

Mr. LEVIN. Mr. President, I am introducing today on behalf of myself and Sen. **MCCAIN** two separate bills relating to stock options. Stock options are unfinished business from the last Congress. They are the 800-pound gorilla that has yet to be caged by corporate reform.

Stock options allow a company's employees, usually its top executives, to purchase company stock at a set price for a specified period of time, perhaps 10 years. If the stock price rises after the option is issued, the executive can exercise the option, buy the stock at the set price, and then sell it on the open market at a profit. Today, most CEOs of U.S. publicly traded companies receive a large percentage of their pay from stock options.

Despite their widespread use, stock options remain a stealth form of compensation because, under current accounting rules, they never have to appear on the company books as a compensation expense. In fact, they are the only form of compensation that companies do not have to book as an expense at any time. In addition, stock options are the only form of compensation that a company can claim as a deductible business expense on its tax return, even when no expense is ever recorded on the company books.

These stock option accounting and tax rules are inconsistent and illogical. The two bills we are introducing today, the Stock Option Accounting Review Act, and the Ending the Double Standard for Stock Options Act, were introduced in the last Congress to address this problem. Each bill tackles a different aspect of the stock option issue. One addresses stock option accounting; the other addresses the stock option tax deduction.

Last year, Senator *McCain* and I proposed the accounting provision as an amendment to the Sarbanes-Oxley corporate reform bill that was before the Senate in July. There appeared to be sufficient support to pass it at the time, but we were unable to obtain a vote on it or on any other stock option legislation. That is why we are back this Congress.

Congress failed to resolve the issue last year, even though stock option abuses were repeatedly linked to serious corporate abuses and dishonest accounting. In fact, virtually every corporate disaster that has struck in recent years has had a stock option component.

Enron, of course, was the poster child. Congressional investigations, including by the Permanent Subcommittee on Investigations on which I sit, showed that, at the same time Enron investors and employees were losing their shirts, Enron executives were cashing in their stock options for tens or hundreds of millions of dollars. Ken Lay, the Chairman of the Board, took home \$123 million from stock options in 2000 alone. Jeff Skilling, the CEO, took home over \$60 million. Another executive, Lou Pai, topped them all by cashing in Enron stock options, in 2000, for \$265 million.

Stock options also contributed to Enron's inflated earnings, since despite providing the lion's share of executive pay, this compensation never appeared on the company books as an expense nor was it ever deducted from earnings. And many have blamed stock options for encouraging Enron management to rig the company's financial statements through other accounting deceptions to help boost apparent income and, in turn, the company stock price, so they could sell their Enron stock at enormous profit.

Still others have noted that Enron used about \$600 million in stock option tax deductions to avoid paying any corporate income taxes in four out of the last five years before its bankruptcy while, at the same time, touting record amounts of corporate income. What is now only beginning to be understood is that Enron's stock option tax deductions played a central role in

much of its wrongdoing, after all, Enron was able to inflate its corporate income with impunity, in part, because its stock option tax deductions allowed it to avoid paying taxes on any of its phony inflated income.

Enron was the poster child for stock option abuses, but it was far from the only company in that category last year. Worldcom, Tyco, Qwest Communications, and many others have stock option stories that are equally disturbing.

And the problems did not stop with companies engaged in accounting deceptions or other corporate misconduct. Even companies that never appeared on the 2002 rollcall of corporate deception have been excoriated in media reports for giving huge stock option pay to executives while socking employees and investors with lower stock prices, mounting losses, and lousy corporate performance.

High tech companies that have been the biggest promoters of stock options have been some of the biggest culprits. Company after company in Silicon Valley paid their executives big bucks via stock options while laying off employees, losing money or market share, and stiffing investors. One example frequently cited in the media is Lawrence Ellison, CEO of Oracle Corp., who exercised options in 2001 to obtain profits of \$706 million, while his company's stock price dropped by more than 50 percent.

Aggregate stock option statistics are also sobering. Business Week, for example, has estimated that stock options now account for "a staggering 15 percent of all shares outstanding." Federal Reserve Chairman Alan Greenspan estimated that stock options have been used to overstate reported company earnings by an average of 6 to 9 percent.

Perhaps that is why Chairman Greenspan has picked honest stock option accounting as his number one post-Enron reform.

Stock option abuses have been linked to inflated company earnings, dishonest accounting, and executive misconduct. These abuses have been facilitated by existing accounting and tax rules which allow stock option compensation to never appear on a company's books as an expense, even when a company claims this compensation as a business expense on its tax return. This double standard is fueling Enron-style abuses, and it is time for it to end.

