# Congress of the United States

Washington, DC 20510

February 3, 2003

Financial Accounting Standards Board
File Reference 1102-001
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P.O. Box 5116
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Sent by email to director@fasb.org

**Re: Employee Stock Option Accounting**

To Whom It May Concern:

In response to the Financial Accounting Standards Board's (FASB) Invitation to Comment on the proper accounting for employee stock options, we wish to strongly voice our support for an honest accounting standard that would require all employee stock option compensation to be shown as an expense on corporate financial statements.

The current U.S. accounting standard allows companies to choose whether or not to report stock option compensation as an expense in their financial statements filed with the Securities and Exchange Commission. This accounting treatment has led to a variety of stock option abuses linked to excessive executive compensation, inflated company earnings, dishonest accounting, and corporate misconduct.

Since the 1980s, stock option compensation has funneled millions of dollars to U.S. corporate executives and now accounts for a large share of compensation paid to chief executive officers (CEOs) at U.S. corporations. Business Week has estimated that, in the aggregate, employee stock options now account for "a staggering 15 percent of all shares outstanding" at U.S. publicly traded corporations. The amounts paid to CEOs are striking, including the $123 million paid to Enron's CEO in 2000, and the $700 million paid to the CEO of a high technology company in 2001. Typically, such payments never appear on a company's financial statement, despite the size of the payment and even though the common practice is that the company claims the compensation as an expense on its federal corporate tax return. The omission of any stock option expense in the financial statement, combined with the inclusion of this expense in the company's tax return, means that huge stock option grants lead to overstated earnings. Federal Reserve Chairman Alan Greenspan has estimated that stock options have been used to overstate reported company earnings by an average of 6 to 9 percent.

But this is not the only problem associated with stock options. A September 2002 report issued by a blue-ribbon panel established by The Conference Board found that the current accounting treatment of stock options helped "foster[] what appears to be a vicious cycle of

increasing short-term pressures to manipulate earnings in order to bolster stock price in order to cash in on options." Such earnings manipulation is associated not only with the Enron scandal, but many of the other accounting scandals in 2002. These stock option abuses and the dishonest accounting associated with them have damaged investor confidence in the accuracy and reliability of U.S. corporate financial statements.

In response to this loss of confidence, over 120 U.S. companies, including such American giants as Coca-Cola, General Motors, General Electric, Dow Chemical, Amazon.com, Home Depot, and Wal-Mart, have announced that they will begin expensing options in 2003, joining longtime expensers like Boeing and Winn-Dixie. Other companies, however, especially in the high technology sector, have announced that they will not expense stock options until required to do so. This division of approach means that, 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 in which everyone operates under the same accounting rules. This discrepancy looms large in light of the huge dollars involved in many stock option awards. Failing to impose a uniform expensing requirement would not only allow companies that do not expense options to inflate their earnings, but would also disadvantage the companies that do report stock option expenses as well as hinder financial analysts and investors attempting to understand company financial statements and compare corporate performance.

Some opponents of stock option expensing argue that, due to the difficulty of precisely estimating stock option values, expensing will confuse rather than educate financial analysts and investors about a company's financial condition. But many accounting standards require estimated valuations and, as Warren Buffett has pointed out, the only value that everyone agrees is incorrect for a stock option is zero. The better approach to curtail stock option abuses and restore investor confidence in financial statements is to require all companies to use the same stock option valuation methodology to ensure stock options are expensed and the comparability of financial statements is strengthened.

Some critics also contend that expensing stock options would eliminate broad based stock option plans and hurt average workers, but this contention is contradicted by the factual record. First, successful U.S. companies that offer broad-based stock option plans to their workforce have already determined that they can expense employee stock options without having to end this form of compensation. Two recent examples are Home Depot and Wal-mart, which offer broad-based plans to many average employees and have announced they will begin expensing options this year. Secondly, only a small percentage of U.S. companies now issue stock options broadly to average workers, even when those workers are eligible to receive them. A recent nationwide survey conducted by the U.S. Bureau of Labor Statistics found that in 2000 – a banner year for stock options – only 1.7 percent of non-executive workers actually received any stock options.

This survey, the most extensive review of actual worker receipt of stock options in corporate America, demonstrates that most workers do not now receive stock options and would be wholly unaffected by any changes in stock option plans, even assuming any change were actually to take place. In short, neither broad based stock option plans nor average workers would be hurt by honest accounting.

Now is the time to end the dishonest accounting of stock options and recognize the expense associated with this compensation. FASB was prevented by political pressures from expensing options in 1994, but has consistently contended over the years that expensing is the correct approach. According to the Association for Investment Management and Research, over 80 percent of U.S. financial analysts and portfolio managers agree. The International Accounting Standards Board is already advocating this approach in its proposed accounting standard for stock-based compensation. Many others also support stock option expensing, from leading figures like Federal Reserve Chairman Alan Greenspan, former Federal Reserve Chairman Paul Volcker, investor Warren Buffett, and Nobel Prize winner Joseph Stiglitz, to such groups as the Council of Institutional Investors, the Investment Company Institute, The Conference Board's Commission on Public Trust and Private Enterprise, and the Consumer Federation of America. The more than 120 companies that are now expensing options also deserve a fair accounting standard that will not place them at a disadvantage with competitors who refuse to show this expense.

