

**SUMMARY OF KEY PROVISIONS OF THE
ENZI-REID STOCK OPTION ACCOUNTING REFORM ACT OF 2003**

Mandatory Expensing of Stock Option Held by Highly Compensated Officers

- The legislation requires that the chief executive officer and the next four most highly compensated executive officers shall expense their stock options in the annual reports filed with the Commission.
- Expensing the options granted to the CEO and next four most highly compensated executive officers would go into effect **immediately**.
- This is consistent with information that must be filed with the Commission as part of Securities Exchange Commission Regulation S-K and as part of proxy statement filings pursuant to Securities Exchange Act Rule 14.
- The section would require that the “fair value” of a stock option would be equal to the value that would be agreed upon by a willing buyer and seller taking into account all of the characteristics and restrictions imposed upon the stock option.
- In light of the extreme inaccuracy of existing stock valuation models (e.g., Black Scholes, binomial, etc.), particularly with regard to the factor that requires companies to predict the volatility of their stock price, the legislation requires that the assumed volatility of the underlying stock option shall be considered zero.

Small Business Exemption

- The legislation exempts from the top five expensing requirement all small businesses as defined currently by the Securities and Exchange Commission pursuant to Regulation S-B.
- The legislation also delays stock option expensing of a small business issuer until three years after an initial public offering has taken place. This would allow a small business issuer’s stock to settle down from the initial volatility of the initial public offering.

Prohibition on Expensing; “Truing Up” Requirement; and Economic Impact Study

- The legislation prohibits the SEC from recognizing any stock option expensing accounting standard set by a standard setting body unless and until:
 1. The expensing standard recognizes the true expense of the stock option on a company’s financial statement when the option is exercised, expires or is forfeited (a “truing up” requirement); and

2. A comprehensive economic impact study has been conducted by the Departments of Commerce and Labor.
- As to the first requirement above, currently, stock options must be expensed based upon the grant date of the option. There is no “truing up,” or correcting, errors made at the time of grant when subsequent events prove the initial estimates to be inaccurate. The legislation requires that when an option is exercised, expires or is forfeited, the company would reconcile the actual expense to the company to the amount expensed previously upon the date of grant.
 - As to the second requirement, the legislation requires the Secretary of Commerce and the Secretary of Labor to conduct and complete a joint study on the economic impact of the mandatory expensing of all employee stock options. The study will address:
 1. the use of broad-based stock option plans in expanding employee corporate ownership to workers at a wide range of income levels with particular focus on non-executive workers;
 2. the role of such plans in the recruitment and retention of skilled workers;
 3. the role of such plans in stimulating research and innovation;
 4. the effect of such plans in stimulating the economic growth of the United States; and
 5. the role of such plans in strengthening the international competitiveness of United States’ businesses.