Letter of Comment No: 18 File Reference: 1101-SCU Date Received: 11/14/02





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# TechNet and AeA Propose Guidelines For Expanded Employee Stock Options Information

## 33 Companies Have Agreed to Make Voluntary Disclosures

Washington, D.C., November 14 – Technet and AeA today announced that 33 companies have voluntarily agreed to provide shareholders and the public with expanded information about employee stock options. The new disclosure guidelines were submitted by TechNet as part of its comments to the Financial Accounting Standards Board (FASB) filed on Nov. 4.

TechNet represents more than 200 chief executive officers and partners of the nation's leading technology companies. With more than 3,000 member companies, AeA is the nation's largest high-tech trade association.

"Investors are looking for more comprehensive information on stock options and their dilutive impact more frequently, more consistently and all in one place. The guidelines we have submitted to FASB are a meaningful step in the right direction. We hope FASB will consider providing guidelines for enhanced disclosures such as these in companies' quarterly financial filings," said Rick White, TechNet's chief executive officer.

The new disclosures are designed to provide shareholders with a "one-stop shopping" approach that presents relevant information about stock options in a separate section of company quarterly SEC filings in a series of easy-to-read tables and charts that will summarize:

- employee and executive option grants
- year-to-date option activity, as well as option activity for the last fiscal year
- information comparing exercise price to current market prices, and the related intrinsic value
  as of the reporting date (i.e., options that have an exercise price below a company's current
  share price, as well as options with an exercise price above the company's current share
  price).

In addition, three separate tables will provide new, detailed information about a company's executive options, including:

- new options granted
- options exercised and the value of those options
- the total number of options held by executives
- the dollar value of all options that are "above water"
- the portion of options that go to executives versus the rest of the company's employees.

(more)

The new disclosures also will provide information about dilution, so that shareholders can see the potential impact of new option grants on the total number of shares outstanding. Most of the participating companies will begin using the new format in their next quarterly 10Q filing.

According to AeA Chairman of the Board Richard C. Cook, "including the expanded disclosures in company quarterly SEC filings would be a significant improvement over the way the information is currently provided." Currently, information about employee stock options is included in two different documents – a company's 10K and proxy statement – filed only once a year. These documents are not always released at the same time, and there is no requirement that companies provide this information in a consistent format, making it difficult for investors to decipher.

By consolidating this information into one section of company 10Q filings, providing it in a consistent format, and disclosing the information to shareholders on a quarterly basis, Cook said the guidelines will give investors "comprehensive, transparent and timely information" about employee stock options. Cook is president and CEO of MAPICS, Inc.

In addition, TechNet's White noted that these kinds of disclosures are important because of the lack of an accurate method to value employee stock options. Noting growing concerns that the Black-Scholes formula, the most widely used valuation method, produces wide-ranging and potentially misleading results, White said, "Quarterly disclosures based on a flawed valuation method will not serve shareholders or investors."

The companies that have voluntarily agreed to adopt the new disclosures are: 3Com Corporation (Nasdaq: COMS), Adobe Systems Incorporated (Nasdaq: ADBE), Altera Corporation (Nasdaq: ALTR), AMD (NYSE: AMD), Ascential Software (Nasdaq: ASCL), Autodesk, Inc. (Nasdaq: ADSK), Axeda Systems Inc. (Nasdaq: XEDA), BTU International Inc. (Nasdaq: BTUI), Cisco Systems, Inc. (Nasdaq: CSCO), CITRIX Systems (Nasdaq: CTXS), Echelon Corporation (Nasdaq: ELON), Electronics For Imaging (Nasdaq: EFII), Genentech, Inc. (NYSE: DNA), Intel Corporation (Nasdaq: INTC), JDS Uniphase Corporation (Nasdaq: IDSU), KLA-Tencor Corporation (Nasdaq: KLAC), Kronos (Nasdaq: KRON), Lexar Media, Inc. (Nasdaq: LEXR), MAPICS, Inc. (Nasdaq: MAPX), Mercury Computer Systems (Nasdaq: MRCY), Merix Corporation, Microtune (Nasdaq: TUNE), NetIQ Corporation (Nasdaq: NTIQ), Novellus Systems Inc. (NYSE: NVLS), Palm, Inc. (Nasdaq: PALM), RAMBUS INC. (Nasdaq: RMBS), RF Monolithics, Inc. (Nasdaq: RFMI), Siebel Systems, Inc. (Nasdaq: SEBL), Sun Microsystems Inc. (Nasdaq: SUNW), Synopsys, Inc. (Nasdaq: SNPS), Teradyne, Inc. (NYSE: TER), VeriSign, Inc. (Nasdaq: VRSN), Xilinx (Nasdaq: XLJX).