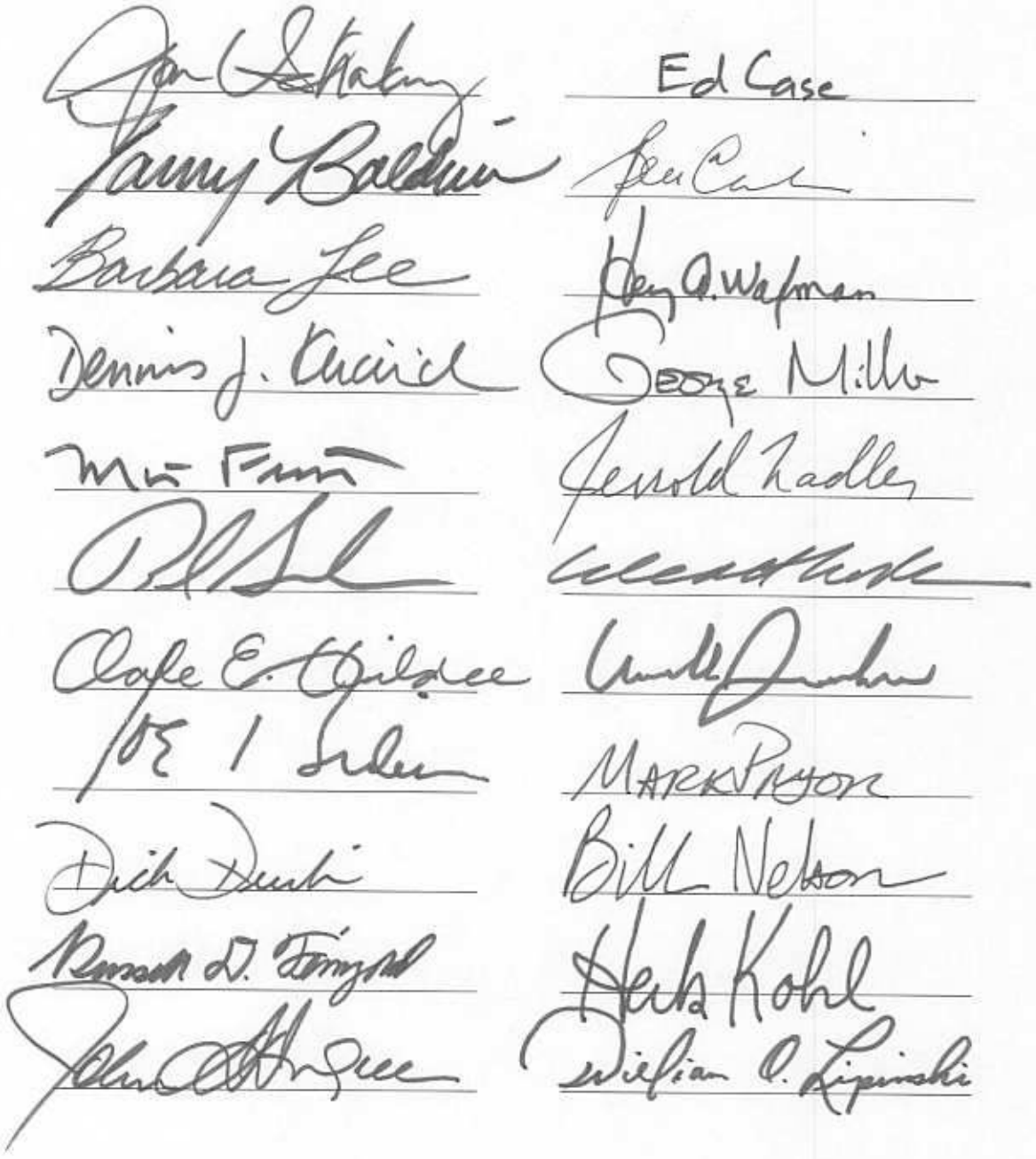
Requiring companies to expense employee stock options would strengthen the accuracy of financial statements and help restore public trust in our financial reporting system, our companies, and our markets. We urge FASB to issue a proposed stock option accounting standard as soon as possible and to promulgate a final standard by the end of 2003.

Sincerely,

John McCain

Pete Stark

Carl Levin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The signatories on the February 3, 2003 letter
to the Financial Accounting Standards Board are as follows:

Sen. John McCain
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Sen. Carl Levin
Rep. Stephanie Tubbs Jones
Sen. Jon Corzine
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Rep. Tammy Baldwin
Rep. Barbara Lee
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