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Ellen J. Grossman

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## NOTES

### U.S. VS. INTERNATIONAL STOCK OPTION DISCLOSURE REFORM: THE INTERNATIONAL COMMUNITY LEADS WHERE THE U.S. COMMUNITY FAILED

“The point, ladies and gentlemen,  
is that greed, for lack of a better word, is good.”<sup>1</sup>

Gordon Gekko<sup>2</sup>

#### I. INTRODUCTION

Disclosure requirements for compensatory stock options were established in the United States (“U.S.”) in 1973.<sup>3</sup> At that time, companies granted stock options almost exclusively to their corporate executives, and did so sparingly.<sup>4</sup> However, since that time, corporations have expanded their use of compensatory stock options, which they now use as an employment compensation mechanism for many, if not all firm em-

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1. WALL STREET (20th Century Fox 1987).

2. Nefarious entrepreneur played by Michael Douglas in the movie WALL STREET. *Id.* Film critic, Roger Ebert, described director Oliver Stone’s film as, “a radical critique of the capitalist trading mentality,” and noted that Stone depicts small investors as dupes. Roger Ebert, *Wall Street*, CHI. SUN-TIMES, Dec. 11, 1987, 33, available at [http://www.suntimes.com/ebert/ebert\\_reviews/1987/12/268135.html](http://www.suntimes.com/ebert/ebert_reviews/1987/12/268135.html).

3. The Accounting Principles Board (“APB”) was established by the American Institute of Certified Public Accountants in 1959 as a successor to the Committee on Accounting Procedure, established in 1939, and as a precursor to the Federal Accounting Standards Bureau (“FASB”), established in 1973. Financial Accounting Standards, QuickMBA, at <http://www.quickmba.com/accounting/fin/standards/> (last visited Sept. 23, 2003) [hereinafter Financial Accounting Standards]. The APB issued thirty-one opinions and four statements, which formed the basis of the FASB’s Generally Accepted Accounting Principles (“GAAP”), the accounting standard followed in the U.S. *Id.*

4. Robert Dean Ellis, *Equity Derivatives, Executive Compensation, and Agency Costs*, 35 HOUS. L. REV. 399, at 412–13 (1998).

employees, and which account for an increasing percentage of each employee's annual compensation package.<sup>5</sup> This Note argues that U.S. accounting rules do not capture accurately corporate operating expenses on financial statements, thus, have failed to evolve accordingly.

The U.S. accounting standard-setting body, the Federal Accounting Standards Board ("FASB"), understood that its accounting standard created a loophole which, almost without exception, every U.S. company used.<sup>6</sup> Although a company was required to charge employment compensation as an expense on its balance sheet, reducing the amount of profit it reflected, a company could issue stock options as part of its employment compensation without recognizing a compensation expense on its financial statement.<sup>7</sup> The FASB studied this disclosure loophole and drafted a revised procedure<sup>8</sup> that, as this Note posits in Part III.B., would have closed the option disclosure loophole. However, Congress, in order to cater to big business interests, effectively overruled the FASB, and disclosure requirements remained largely unchanged.<sup>9</sup>

Since that time, an international group of accounting regulation agencies, which include the FASB, known as the International Accounting Standards Board ("IASB"), studied this disclosure issue.<sup>10</sup> The IASB recognized the need for new disclosure regulations and prepared its own preliminary standard,<sup>11</sup> which it made available to the public for comment through March 7, 2003.<sup>12</sup> The IASB claims that its proposed standard

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5. *Id.*

6. Robert W. Rouse & Douglas N. Barton, *Stock Compensation Accounting*, J. OF ACCOUNTANCY 67, 68 (June 1993).

7. *Id.*

8. *Id.*

9. See *Legislation Introduced to Overturn FASB Stock Option Proposal*, J. OF ACCOUNTANCY 15, 16 (Oct. 1993) [hereinafter *Lieberman Legislation*].

10. See *supra* Part IV.A.

11. IASC Chronology (1973–2001), International Accounting Standards Bureau, at para. 1, at <http://www.iasc.org.uk/cmt/0001.asp?s=1400100&sc={A29ECA6C-5273428A-8D42-DF0E2776131A}&n=90> (last visited Sept. 23, 2003).