All maintain broad-based stock option programs, which provide stock options to at least 50 percent of their full-time employees. The companies believe that broad-based plans have and will continue to be essential to their own growth and productivity, as well as a key driver of innovation and growth essential to a strong economic rebound and maintaining America's competitiveness.

Copies of TechNet's and AeA's comment letters to the FASB, a template illustrating the proposed new disclosures and an explanation of the disclosures are attached.

#### ###

TechNet (www.technet.org) is a network of senior executives of the nation's leading companies founded in 1997 to advocate public policy favorable to the New Economy. TechNet's member companies include hardware, software, biotech, and content providers, as well as venture capitalists, investment banks and law firms.

Advancing the business of technology, AeA (www.aeanet.org) is the nation's largest high-tech trade association. AeA represents more than 3,000 companies with 1.8 million employees. These 3,000+ companies span the high-technology spectrum, from software, semiconductors, medical devices and computers to Internet technology, advanced electronics and telecommunications systems and services.

# Suggested Quarterly Stock Options Disclosures

### Section I. Option Program Description

### Section II. Distribution and Dilutive Effect of Options

Employee and Executive Option Grants

As of End of Current Interim Reporting Period

	2002 YTD	2001	2000
Net grants during the period as % of outstanding shares (#)			
Grants to listed officers* during the period as % of total options granted (%)			
Grants to listed officers* during the period as % of outstanding shares (%)			
Cumulative options held by listed officers* as % of total options outstanding (%)			

<sup>\*</sup>See section IV for listed officers; these are defined by the SEC for the proxy as the CEO and each of the four other most highly compensated executive officers.

#### Section III. General Option Information

Summary of Option Activity
As of End of Current Interim Reporting Period

			Options Outsta	nding
				Weighted
		Shares		Average
		Available for	Number of	Exercise
	(Shares in thousands or millions)	Options (#)	Shares (#)	Price (\$)
Last Fiscal Year	December 29, 2000			
(as reported in the 10K)	Grants			
	Options assumed in acquisitions			
	Exercises			
	Cancellations			
	Additional shares reserved			
	December 20, 2001			
Year to Date	Grants			
(As of End of	Options assumed in acquisitions			
Current	Exercises			
Interim	Cancellations			
Reporting	Additional shares reserved			
Period)	End of Quarter Date			

# In-the-Money and Out-of-the-Money Option Information As of End of Current Interim Reporting Period

	Ex	rcisable	Unexerc	Sable Wtd. Avg.	Tot	Wtd, Avg.
As of End of Quarter (Shares in thousands or millions)	Shares (#)	Wtd. Avg. Excreise Price (\$)		xeroise Price (\$)	Shares (#)	Exercise Price (\$)
In-the-Money						
Out-of-the-Money (1) Total Options Outstanding						

(1) Out-of-the-money options are those options with an exercise price equal to or above the closing price of \$XX.XX at the end of the quarter. This information may also be shown in greater detail with more information on the range of exercise prices.

