From: Larry Nochowicz [lnochowi@cisco.com]
Sent: Tuesday, April 20, 2004 9:52 PM
To: Director - FASB
Subject: Employee Stock Options

Please see attached.
Via E-Mail: director@fasb.org

April 20, 2004

Chairman Robert H. Herz
Financial Accounting Standards Board

Subject: Expensing Employee Stock Options

Reference: File No. 1102-100

Dear Mr. Herz:

I am writing this letter to point out my concerns related to the proposed accounting change regarding the expensing of employee stock options. I believe that if FASB requires the expensing of employee stock options it unfairly punishes the company, the shareholders and the employees.

Although I am no accountant, I understand the premise of expensing stock options under the guise that this action will show a “true” picture of a company’s financial health. However, I fail to see how the expensing of what is basically an opportunity cost is a legitimate accounting concept.

If a stock option is granted at $10.00 and is subsequently exercised by an employee when the market value is $20.00 (let’s say 12 months later) result in a true expense. The company gets $10.00 cash proceeds and the employee now owns the stock (to hold or sell for their benefit). I understand that had the company waited the 12 months it would have received $20.00 in cash proceeds, but to suggest that this opportunity cost should be expensed is almost the same as saying that if services or equipment are sold for $10.00 today, but will fetch $20.00 in a year, that the company needs to expense the additional $10.00 because they sold the goods too soon!

The financial impact of granting options (of any kind) is already captured in the financial statements of companies via the diluted earnings figures. An astute investor recognizes this, and there certainly has been enough publicity regarding this issue that I dare say a novice investor recognizes this fact as well.

While I also recognize the fact that if expensing Employee Stock Options becomes a FASB requirement (across the board) that, within the industry, the fight for resources and talent will likely remain equal (I’m sure some small companies and start-ups would disagree with this
view). However, this can not be said for talent on a global basis. We do live in a global village and it is clear that competition from foreign companies is increasing. In addition, we see the continued ‘outsourcing’ of jobs to obtain a competitive advantage. I firmly believe that expensing of Employee Stock Options will only heighten this trend.

I have heard the argument that shareholders and investors will benefit from the “more accurate” portrayal of a company’s financial health, if FASB requires expensing of Employee Stock Options. How does lowering a company’s net income based on some mythical number help anyone, other than accountants who will now have increased billable hours? I personally have Employee Stock Options that are significantly “out of the money”. I have a few years left before they expire, but assuming they expire worthless, does the company get to record a “Gain on the non-exercise of Options” because there is no costs (not even opportunity costs) to the company?

Non compensatory Stock Options have the effect of making every employee an owner of the company, and thus their actions help or hurt the financial condition. It is easy for an investor to demand better performance from the Board of Directors and the Senior Management Team, but the only one the employees can blame is themselves. It is in their best interest to give 110% to make sure the company meets its goals. A close look at our company shows the benefits of employee ownership, increased worker productivity, record profits, gaining market share. How can investors not applaud this track record!

Of course I am very biased on this issue. This is my livelihood. Employee Stock Options are a part of my compensation package. There have been no raises at Cisco for the last three years, but we have been granted options. These options vest over a 5 year period. This is a long term commitment. The rewards for these options are instantaneous. We are not day traders, or arbitrageurs. We have to work hard and meet the company goals, and hopefully the market place will reward us with an increased share price. Just as the investors of the company will benefit from seeing their risk capital return a premium, so will the employee owners who have just as much at stake, if not more.

Very truly yours,

CISCO SYSTEMS CAPITAL CORPORATION

By Larry Nochowicz
Title: US Manager, Cisco Capital