COMPLIANCE WEEK

FASB Moves Forward With Requirement To Expense Options

By Susan Schott Karr — August 10, 2004

Despite the recent House vote that would derail its efforts, the Financial Accounting Standards Board continues to move forward over the contentious issue of accounting for employee stock options.

Thus far, the FASB has no intention of changing its December 15 proposed date of when public companies must begin to expense the value of employee-based compensation. By the fourth quarter, 2004, the FASB expects to finalize its plan and issue a statement to this effect.

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"The Board will continue its public deliberations as long as is necessary to develop a high-quality and cost-effective accounting standard that will best serve the needs of individuals, creditors, and other consumers of financial reports," says Steve Getz, spokesman for the FASB.

At its August 4 meeting, the Board agreed to continue to support its decision to require companies to recognize the cost of stock options on their income statements.

Currently, companies are only required to make disclosures in the footnotes of financial statements that estimate the expense and its effects. Over 600 companies, including General Electric and General Motors, currently expense—or plan to expense—options.

At the meeting, the Board discussed its analysis of the 13,775 comment letters received on the March 2004 Exposure Draft, "Accounting for Stock-Based Compensation." The Board also addressed the appropriate attribute and date to use in measuring an exchange transaction involving equity awards granted by public companies to their employees. Again, Board members unanimously concurred that the fair-value method, proposed earlier, was the most consistent as well as the most reasonable method available. Likewise, they persisted in their belief that the grant date was the most appropriate date to use.

What's Next?

Miller

According to Paul Miller, a former FASB member who is now a professor of accounting at the University of Colorado, the FASB members and staff are likely dumbfounded and stunned by the recent House vote, but he also believes caving in to Congress would be a mistake.

In late July, the U.S. House of Representatives voted to oppose most of the key FASB provisions. The House bill would only require companies to deduct from revenues the value of the options of its top five executives. The bill would also exempt small businesses—those with less than $25 million in revenues—and companies that have been public for less than three years. It would also require a one-year study on its possible effect on the economy before the Securities and Exchange Commission can approve an options-expensing rule.

The expensing route has been endorsed by Federal Reserve Board Chairman Alan Greenspan, SEC Chairman William Donaldson, and William McDonough, head of the Public Company Accounting Oversight Board. Key members of the Senate—including Senate Banking Committee Chairman Richard Shelby (R-Ala.)—have also said that they will fight to defeat the House action.

According to Miller, the next deliverable for the FASB is a standard requiring that the initial value of granted options be expensed during the vesting period—usually three to five years.

When asked if the Board should consider rewriting the standard to satisfy Congress, Miller quips, "They had better not." According to Miller, the House bill specifies that the value of the options must be estimated under the assumption that there will be no changes in the stock's value over the life of the options. In other words, there would be no acknowledgement of the very feature that gives options their value. This part of the proposed law essentially makes the *estimated* value of all the options equal zero. Therefore, it doesn't matter whether it is limited to the top five or not; there will be nothing on the income statement. "If FASB were to rewrite to accommodate the Congressional approach, there would be no reported expense, and inferior information would flow to the capital markets," says Miller.

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