Castles	E17	Executive	Ontions

Options Granted to Listed Officers*	
Year-to-Date, as of End of Current Interim Reporting Period	

		Individual Grants				
	Number of Securities	Percent of Total Options Granted to Number of Securities Employees	Exercise of		Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (S)	
	Underlying Options Per Grant (#)	Year to Date (%) **	Base Price (\$/Share)	Expiration Date		10%
Top Officer #1						
Top Officer #2						
Top Officer #3						
Top Officer #4						

\*The definition of "listed officers" here is the same definition used in the proxy statement : the CEO and each of the four other most highly compensated executive officers. This information may be presented for each officer or for the listed officers in the aggregate.

### Options Exercises and Remaining Holdings of Listed Officers\* Year-to-Date, as of End of Current Interim Reporting Period

			Number	of Securities	Ì	
			Underlyin	g Unexercised	Values of U	inexercised In-
			Options at	End of Quarter	the Money	Options at End
	Shares Acquired on	Value	D:	ate (#)		T Date (\$)**
Name	Exercise (#)	Realized (\$)	Exercisable	Unexercisable	Exercisable	Unexercisable
Top Officer #1			1		l	
Top Officer #2			i		l	
Top Officer #3			ľ		l	
Top Officer #4			ŀ		l	
Top Officer #5			l		l	

<sup>\*\*</sup>Based on a year-to-date total of xxx,xxx,xxx shares subject to options granted to employees under the company's option plans.

<sup>\*</sup> Definition of "listed officers" is same as above table \*\*Option values based on stock price of XX on (end of quarter date)

# Section V. Equity Compensation Plan Information

(Shares in millions)	(t)	(2)	(3)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (#)	Weighted-average exercise price of outstanding options, warrants, and rights (\$)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (1))
Equity compensation			
plans approved by	l l	1	1
shareholders			
Equity compensation		ŧ	1
plans not approved by			1
shareholders			
TOTAL			

# SUGGESTED QUARTERLY STOCK OPTION DISCLOSURES Explanation of Charts

Currently, the accounting rules of the Financial Accounting Standards Board (FASB) require companies to provide information about their employee stock option plans to sharcholders only once a year. The required information includes a summary of option activity for the year, the estimated value of the options granted during the year using the Black-Scholes formula, and a description of the method and assumptions used to make the Black-Scholes computation\*. Recently, FASB called for companies to comment on a proposal to provide the public with information about their employee stock option plans on a quarterly basis.

In addition, the SEC requires annual disclosure about option grants to executives. Shareholders must examine two company reports to obtain information on stock option activity: the company's Annual Report on Form 10-K, and the company's proxy statement. These two reports are not necessarily available to shareholders at the same time.

Members of TechNet and the American Electronics Association have developed the following six tables to provide shareholders with more detailed and meaningful information about their executive and employee stock option plans in a consistent, easy-to-read approach that will be found in one place – a company's quarterly financial filings. These tables will provide investors with significant additional information about how a company uses stock options to reward and retain employees. Coupled with the new NYSE and NASDAQ rules on shareholder approval of option plans, the information contained in these disclosures will significantly empower investors to make informed decisions

## Section I: Option Program Description

Companies would provide investors with a narrative description of their specific stock option plans for employees and executives.

# Section II: Distribution and Dilutive Effect of Options

This table, "Employee and Executive Option Grants," provides significant new information about the options granted (year-to-date) to the company's "listed officers" (for example, the CEO and the four other most highly compensated executives), as well as information about how these options could potentially dilute shareholder equity in the future. The table would respond to investor calls for more information about stock option grants to high-level executives.

By showing the percentage of new option grants as a percentage of outstanding shares of stock, the table illustrates to sharcholders how the options granted so far during the current fiscal year could affect their "slice of the pie," or their percentage of ownership interest in the company, if exercised. The higher the percentage, the greater the potential dilution of shareholder ownership interest.

The table also provides information about the company's distribution of options between a company's "listed officers" and the rest of the employees of the company.

## Section III: General Option Information

The first table, "Summary of Option Activity," provides shareholders each quarter with a summary of a company's year-to-date option activity, as well as activity for the last fiscal year. Currently, this information is required to be disclosed only once a year in company financial statements.

