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Letter of Comment No: 2014
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From: Rob Wiley (rwiley) [rwiley@cisco.com]
Sent: Tuesday, April 27, 2004 9:05 AM
To: Director - FASB
Cc: savestockoptions@cisco.com
Subject: File Reference No. 1102-100, treatment of stock options as an expense



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To Chairman Robert H. Herz,

Dear Sir,

I wanted to voice my opinion concerning the draft plan stating that the, Financial Accounting Standards Board (FASB), intends to treat stock options as an expense. I have read several articles on the subject in the last year. From what I have read there seems to be more cons against what is drafted in this plan, then pros and the pros seem to have better solutions then what is drafted.

With his permission, I would like to site this article by: Charles J. McPeak, MBA, CPA
cmcpeak@pepperdine.edu

<http://gbr.pepperdine.edu/024/options.html>

In his article, Mr. McPeak, lists the following pros, cons and conclusions:

PROS AND CONS OF "EXPENSING STOCK OPTIONS"

Several arguments have been made, both pro and con, regarding this issue. Following is a summary of the key arguments on both sides. Pros

- * Expensing options will 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.
- * It will improve corporate governance by reducing or eliminating incentives to inflate income and earnings per share.

Cons

* The playing field is already level. A company using cash bonuses as management incentive compensation 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.

* Regarding improved corporate governance, 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.

As a footnote to the "follow the cash" guideline, it is 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.

CONCLUSIONS

With regard to FASB's original position, there appears to be no reason to make the proposed change in order to provide a level playing field.

As to the improved corporate governance argument for the change, the Securities and Exchange Commission certainly has just cause to seek improvements in corporate governance. However, there are ways of accomplishing this without creating controversial accounting requirements and penalizing employees below the top level of management. There are more effective ways to accomplish this than the FASB proposal on expensing options.

Two suggested methods of dealing with options that could improve corporate governance are:

* The SEC could place a limit on the percentage of a company's options that could be issued to the top three people in the company.

* The SEC could require that the top three people in the company be issued options on restricted stock (often called "letter stock" or Rule 141 stock). This stock must be held for two years before it can be sold.

Now, for my personal view, I began work at Cisco just over two years ago as a Wireless Network Test Engineer. When I was interviewed I was told about the stock options and Cisco's reasoning behind granting them. The granting of stock options by Cisco to me was intended to compensate me for my hard work, and at the same time, allow me to become part owner of Cisco. Once I become part owner of the company it will help drive me to want to make Cisco a better, stronger company while proving that my hard work is being recognized by the company I am working for. This is one of reasons I made the decision to accept a position at Cisco.

My wife and I are now looking at the stock options provided as a nest egg for college tuition for our four children and our retirement.

This type of commitment to it's employees makes Cisco a better company to work for and in turn makes U.S. companies more competitive in the international market particularly in china where they do not treat stock options an expense.

As for the drafted plan I agree with Mr. McPeak's conclusions. The plan will not provide a level playing field and governance of senior managers business decisions needs to be handled by way of other mechanisms, mechanisms other then something as convoluted as stock options.

Thank-you,

Robert M. Wiley
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Cisco Systems, Inc.

Rob Wiley
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Cisco Systems, Inc. *OK*