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File Reference: 1102-100

From: Bruce Nevin [bnevin@cisco.com]
Sent: Tuesday, April 20, 2004 10:41 AM
To: Director - FASB
Cc: bnevin@cisco.com
Subject: Stock options should not be expensed

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Dear Chairman Herz:

I understand that the Financial Accounting Standards Board (FASB) intend to treat stock options as an expense with a proposed valuation that would make it very difficult to continue broad-based employee stock option programs like the one we currently have at Cisco.

I have been with Cisco since January 1996. I am not an executive at Cisco, I have no direct reports and no budget oversight. But "worker bees" like me get the benefit of substantial stock options. At Cisco, even receptionists (termed "Ambassadors") receive stock options. The number of options that I received last year was about average.

How do I know the average? Last September, Cisco distributed 141 million merit-based options to employees, with about 2% going to executives and none to Chief Executive John Chambers
<http://biz.yahoo.com/djus/030905/1001000416_1.html>. Cisco gave eight executives a total of 2.99 million stock options in grants ranging from 82,500 options to 600,000 options, according to regulatory filings
<http://biz.yahoo.com/djus/030905/1001000416_1.html>, a bit more than 2% of all options granted. We were 34,466 employees at the end of Q4 FY2003. 141M less 2.99M is 138.01M options distributed over 34,458 employees.

What do options mean to us? We are shareholders. More than once in meetings I have heard colleagues refer to stock value as among reasons to work through tough issues and deliver what is needed so as to improve our customer satisfaction scores. (Everything at Cisco is driven by customer satisfaction.) But doesn't the employee stock purchase plan do the same thing? Where I worked previously there was an employee stock purchase plan, and most of my colleagues sold their stock as soon as they got it. Options focus attention on the longer term.

What do options mean to me? They will pay down the debt for our middle daughter's college tuition. She is graduating from Smith this year. Awareness that my options were there, maturing, gave us the confidence to support the debt for her tuition (at the rate of \$30,000 per year after scholarships). Our youngest daughter will be graduating from high school in two years. My oldest daughter's husband is working through the valley of career change. Availability of those options, many now vested, has given me the confidence to add to that debt and give more assistance to them and their three children than I otherwise could have. When the stock comes back up (and it will), my options will enable me to retrofit solar heating and power systems on our home, greatly reducing our cost of living when I eventually retire. And I plan to diversify into income-producing investments that will contribute to our income as interest rates rise (as they will).

But I am not eager to retire, and one reason is that I want to keep those options vesting.

The proposed policy would require stock options to be accounted as expenses. But no valuation scheme, Black-Scholes or any other, makes good sense. The core reason that they cannot assign appropriate valuation is that options have no value until they are exercised. I don't pretend to

tell you anything in your area of expertise. I'm only trying to express the incredulity that I feel that this is even being seriously considered, given the many obvious and great benefits of a properly designed, broad-based stock option plan like that at Cisco and at most other high-tech companies.

The proposed FASB policy is, I think, directed at companies whose stock option programs benefit only or mainly upper management, and abuses like those that infamously devastated employees at Enron and Worldcom. The proposed policy throws out a healthy, happy baby with the bathwater. It would effectively eliminate stock options as a broad-based benefit, and it would disproportionately penalize those companies that distribute stock options broadly across their entire employee base -- especially in the high-tech sector that has been a major driver of our prosperity. Much better to craft a policy that encourages the Coca-Colas and GMs and Gillettes of our economic world to open their stock option programs more broadly to all their employees.

I hope you will take my concerns into consideration. Please, do not destroy one of the most wonderful features of the part of the economy that I have the good fortune to inhabit. Don't force my employer to revert to the way that stock options are handled in companies with a more feudal compensation hierarchy. Instead, encourage those companies to spread the options around. If they care about productivity, and if you care about long term benefit to the economy and to our society, we will all be glad you did.

Bruce Nevin