The second table, "In-the-Money and Out-of-the-Money Option Information," would provide investors with accurate and up-to-date information about options' potential dilution of shareholder ownership. It shows the total number of options outstanding at the end of the quarter, along with the number of options that can and cannot be exercised according to vesting schedules. For example, the table allows investors to see that even if there are options outstanding, many of them may not be exercisable yet and therefore, cannot have a near term dilutive effect on shareholder equity.

The table also shows how many of the outstanding options are "in-the-money" vs. "out of-the-money", as of the report date. Options are considered "in-the-money" (or "above water") if the exercise price is less than the market share price of the stock. Options are considered to be "out-of-the-money" (or "underwater") if the amount of money the employee would have to pay to exercise the option is greater than the market price. Options that are significantly "out-of the-money" are not likely to be exercised and, therefore, are not likely to have any dilutive effect in the near term. As a result, this table shows shareholders the maximum potential dilution of their ownership stake in the company from all outstanding options and the potential near-term dilution from "in-the-money", exercisable options.

### Section IV: Executive Options

The two tables in this section respond to investor calls for additional information about executive stock options. The tables cover year-to-date stock options granted to and exercised by a company's "listed officers". Currently, shareholders receive information

about executive options once a year in a company's proxy statement. These tables will provide investors with this information on a quarterly basis.

The first table summarizes "Options Granted to Listed Officers" on a year-to-date basis. The first column of the table shows the number of shares that would be received by the officer if he or she exercised all of the new options granted during the current year. The second column shows the percentage of new options granted to each officer as compared to the total new options granted to all employees. The third column shows the exercise price (i.e., the price the officer would have to pay to buy the stock) for each option grant. The fourth column shows the options' expiration date, the last date the officer could exercise the options. The final two columns show the potential net profit to the officer from the exercise and sale of the options if the stock price were to appreciate from the date of grant to the expiration date at annualized rates of 5 and 10 percent. Conversely, if the stock price were to drop below the exercise price of the options, the potential realizable value would be zero. These options would then be "underwater" and thus, even if yested, would not be exercised.

The second table summarizes "Option Exercises and Remaining Holdings of Listed Officers." The first two columns show the number of shares of stock each executive received upon exercising any options during the current fiscal year, as well as the profit realized on those shares. The second two columns show the number of shares remaining that could and could not be exercised at the end of the quarter, based on when the options vest. The final two columns provide, as of the report date, the value of the officer's "above water" options that can be exercised and the value of "above water" options that are unvested and therefore, cannot be exercised.

This information provides additional transparency to investors because they can see recent option exercises by the officers. These exercises are placed in a meaningful context because the officers' remaining options are also shown.

# Section V: Equity Compensation Plan Information

The first column of the table shows the number of shares that would be issued upon exercise of outstanding options, warrants or other rights. The second column provides the weighted average exercise price of all the options, warrants, and other rights. The third column shows the number of shares that are available for issuance in the future under the plans.

<sup>\*</sup> The current accounting rule for stock options, FAS 123, requires companies to provide the following on an annual basis: a general description of the plan; a rollforward of option activity from the prior year; for options outstanding at the period end, the range of exercise prices (and the weighted average exercise price) as well as the weighted average remaining life (for all options outstanding and for options exercisable); and, for those companies who do not recognize the fair

value of options in their financial statements, the company is required to disclose the pro forma effect on earnings as if the company had recognized the fair value of the options in its financial statements (as well as the method and assumptions used to make the computations).



### Via E-Mail

November 4, 2002

Financial Accounting Standards Board MP&T Director - File Reference 1101-001 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856

Dear Sir or Madam:

On behalf of the members of the Technology Network ("TechNet"), thank you for the opportunity to submit our comments on the Proposed Statement of Financial Accounting Standards, Accounting for Stock-Based Compensation - Transition and Disclosure (an amendment of FASB Statement 123), dated October 4, 2002 (the "Exposure Draft"). Our comments will focus on the proposed amendments to the disclosure provisions of SFAS 123.