Many in the U.S. business community apparently agree and, unlike the Congress, have taken direct action on the stock option issue. In fact, over the last year, there has been significant movement in the business world to end dishonest stock option accounting.

Over 120 companies, including such American giants as Coca-Cola, General Motors, General Electric, Dow Chemical, Wal-Mart, and Home Depot have announced that they will begin expensing options in 2003, joining longtime expensers like Boeing and Winn-Dixie. Standard and Poors has created additional pressure for honest stock option accounting by announcing a new "core earnings" calculation for companies which requires stock option compensation to be subtracted from a company's earnings.

Accounting experts are also moving. The International Accounting Standards Board in London has announced that, by the end of 2003, it will issue accounting standards requiring companies to expense stock options. The U.S. equivalent, the Financial Accounting Standards Board, or FASB, has announced that it will decide by the end of the first quarter of this year whether it will issue stock option accounting standards similar to those of the International Board.

While there has been a major shift in the U.S. business world toward honest stock option accounting, not all companies are on board. Some companies, especially those in the high tech sector, have announced that they will not expense stock options until forced to do so. That means, until FASB acts, there will be a discrepancy between those companies that are voluntarily expensing options and those that are not, when there ought to be a level playing field where everyone plays by the same accounting rules. It is this discrepancy that continues to make our stock option legislation relevant and necessary for Congressional action this year.

The bill does not specify the stock option accounting standards that FASB should issue; that matter is left to the experts where it belongs. But the bill does put the Senate on record as urging FASB to review the existing rules and take appropriate action within one year. This legislative directive is important, because the only other time the Senate has spoken on this issue, in 1994, the Senate majority urged FASB to keep allowing companies to exclude stock option expenses from their financial statements. The Senate's position contradicted FASB's position at the time which was to require stock option expensing. It is long past time for the Senate to rescind its mistaken advice.

The second bill we are introducing today is the Ending the Double Standard for Stock Options Act. This bill would not address the accounting treatment of stock options. Instead, it would address the tax treatment of stock option compensation, ending the costly double standard in federal law, which allows a company to take a tax deduction for stock option compensation, even if the company does not show that compensation as a business expense on its financial statements.

Essentially, our bill would prevent a company from claiming a stock option expense on its tax return unless the company also includes that expense on its books. It would require companies to be consistent in how they treat stock options, and take a corporate tax deduction that mirrors the expense shown on the company books. If a company took the position that it incurred no expense from stock option compensation on its books, the bill would allow the company to take that position, but would also require it to take the same approach on its tax return and forego any deduction. The bill would stop companies from telling stockholders one thing, that it has no stock option expenses, while telling the opposite to Uncle Sam.

And to add insult to injury, in 2001, the IRS issued Revenue Ruling 2001-1 which determined that companies whose tax liability was erased through stock option expenses were not subject to the corporate alternative minimum tax. That revenue ruling meant that our most successful publicly traded companies, if they doled out enough stock options to insiders, could arrange their affairs to escape paying any taxes. That absurd result leaves the average taxpayer feeling like a chump for paying his fair share when a company like Enron can use its success in the stock market to apparently end up tax free.

One last point. Some opponents of stock option reform argue that reining in stock options would hurt the average worker, but this contention is nothing more than a red herring. While many average workers are eligible for stock options, few actually receive them. Stock options are overwhelmingly reserved for top corporate executives.

A recent Bureau of Labor Statistics survey did the research. This nationwide government survey found that in 2000, a banner year for stock options, only 1.7 percent of non-executive workers actually got any stock options. The BLS survey also looked at corporate executives and found

that only about 5 percent of these corporate executives received any stock options. These results are consistent with the findings of a private sector group not associated with the government called the National Center for Employee Ownership, which favors stock options. Looking at a small sample of companies, the Center reported that 70 percent of all stock options were given to managers rather than other employees, and about 50 percent were given to the most senior executives. The reality is that stock options are a perk mainly reserved for a very small group, and neither average workers nor most executives would be affected by honest accounting or consistent tax and accounting treatment for stock options.

It is also important to understand that neither of our bills would bar any company from issuing stock options. Companies would still be able to issue stock options to their executives and other employees. The goal of this legislation is not to stop the use of stock options, but to promote honest accounting and consistent treatment of stock options on federal corporate tax returns.

Stock option abuses have damaged investor confidence in American business. I hope our colleagues will support enactment of these bills to help restore investor confidence and end stock option abuses. I ask unanimous consent to have reprinted in the **RECORD** after my remarks the text of both bills.