billion, to $423 million.

The impact of options on Cisco's fiscal 2000 results was even more pronounced and even more stunning. According to the 10-K (footnote 11), the tax benefit derived for the exercise of options amounted to $3.077 billion. At the assumed 33% tax rate, that amount translates into over $9 billion of salaries.

Especially noteworthy is that fully $2.147 billion of that $3 billion-plus was generated during the final fiscal quarter, the May-July time span. Clearly, as Cisco's share price dropped, options holders made a mad dash to cash in their chips, in the process triggering roughly $6 billion of imputed salaries and wages.

How should that humongous full-year figure of $9 billion of imputed wages and salaries be factored into fiscal 2000 operating results? Let's assume only $310 million of tax benefit is "normal" for the fourth quarter (the average of the first three quarters of the year) rather than the actual total, hugely swollen by the period's extraordinary stampede to sell. That would make the "normalized" tax benefit from exercised options for fiscal 2000 a not exactly modest $1.246 billion, implying an addition to the year's operating expenses of $3.7 billion and an after-tax reduction of the bottom line by $2.5 billion.

Put another way, if Cisco had treated the exercise of options as they should be treated -- that is, as a charge to income -- the company would have reported not the $2.1 billion in earnings it did report, but a loss of $363 million (excluding $531 million of net gains on minority interests).

My restatement of Cisco's income to give due allowance to the cost of options is not a capricious exercise. For it's squarely in accord with underlying accounting precepts, especially Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." The statement, promulgated over a quarter-century ago, holds that a loss should be accrued as a charge to income when "it is probable ... a liability had been incurred" and "the amount of loss can be reasonably estimated." In other words, the charge to income from stock options kicks in when those options are exercised.

The result of Cisco's accounting aggressiveness, both in its energetic use of pooling and its treatment of exercised options, then, has been to enormously inflate reported earnings. And enormously inflated earnings have played no small role in elevating the company -- and its stock -- to the pinnacle of investor esteem.

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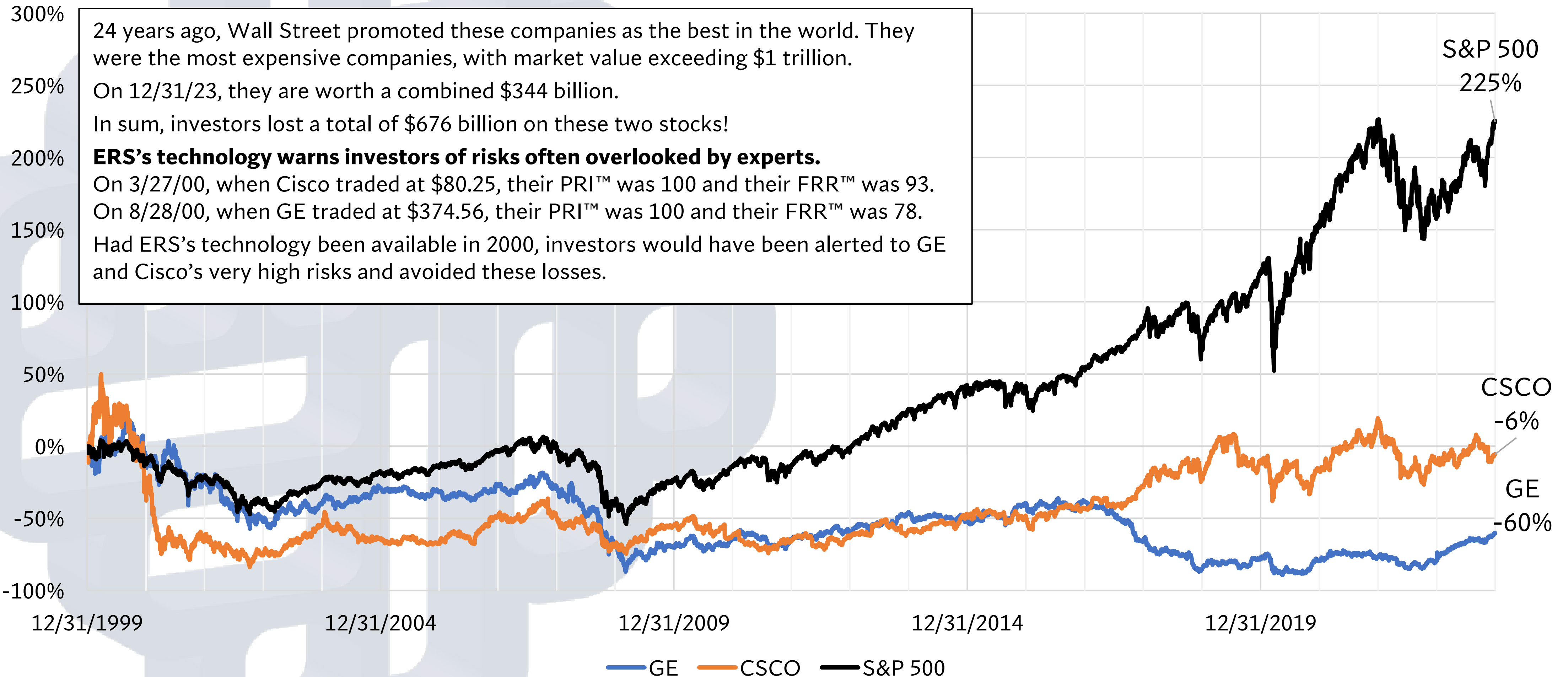
GE & CSCO – 12/31/99 TO 12/31/23



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Market data and industry information used herein are based on our management's knowledge of the industry and the good faith estimates of management. We also relied, to the extent available, upon managements review of independent industry surveys, forecasts and publications and other publicly available information prepared by a number of third-party sources. All of the market data and industry information used herein involves a number of assumptions and limitations which we believe to be reasonable, and you are cautioned not to give undue weight to such estimates. Although we believe that these sources are reliable, we cannot guarantee the accuracy or completeness of this information, and we have not independently verified this information. Projections, assumptions and estimates of our future performance and the future performance of the industry in which we operate are subject to a high degree of uncertainty and risk due to a variety of factors, including those described, above. These and other factors could cause results to differ materially from those expressed in our estimates and beliefs and in the estimates prepared by independent parties. In all cases, you should conduct your own investigation and analysis of the Company and the information contained in this presentation. All estimates and forecasts are subject to change and past results are not necessarily an indication of future performance.

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