TechNet is a national network of more than 200 chief executive officers and senior partners of the nation's leading technology companies in the fields of information technology, biotechnology, venture capital, investment banking and law. We are proud of the role that our industries have played in the growth of the U.S. economy, due in large part to the use of broad-based stock option and other equity-based incentive plans to attract and retain talented employees. By giving employees at all levels a chance to share

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in their company's financial success through equity ownership, broad-based stock option plans boost productivity and are essential to America's competitiveness and economic growth.

With respect to the proposed amendments to the disclosure provisions of SFAS 123, we commend the Board's proposal for quarterly disclosures of information related to employee stock options. Investors should have timely, accurate and meaningful information about employee stock options in order to make informed investment decisions. Providing information about stock options on an annual basis is not sufficient. We believe that companies should provide information about stock options on a quarterly basis, in connection with their 10Q filings.

We do, however, take issue with the type of information to be provided under the Board's proposal. Specifically, we firmly believe that employee stock options do not represent an expense. Further, we do not believe that an accurate, reliable method of valuing stock options currently exists. In our view, there is a growing consensus that current option pricing models, when applied to employee stock options, produce wide-ranging and therefore often misleading results. Quarterly disclosures based on a flawed valuation will not serve shareholders or investors.

There are significant problems with applying current option pricing models, including the Black-Scholes valuation method, to employee stock options because many of the unique

aspects of stock options are not accounted for in these models. For example, these models were designed to value freely transferable options, yet there are significant restrictions on the transferability of employee stock options. Current option pricing models do not factor in a lack-of-marketability discount to address such restrictions.

In addition, models such as Black-Scholes were designed for options that are exercisable only upon expiration. Employee options, in contrast, typically have long vesting requirements and are then exercisable for a period of time, but are worthless if the employee terminates employment prior to vesting. Option pricing models do not accurately account for these factors.

An additional significant prediction that must be incorporated into such models is the volatility of the underlying stock expected over the life of the option. Commonly used historical estimates of volatility can vary over a significant range depending on the length of the historical period and the sampling frequency selected during the period. Future stock volatility is impossible to predict.

In short, by failing to account for the restrictions and other characteristics of employee stock options, current option pricing models produce unreliable and misleading results when applied to employee stock options. Requiring quarterly disclosures based on such models will not provide investors with accurate and reliable information.

The real cost of employee stock options is the potential dilution of each investor's share of company ownership. Because the number of outstanding shares will potentially increase when options are granted, shareholders have a right to know the amount by which earnings per share will be diluted. That information is disclosed today, but the usefulness and frequency of those disclosures should be improved.

In fact, shareholders should have access to comprehensive, accurate information about company stock option activity on a quarterly basis. In lieu of more frequent reporting of the Black-Scholes value of employee stock options, we urge the Board to consider more meaningful disclosures about employee stock options. These disclosures should provide shareholders with detailed, relevant information about employee stock options in a separate section of company quarterly financial statements in a series of easy-to-read tables and charts.

These disclosures should include the following information:

- employee and executive option grants;
- year-to-date option activity, as well as option activity in the prior fiscal year;
- "above water" and "underwater" option information as of the reporting date
   (i.e. Options that have an exercise price below a company's current share price, as well as options with an exercise price above the company's current share price).

 the portion of options that go to executives versus the portion provided to the rest of the company's employees.

In addition, separate tables should provide new, detailed information about options granted to a company's listed officers, including:

- · new options granted during the quarter;
- options exercised during the quarter and the value of those options;
- · the total number of options held by executives;
- the dollar value of options that are "above water".

The disclosures should also provide new information about dilution, enabling shareholders to see the potential impact of new option grants on the total number of shares outstanding.

Currently, corporations provide information about employee and executive stock options in two different documents—their 10K and proxy statement - filed only once a year.

These documents are not always released at the same time, and there is no requirement that companies provide this information in a consistent format, making it difficult for investors to decipher.

