

Stock Option Expensing - Legislative Update

In November 2003, Senator Mike Enzi (R-WY) plans to introduce the [Stock Options Accounting Reform Act of 2003](#). Original co-sponsors are expected to include Senators Reid (D-NV), Boxer (D-CA) Allen (R-VA) and Ensign (R-NV). The bill would mandate the expensing of stock options for the top 5 officers of a company. It would also bar the SEC from recognizing any stock options expensing standard unless it allowed for reconciliation of the prior expense when the option is exercised, forfeited or expires and until after a Commerce Department study is concluded. No expensing would be required of "small companies." For options that are required to be expensed and for which Black-Scholes is used to value, volatility will be zero. [Enzi Bill Summary](#)

On September 24, 2003, The FSA, with the AeA, participated in an executive-level, high-tech lobby day in Washington, DC to persuade Members of Congress to lobby Congress on passage of the Broad-Based Stock Option Plan Transparency Act of 2003 (S. 979 and HR 1372). The proposed legislation seeks to delay implementation of mandatory stock option expensing as proposed by the Financial Accounting Standards Board (FASB) for a minimum of three years. Thirty senior executives from some of America's most innovative high-tech corporations met with more than 35 Senators and Members of Congress, along with a Commissioner and staff of the Securities and Exchange Commission (SEC). Bob Bailey, President and CEO of PMC-Sierra, Inc. and Dwight Decker, Chairman and CEO of Conexant Systems, Inc. led the FSA delegation.

Senators John Ensign (R-NV) and Barbara Boxer (D-CA) are sponsors of S.979. As a result of the lobbying, Representative David Dreier (R-CA), who sponsored HR 1372 with Rep. Anna Eshoo (D-CA), reported he had been approached by House members who had met with the AeA executives and were now prepared to become co-sponsors of the legislation. The following week the San Jose Mercury News changed its editorial support for mandatory stock option expensing, and announced that it now favors holding off on these changes as a direct result of this lobby day.

In a press conference held that day with by Dick Cook, Chairman of the AeA Board of Directors and President and CEO of MAPICS, Mr. Cook said, "We're here to let Congress know that the Financial Accounting Standards Board (FASB) proposal to expense stock options will hurt rank-and-file employees' ability to participate in the ownership of their own company. High-tech companies like ours need stock options for attracting and retaining the most capable workers. Stock options, given to the vast majority of our employees, provide our companies with a competitive edge for keeping skilled workers."

At the conclusion of the full day of visits and briefings, the delegation met with Commissioner Paul Atkins of the Securities and Exchange Commission. The SEC is responsible for implementing any changes to Generally Accepted Accounting Principles (GAAP), including any changes to the stock option accounting rules as directed by FASB. AeA executives impressed upon Mr. Atkins the need to avoid a rush to expense stock options. This legislation is critical to slowing the rush to judgment on stock options and for giving accounting regulators the time they need to evaluate the full range of economic and accounting issues surrounding stock option plans.

The FSA agrees with the AeA, which has emphasized that this rush is primarily driven by outrage in a number of circles to the perceived notion that options contribute to excessive compensation for business executives. Additionally, the AeA delegation urged Members of Congress and the SEC Commissioner to understand that the FASB expensing proposal will not solve the perceived problem. Implementation of mandatory expensing could destroy plans that are currently benefiting, or will benefit, the rank-and-file employees of hundreds and hundreds of smaller companies. Commissioner Atkins was very receptive to AeA's concerns. Executives in the AeA delegation delivered a consistent message during their lobby visits. Specifically, they emphasized that the FASB proposal is lacking in several areas:

- 1) It requires bad accounting practices that will obscure the real performance of the company because the company has spent no cash.
- 2) It provides no flexibility for companies to determine the best way to inform investors of accurate financial performance. No single approach works for all companies.
- 3) It will force companies to use what is likely a meaningless value for stock options. FASB has acknowledged in the past the difficulty of valuating stock options.
- 4) It will actually lead to less information in financial statements than is currently available in the footnote and give a misleading view of a company. We need more transparency not less.

In 2002, the AeA conducted a survey which found that public high-tech companies on average grant stock options to 84% of their employees. Rank-and-file workers of public high-tech companies are the recipients of the lion's share of options with 66 percent of option grants going to non executives.

The FSA conducted a similar survey of fabless semiconductor companies in September 2002, revealing that the vast majority of fabless semiconductor companies - 97% of public and 98% of private, grant stock options to their employees.

FSA Survey of Fabless Semiconductor Companies The Impact of Expensing Employee Stock Options						
	% Stock Options Granted to Employees	Top 5 Executives	All Executives	Non-Executive Employees	Opinion: expensing impact on retention of employees	Opinion: expensing impact on innovation
Public Fabless Companies	97%	19%	32%	68%	Yes=82%	Yes=74%
Private Fabless Companies	98%	29%	45%	55%	Yes=73%	Yes=65%

In July 2003, more than 230 small to mid-sized AeA and FSA member companies signed a [letter to Congress](#) expressing strong support for the Broad Based Stock Option Transparency Act of 2003.

In other research released in October 2003, a Deloitte Technology Stock Compensation Survey indicated that CEOs and CFOs of technology companies expect to run out of stock option shares for employees within two years and anticipate moving to alternatives such as restricted stock and cash compensation. Ellie Kehmeier, deputy national tax leader for Deloitte's Technology, Media & Telecommunications (TMT) Group, says "Companies are running out of shares to offer employees; employees are mad about worthless options; investors, already concerned over excessive compensation, now have more power to veto stock plans; and regulators are bearing down on the accounting front. All these factors are causing a sea change in the world of equity compensation."

Almost three-fourths of public company respondents (72%) expect to run out of shares to grant to employees within two years. One-fifth (20%) expect to run out of shares within one year, while more than half (52%) expect to run out between one and two years. Most technology companies have historically granted options to all or most of their employees, but now companies are running out of shares and require shareholder approval before they can grant additional shares, says Michael Kesner, a partner in Deloitte's Human Capital practice.

"The SEC recently approved new rules requiring companies listed on the NYSE and Nasdaq to get shareholder approval for all new equity compensation plans and for share increases in existing plans. These rules could make it harder for companies already facing a dwindling supply of shares and I'm not sure companies have focused on that yet," Mr. Kesner says. "Shareholders typically frown on companies they feel have granted too many options, viewing it as a transfer of wealth from them to employees. Companies will need to better understand their shareholders' tolerance for equity awards to employees if they want to win their votes."

Eighty percent of public company respondents said the potential requirement to expense employee options is the top, or second most important, issue impacting their equity compensation practices. Potential dilution from employee stock options ranked second in public companies' concerns, followed by the new rules giving shareholders an increased say over equity compensation matters and underwater options. The survey noted that while publicly held companies are more concerned about option expensing than their privately held counterparts, both groups are adopting expense accounting at essentially the same rate. The Deloitte survey found that 3% of public and 5% of private companies indicate that they are currently expensing, and an additional 5% of both public and private companies plan to start expensing before it becomes required. This means that roughly 90 percent of companies are not currently expensing options, and they have no plans to do so unless required.