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Letter of Comment No: 4240  
File Reference: 1102-100

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**From:** Franklin Grosvenor (fgrosven) [fgrosven@cisco.com]  
**Sent:** Friday, June 11, 2004 2:19 PM  
**To:** Director - FASB  
**Cc:** savestockoptions@cisco.com; senator@boxer.senate.gov; senator@feinstein.senate.gov;  
annagram@mail.house.gov  
**Subject:** File Reference No. 1102-100

Attn: Chairman Robert H. Herz

Re: Proposed stock option expensing rules

Dear Chairman Herz,

I am writing today to strongly urge you to reconsider FASB's push for full expensing of employee stock options. I am a Director in the Manufacturing organization at Cisco Systems, Inc. and will likely feel significant personal financial impact if this rule is implemented as it stands today. As you know, even by Silicon Valley standards, Cisco is fairly generous with its stock option grants to "rank and file" employees like me. The options I have been granted at Cisco have enabled me to afford a down payment on a modest house here in the bay area. Given the inflated housing market here, and despite my relatively "senior" rank at Cisco I would not have been able to afford even this small symbol of middle class America without options. Stock options also have allowed me to contribute to a 529 plan to help ensure that I will be able to afford a quality college education for my two sons. Again, given the rising cost of a college education, this is becoming extremely challenging even for solidly upper-middle class families. Employee stock options allow people like myself an opportunity to achieve some degree of financial security that might not be otherwise available to us, and I am deeply concerned that implementation of the FASB proposal on stock option expensing will greatly impact that opportunity.

Personal considerations aside, there are also a number of objective reasons why stock option expensing as proposed is not appropriate:

**1.) FASB Motivation** -- an honest assessment of the drivers behind the current interest in option expensing would clearly indicate that a prime motivator for this movement is the egregious behavior of a small number of companies and senior executive teams. This proposal has been hailed as a way to limit the incentive of corporate executives to illegally manipulate financial reporting for personal gain. First, the relatively small number of cases (i.e. Enron, Tyco, WorldCom, et al), while certainly high profile are not representative of the vast majority of corporate America. Second, FASB should be focused on objective rule making and not be caught up in popular or political ground swell based on a few cases of malfeasance. Nor should FASB take advantage of such ground swell to push an agenda that otherwise would not be successful.

**Counter Proposal:** If the true motivation is to positively impact corporate governance and executive behavior, then I urge you to consider the proposal put forth by some members of the House of Representatives that would require the expensing of stock options for only the most highly compensated executives in a given company. This could have the desired effect without penalizing lower level employees or heavily distorting financial reporting which the current proposal will most certainly do (see below). It is also consistent with other regulations focused on executive compensations such as the limit of salary deductibility to only the first \$1 million.

**2.) Double Counting** -- While no one would argue that stock options are cost-less, these costs are today fully reflected in existing financial reporting. I am not talking about footnote accounting but about fully diluted EPS which takes all option grants into consideration in the calculation. Thus stock option cost is completely and directly reflected in the dilution affect on existing shareholders who are also able to set the P/E multiple that a stock can support based on that dilution. Including options as an expense on the income statement would effectively double count the cost of the option.

6/15/2004

**3.) Valuation Methodology** -- I have an MBA in Finance with industry experience in financial analysis, but any first year finance student could tell you that the proposed valuation methodology is not appropriate for incentive stock options. The stock options that Cisco and most other companies grant to their employees have very long maturities, and given the typical four year vesting period, are often highly illiquid. The proposed methodologies are barely applicable to publicly traded options that are liquid and have generally short maturities, and certainly are not accurate measures of the cost of long term employee stock options. It is incomprehensible to me that FASB, whose stated mission is the accuracy and transparency of financial reporting, would propose an approach which could be so wildly inaccurate.

**Counter Proposal:** Given the uncertainty of future value of options (which could easily be zero if stock price appreciation is not achieved), if they must be directly reflected in the financial statements it should be as a contingent liability on the balance sheet and a use of cash on the cash flow statement if and when they are exercised. Alternatively, if FASB insists that they be reflected on the income statement, (despite the double counting argument above), then the expense should only be recognized when the options are exercised. At that time, and only at that time, is the true cost of the option understood.

Chairman Herz, I am certain that none of the arguments I have articulated are new to you, but I felt the need to add my voice to the millions of people who will be personally and professionally impacted by your proposal. Option expensing will reduce both the entrepreneurial force of the U.S. economy as well as the opportunity for financial security for families such as mine. I respectfully request that you withdraw or substantially amend the proposed rules.

Thank you for your consideration.

Regards,  
Franklin S. Grosvenor