12. *Exposure Draft ED 2 Share-Based Payment*, Int'l Accounting Standards Bd., at 5 (Nov. 2002), available at <http://www.iasc.org.uk/docs/ed02/ed02.pdf> (last visited Sept. 23, 2003) [hereinafter *IASB Exposure Draft*]. See, e.g., AICPA, Letter to IASB Share Based Letter (Mar. 3, 2003), available at [http://www.aicpa.org/members/div/acctstd/comltrs/iasb\\_share.htm](http://www.aicpa.org/members/div/acctstd/comltrs/iasb_share.htm).

will provide investors with clearer disclosure than either the U.S. standard or other standards adopted internationally.<sup>13</sup>

Part II of this Note explains how compensatory stock options function as corporate securities. It then analyzes how and why companies issue compensatory stock options as part of executive compensation packages. Part III first discusses the original U.S. stock option accounting standard and the rationale behind it. Second, it examines the subsequent proposed changes to that standard, which ultimately were rejected. Finally, it considers the political melee that ensued, leading to the rejection of the FASB's proposed changes, and discusses the standard that was adopted.

Part IV sets forth the history of the international accounting standard-setting bodies, and then examines the international response to the stock option disclosure controversy. This Part also outlines the international option disclosure regulation currently being considered. Finally, Part V contends that compensatory stock options should be recognized as an expense on corporate financial statements in order to improve disclosure. It also advocates, among other things, that such a standard should be set by an international, rather than a national, standard-setting body.

## II. STOCK OPTIONS AS A CORPORATE SECURITY

A stock option is a contract between the corporation and the holder ("grantee") that awards the grantee the right to purchase a certain number of shares of the company's underlying stock at a stated price per share (typically known as either the "exercise price" or "strike price" or "grant price").<sup>14</sup> This right usually

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13. See *Accounting for Share-Based Payment Project Summary*, Int'l Accounting Standards Committee Found., July 22, 2002, at para. 1, at <http://www.iasc.org.uk/cmt/0001.asp?s=1406384&sc={3F02305A-2976-47E1-866A-7FA492B49D31}&n=3318> (last visited Sept. 23, 2003) [hereinafter *IASB Summary*].

14. Max J. Schwartz, *PLI Tax Law and Estate Planning Course Handbook Series, A Primer on Stock-Based Compensation and Selected Recent Developments*, 537 PLI/TAX 9, 14 (2002); Eric L. Johnson, *Waste Not, Want Not: An Analysis of Stock Option Plans, Executive Compensation, and the Proper Standard of Waste*, 26 J. CORP. L. 145, at 146-48 (2002). See James M. Scannella, *Payments in Cancellation of Stock Options*, THE CPA J. ONLINE, July 1989, at para. 1, at <http://www.nyscpa.org/cpajournal/old/07688672.htm> (last visited Nov. 7, 2002).

vests over time, making the option exercisable at a future date.<sup>15</sup> Both the exercise price and the underlying number of shares granted can be determined either at the date of grant (“grant date”) or at some point after the grant date.<sup>16</sup> The grantee, in turn, can exercise her option to purchase shares of the underlying stock at some point after the option vests or partially vests and before it expires.<sup>17</sup> The grantee, likely, will choose to exercise her option when the price per share of the underlying stock exceeds the option’s exercise price, at which point she either may retain the stock or sell it and realize a cash profit.<sup>18</sup>

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15. Schwartz, *supra* note 14, at 14.

16. *Id.*

17. There are three basic exercise methods: (1) cash exercise, in which the grantee pays the exercise price, together with the requisite transactional fees and withholding taxes; (2) cashless exercise, in which the grantee uses a portion of her options to purchase shares of stock, which the grantee simultaneously sells to pay the transaction fees, exercise cost and withholding taxes (if any) and (3) swap, in which the grantee uses company stock that she already owns to cover the exercise cost, and the grantee will pay transaction fees and withholding taxes, if applicable. The company provides for its exercise method(s) in its stock option plan. *Stock Option Basics*, Charles Schwab, at <http://www.schwab.com/SchwabNOW/SNLibrary/SNLib123/SN123Article/0,5637,872%7C4816,00.html> (last visited Sept. 23, 2003). Additionally, a relatively new exercise method, the “West Coast Option” or “Reverse Vesting Option,” allows the grantee to exercise unvested options and receive its underlying stock, subject to a repurchase right by the company, which right will lapse according to the option’s vesting schedule. Pamela B. Greene, Memorandum Regarding Early Exercise of Unvested Options, 1 (Jan. 31, 2002) (unpublished corporate form document produced by Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.) (on file with author).

