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Sent: Thursday, May 20, 2004 1:49 PM
To: Director - FASB
Subject: File Reference No. 1102-100

Letter of Comment No: 2600
File Reference: 1102-100

Importance: High

Chairman Robert H. Herz

I am writing to let you know of my strong opposition to the FASB's proposal to expense stock options. The models recommended by the FASB are inadequate to value employee stock options because employee stock options are non-transferable. It has also been reported that the current models could overstate substantially the true fair value of employee stock options. While efforts are underway to develop new models to calculate the fair value of employee stock options, more work needs to be done.

The FASB proposal is based on arguments that cannot be substantiated.

Expensing options will not provide a level playing field so that companies that use cash bonuses and companies that use stock options each have an expense on the income statement. The playing field is already level. A company using cash bonuses as management incentive compensation already has a reduction in net income and a resultant reduction in earnings per share. When a stock option has been awarded and the strike price is in the money, the additional shares become outstanding for purposes of calculating earnings per share. Since earnings per share is calculated by dividing net income by weighted average shares outstanding, as the shares outstanding increase, the earnings per share decrease. To require a company to record an expense for the option, and subsequently increase the shares outstanding is a double hit to earnings per share.

It will not improve corporate governance by reducing or eliminating incentives to inflate income and earnings per share. It is difficult to believe that the management or the Board of Directors of Enron would have limited the number of options simply because of the requirement to record an expense. Management that is truly unscrupulous is concerned strictly about personal gain and not about the company's income statement.

During recent years, each time that earnings management is scrutinized, analysts regularly state, "follow the cash." Ignore entries that are purely accounting and have no cash impact. Such is the nature of recording an expense when an option is awarded. This is an accounting entry with no cash impact. It is very likely that analysts will remove the option expense from the income statement to obtain a clear view of the company's performance. This would likely lead to companies including a pro forma income statement which excluded the option expense.

It is also interesting to note that, not only is there no cash impact from the expense option, there is positive cash flow to the company. At the time the option is exercised, the employee must pay for the shares received.

Hi-tech companies have traditionally issued options to multiple levels of employees with two purposes in mind: attract high quality employees to the company; and motivate workers at all levels. If hi-tech companies were required to record an expense at the time options are granted, many employees at all levels would most likely lose the options. Executive compensation continues to rise, but salaries and benefits for the rank and file have not increased proportionally over the years. Stock options keep more individuals active and vested in the stock market. When people exercise their options, they tend to use the funds to purchase property, or divest into other investments. Both of these activities stimulate the

economy, a move which is sorely needed in California, as well as the rest of the country right now. With interest rates rising, individuals will need to rely on other investments to enable them to purchase property. Stock options are often used as a method for first time home buyers.

The actions by the FASB will have a detrimental impact to the slow economic gains we are making. Now is not the time to change something that is working for individuals and corporations alike. The FASB needs to step back and ensure that this is not an ill planned reaction to a few instances of mismanaged companies. Knee-jerk reactions often result in bad decisions.

I strongly urge you NOT to support expensing stock options.

Regards,

Kathleen Sulgit