The Washington Post

AN INDEPENDENT NEWSPAPER

Money Talks

ALAN GREENSPAN, perhaps the nation's most revered economist, thinks employee stock options should be counted, like salaries, as a company expense. Warren Buffett, perhaps the nation's foremost investor, has long argued the same line. The Financial Accounting Standards Board, the expert group that writes accounting rules, reached the same conclusion eight years ago. The London-based International Accounting Standards Board recently recommended the same approach. In short, a rather unshort list of experts endorses the common-sense idea that, whether you get paid in cash or company cars or options, the expense should be recorded. Yet today's Senate Finance Committee hearing on the issue is likely to be filled with dissenting voices. There could hardly be a better gauge of money's power in politics.

Why does this matter? Because the current rules—which allow companies to grant executives and other employees millions of dollars in stock options without recording a dime of expenses—make a mockery of corporate accounts. Companies that grant stock options lavishly can be reporting large profits when the truth is that they are taking a large loss. In 2000, for example, Yahoo reported a profit of $71 million, but the real number after adjusting for the cost of employee stock options was a loss of $1.3 billion. Cisco reported $4.6 billion in profits; the real number was a $2.7 billion loss. By reporting make-believe profits, companies may have conned investors into bidding up their stock prices. This is one cause of the Internet bubble, whose bursting helped precipitate last year's economic slowdown.

It is not surprising, therefore, that the expert consensus favors treating options as a corporate expense, which would mean that reported earnings might actually reflect reality. But the dissenters are intimidated by neither experts nor logic. They claim that the value of options is uncertain, so they have no idea what number to put into the accounts. But the price of an option can actually be calculated quite precisely, and managers have no difficulty doing the math for the purposes of tax reporting. The dissenters also claim that options are crucial to the health of young companies. But nobody wants to ban this form of compensation; the goal is merely to have it counted as an expense. Finally, dissenters say that options need not be so counted because granting them involves no cash outlay. But giving employees something that has cash value amounts to giving them cash.

The dissenters include weighty figures in both parties. Sen. Joe Lieberman (D-Conn.) is the chief opponent of options sanity in the Senate, and last week President Bush himself declared that Mr. Greenspan is wrong on this issue. What might be behind this? Many of the corporate executives who give generously to politicians are themselves the beneficiaries of options—often to the tune of millions of dollars. High-tech companies, an important source of campaign cash, are fighting options reform with all they've got. But if these lobbyists are allowed to win the argument, they will undermine a key principle of the financial system. Accounting rules are meant to ensure that investors get good information. Without good information, they cannot know which companies will best use capital, and the whole economy suffers in the long run.