18. In deciding whether to exercise a stock option, the grantee should take account of several personal investment and tax considerations, including impact on capital gains taxes and on estate taxes. Sonja Lepkowski, *Compensatory Stock Options*, THE CPA J., Sept. 2000, at sub-heading When to Exercise Options et. seq., at <http://www.luca.com/cpajournal/2000/0900/dept/d95600a.htm>. When the market price of the underlying stock is below the exercise price, the option is deemed “under water.” *Bottom Line: Treat Options as an Expense*, MERCURY NEWS, May 30, 2002, at Definitions, at <http://www.bayarea.com/mld/mercurynews/news/opinion/3364740.htm> [hereinafter *Bottom Line*]. Although under water options typically are not exercisable (because the grantee could purchase the same number of shares on the open market for less than the grantee’s exercise price), the under water options still have value because the stock price can rebound before the option expires. *Id.* When an option’s exercise price equals the market price of the underlying stock, the option is deemed “at the money.” At the money, Investorwords.com, at <http://www.investorwords.com/cgi-bin/getword.cgi?319> (last visited Sept. 23,

Compensatory stock options are stock options granted to employees and consultants in payment of services rendered to the issuing company.<sup>19</sup> Typically, companies issue them as part of an employment compensation package.<sup>20</sup> Moreover, compensatory stock options usually are issued subject to a plan that has been adopted by the issuing company's board of directors and stockholders.<sup>21</sup> The plan sets forth the purposes, parameters and requirements of the company's compensatory stock program.<sup>22</sup>

There are two types of compensatory stock options: the first is a statutory or "incentive" stock option ("ISO"), and the second is a non-statutory or "nonqualified" stock option ("NSO").<sup>23</sup> Both are so named to signify their respective tax treatment under the Internal Revenue Code of 1986, as amended ("Code").<sup>24</sup> As one author notes, "[t]he basic distinctions between these two types of options are how the gain from the option is taxed and what formal requirements the options must have. Generally, while the incentive stock option is more tax-favored, the nonqualified stock option is more flexible."<sup>25</sup>

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2003). When the market price exceeds the exercise price, the option is deemed "in the money." In the money, Investorwords.com, at <http://www.investorwords.com/cgi-bin/getword.cgi?2580&in%20the%20money> (last visited Sept. 23, 2003).

19. Scannella, *supra* note 14.

20. Whitney Tilson, *The Stock Option Travesty*, THE MOTLEY FOOL, Mar. 20, 2002, at para 2, at <http://www.fool.com/Server/FoolPrint.asp?File=/news/foth/2002/foth020320.htm>.

21. Marc H. Folladori, *Disclosures Regarding Executive Officer and Director Compensation and Shareholder Approval of Compensation Plans*, 1285 PLI/CORP 211, at 254 (2002).

22. See, e.g., Amazon.com, Inc. 1997 Stock Option Plan, Findlaw Corporate Counsel Center, Findlaw.com, available at <http://contracts.corporate.findlaw.com/agreements/amzon/stockoption.1997.html> (last visited Oct. 11, 2003).

23. Schwartz, *supra* note 14, at 15.

24. *Id.* The tax treatment in the Code refers to that of the grantee. Generally, ISO's have a more favorable tax treatment under the Code than NSOs. NSOs are regulated by § 83 of the Code and ISOs are regulated by § 421 and § 422 of the Code. *Id.* For more information regarding tax treatment of stock options and other stock-based executive compensation, see *id.* at 15-24. See Scott P. Spector, *Significant Issues Relating to Stock-Based Compensation for Executives*, 503 PLI/TAX 745 (2001).

25. Johnson, *supra* note 14, at 147.

*A. Two Types of Compensatory Stock Options: ISOs and NSOs*

ISOs were created by Congress as an instrument through which companies could attract and retain qualified personnel, particularly senior management.<sup>26</sup> The “incentive” in the ISO refers to a tax incentive provided in the Code to the grantee.<sup>27</sup> For a stock option to be deemed an ISO, it must meet several requirements set forth in the Code.<sup>28</sup> First, an ISO must be granted pursuant to an incentive stock plan, which must be approved by the company’s stockholders within twelve months of the plan’s adoption by the Board of Directors.<sup>29</sup> An ISO can be granted only to an employee of the company issuing the option, and the employee cannot transfer the ISO to a third party.<sup>30</sup> Further, the option’s exercise price must equal or exceed the fair market value of the underlying stock on the grant date, and it “must be exercisable within ten years” of the grant date.<sup>31</sup> Finally, as of the grant date, the employee must own less than 10% of the company’s voting stock.<sup>32</sup>

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26. *Id.*

The legislative history of section 422 [of the Code] states that the retention of employees was one of Congress’ purposes in creating the ISO. Further evidence of Congress’ intent is the requirement that the person exercising the option must be an employee of the employer granting the option “at all times during the period beginning on the date of the granting of the option and ending on the day [three] months before the date of such exercise.” This provision works in tandem with another section 422 requirement – – if the employee exercises the option within two years of the granting, then she will no longer qualify for the favored tax treatment. Therefore, the employee would want to remain employed at least two years by the corporation, so that any gain from the exercise she receives will not be taxed as income.