By consolidating this information into one section of company financial statements, providing it in a consistent format and disclosing the information to shareholders on a

November 4, 2002

quarterly basis, companies will provide investors with accurate, reliable and comprehensive information about employee stock options.

TechNet believes these enhanced quarterly disclosures will provide investors with a comprehensive and accurate picture of a company's stock option activity. We firmly believe that these disclosures represent the type of clear, accurate information that would be most valuable to investors. We have attached guidelines illustrating a proposed format for these new disclosures as well as an explanatory document.

We firmly believe that a comprehensive disclosure approach as described above and in the attachments will effectively meet the Board's stated goals of ensuring consistency and comparability of financial statements and "providing greater clarity of the effect of stock-based employee compensation on reported results". We further believe that such disclosures will address the legitimate demands by investors and the public for more comprehensive, transparent and timely information about employee stock options.

We appreciate the opportunity to offer these comments and look forward to further opportunities to work with the Financial Accounting Standards Board to improve financial reporting.

Comments on Proposed SFAS, Accounting for Stock-Based Compensation - Transition and Disclosure Submitted by The Technology Network November 4, 2002

Sincerely,

Rick White President and CEO

### Attachments

- Proposed guidelines for enhanced quarterly disclosures
- Explanatory document

Rich White





### November 4, 2002

Robert H. Herz Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

Re: File Reference No. 1101-001 Comments on Exposure Draft: Accounting for Stock-Based Compensation – Transition and Disclosure

### Dear Mr. Herz:

Because the Financial Accounting Standards Board's (the "Board") proposal will have a direct effect on our members, AeA has followed with great interest the deliberations of the Proposed Statement of Financial Accounting Standards, Accounting for Stock-Based Compensation – Transition and Disclosure, dated October 4, 2002 (the "Exposure Draft"). We appreciate the opportunity to comment.

Advancing the business of technology, AeA is the nation's largest high-tech trade association. AeA represents more than 3,000 companies with 1.8 million employees. These 3000+ companies span the high-technology spectrum, from software, semiconductors, medical devices and computers to Internet technology, advanced electronics and telecommunications systems and services.

We wish to point out that the majority of AeA's public companies utilize broad-based stock options to attract and retain a highly skilled workforce. We continue to believe that any attempt to mandate the expensing of options is misleading and inaccurate because there are no models that can accurately compute a "cost" of the options. Accordingly, we believe the current choice provided by FAS 123 is working and should continue.

With regard to the new quarterly disclosure proposal, AeA agrees that providing stock option information to investors on a more frequent basis than annually is a positive step. Having said that, however, quarterly disclosure of stock options "expense," generally using the Black-Scholes model, will not provide meaningful information to investors. We believe providing a "bad number" four times per year would be even more misleading to investors.

There is a growing consensus that the Black-Scholes valuation method, the most widely used valuation method, produces wide-ranging, and therefore often misleading, results.

Robert H. Herz Chairman, Financial Accounting Standards Board November 4, 2002 Page 2

Models like Black-Scholes allow for huge differences in the expense number depending on what inputs are used. Volatility probably moves this number the most. Commonly used historical estimates of volatility can vary over a significant range depending on the length of the historical period and the sampling frequency (e.g., daily, weekly, etc. stock price) selected during the period. A company's guess at what its stock's volatility is going to be is truly trying to predict the future.

Rather, AeA encourages FASB to further explore alternatives of stock option valuation that does not cause companies to accrue an expense that cannot be known today -- just predicted -- and that does not have the end result of over-reporting the value of employee stock options. AeA believes a comprehensive disclosure standard is better than providing a Black-Scholes number. The content of such a disclosure could include:

- · Summaries of employee and executive option grants
- · Year-to-date option activity
- Updated information about options that have an exercise price below a company's market share price, as well as options with an exercise price above the company's market share price.

Again, thank you for the opportunity to comment on these proposed changes, and we look forward to working with you in the future to help serve the information interests of investors.

Sincerely,

William T. Archey President and CEO