*Id.* at 149.

27. *Id.* at 147.

28. Robert W. Wood, *Executive Compensation, Stock Options and Golden Parachutes*, SG016 ALI-ABA 957, 960–961 (2001).

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* If at the time of the grant, the grantee owns more than 10% “of the total combined voting power of all classes of stock” of the issuing company, or one of its parents, subsidiaries or affiliates, as defined in § 424 of the Code, the option’s grant price must equal at least 110% of the fair market value per share as of the grant date. Anne Bruno & Pamela B. Greene, Plan Description for Employee, Director and Consultant Stock Option Plan, 5 (Nov. 30, 2001)

The “incentive” supplied in the Code refers to the fact that an ISO grant can provide the grantee with better tax treatment than an NSO grant.<sup>33</sup> Under an ISO grant, the grantee is not taxed when she exercises her option, but when she disposes of the option’s underlying stock.<sup>34</sup> Therefore, the grantee will not be forced to pay the Internal Revenue Service (“IRS”) for the income received until she actually realizes a cash profit from the stock sale.<sup>35</sup> Additionally, the ISO holder may qualify to receive preferential capital gains tax treatment.<sup>36</sup> However, to reap this tax benefit, the ISO grantee must hold the option for two years prior to exercising it.<sup>37</sup> Additionally, the grantee then must hold the underlying stock for at least one year before selling it.<sup>38</sup>

Unlike an ISO, an NSO is not subject to such rigorous statutory requirements, and thus, provides the company with greater flexibility.<sup>39</sup> Companies can grant NSOs to employees, consultants and others without being restricted by the option’s conditions or expiration date, at an option price above or below the fair market value of the underlying stock.<sup>40</sup> Under an NSO grant, the grantee is taxed when she exercises her option.<sup>41</sup> Although the purpose of an ISO is to provide the grantee prefer-

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(unpublished corporate form document produced by Mintz, Levin, Cohn, Ferris, Glosky and Popeo, P.C.) (on file with author). For all of the requirements to be deemed an ISO, see I.R.C. § 422.

33. Schwartz, *supra* note 14, at 15–17.

34. *Id.* at 16.

35. *See generally id.* at 20–21.

36. *Id.*

37. Bruno & Greene, *supra* note 32, at 14.

38. *Id.* Pursuant to the Taxpayer Relief Act of 1997, under an ISO grant, the grantee will receive beneficial (long-term capital gains) tax treatment if she holds the underlying stock for more than twelve months after she exercises her option. Otherwise, the grantee will be taxed at the same rate as an NSO grantee. Schwartz, *supra* note 14, at 16.

39. Schwartz, *supra* note 14, at 16–20; Johnson, *supra* note 14, at 147–48.

40. Wood, *supra* note 28, at 959.

41. Schwartz, *supra* note 14, at 16. The grantee must pay income tax on the increased value of the option, which is the difference between the value of the shares at exercise and the option’s exercise price. Interestingly, the issuing company can take a tax deduction on the same amount that the employee is taxed. Bruno & Greene, *supra* note 32, at 14–15. Such compensation income of grantees may be subject to withholding taxes, and a deduction may then be allowable to the company in an amount equal to the grantee’s compensation income. *Id.*



ential tax treatment, due to the ISO's holding requirements, most ISO grantees never actually receive its tax benefit.<sup>42</sup> Thus, the benefit of an ISO grant to its employees is often a perceived tax benefit, rather than an actual tax benefit.

*B. Stock Option Rationale: Why Companies Issue Them as Executive Compensation*

Granting stock options as part of an executive compensation package became increasingly popular in the 1990s during the explosion of high technology start-up companies.<sup>43</sup> By the late 1990s, "more than eighty percent of the largest [U.S.] companies use[d] equity-based compensation to link executives to long-term corporate performance. The long-term variable component of such pay comprise[d] sixty percent of the typical CEO's gross annual compensation."<sup>44</sup> The theoretical rationale for this phenomenon is fourfold.

First, agency theorists argue that by linking a significant percentage of an executive's compensation to the price per share of the of the company's stock, "it will encourage the executive to increase the firm's profitability to achieve higher stock prices."<sup>45</sup> Thus, the executive will gain or lose personally, along with the stockholders.<sup>46</sup>

Second, this link also aligns executives' willingness to take risks with that of the company's stockholders.<sup>47</sup> Corporate executives are typically risk-averse.<sup>48</sup> However, if a CEO's financial success is tied to that of her company, she will be more likely to take greater risks so that her decisions will make

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42. *See id.*

43. *See* Roberta S. Karmel, *Securities Regulation the Fuss Over Stock Options*, N.Y. L.J. 3 (June 20, 2002). "Equity-based compensation, and particularly stock options, helped to fuel the stock market bubble of the 1990s. Corporate executives were motivated to focus on stock market prices rather than long-term profitability." *Id.*

44. *See* Ellis, *supra* note 4, at 412-13.

45. Johnson, *supra* note 14, at 148. *See* Ellis, *supra* note 4, at 405. For a discussion on the Agency-Cost Model, see Johnson, *supra* note 14, at 405-17.

46. Johnson, *supra* note 14, at 148. For a discussion of this insight from the Agency-Cost Model and its potential shortcomings in describing actual practice, see Ellis, *supra* note 4, at 405-17.

47. *See* Johnson, *supra* note 14, at 148-49.

48. *Id.*

higher gains for the company's stockholders, and for herself, under a "nothing ventured, nothing gained" philosophy.<sup>49</sup>

Third, companies grant stock options to retain management.<sup>50</sup> By establishing both a vesting period (typically over a number of years) and a requirement that the employee remain employed by the company in order to exercise her stock options, the company encourages the employee to be invested in her job.<sup>51</sup> As a corporate retention policy, the employee will weigh the additional cost of losing her unvested options before deciding to leave her job.<sup>52</sup>

Finally, companies grant stock options as an inexpensive, yet effective incentive to attract talented management whom, particularly at start-up companies, they could not afford to compensate in cash.<sup>53</sup> Although start-up companies rarely have sufficient capital to attract qualified management with cash compensation, stock options can create potentially lucrative compensation packages due to the high growth potential of high-technology, start-up companies.<sup>54</sup>

### III. HISTORY OF U.S. ACCOUNTING PROCEDURE

#### A. *Opinion No. 25, Accounting for Stock Issued to Employees*

Although under accounting rules, including the GAAP,<sup>55</sup> employee compensation is treated as a corporate expense,<sup>56</sup> Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("Opinion No. 25")<sup>57</sup> carves out "a rather broad exemption from compensation accounting for certain broad-based plans."<sup>58</sup> Opinion No. 25 sets forth regulations and

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49. *Id.*

50. *Id.* at 149. See Christine I. Wiedman & Daniel J. Goldberg, *Accounting for Stock-Based Compensation: As Easy as SFAS 123?*, IVEY BUS. J., July/Aug. 2001, 6, at 6-9.

51. Johnson, *supra* note 14, at 149.

52. *Id.*

53. *Id.* at 149-50. See Wiedman and Goldberg, *supra* note 50.

54. Johnson, *supra* note 14, at 149-50.

55. For a definition of GAAP, see *supra* note 3.

56. See generally Rouse & Barton, *supra* note 6.

57. Financial Accounting Standards, *supra* note 3.

58. *Summary of Recent Accounting Literature Interpreting APB Opinion No. 25, Accounting for Stock Issued to Employees*, Ernst & Young, para. 13, at [http://www.ey.com/global/Content.nsf/US/AABS\\_-\\_Assurance\\_Articles\\_Inter](http://www.ey.com/global/Content.nsf/US/AABS_-_Assurance_Articles_Inter)

accounting procedures for stock-based compensation given to employees.<sup>59</sup> Specifically, if a company adopts a broad-based employee stock option plan that meets certain requirements set forth in the Code, the company can avoid recognizing a compensation expense in its financial statement when it grants options to its employees under that plan, even though it must recognize such an expense for its employees' salaries.<sup>60</sup> The rationale behind this carve-out is that although, technically, all employee stock option grants compensate employee grantees, the granting company adopts its compensatory stock plan to increase its capital account (by paying less cash compensation to its employees in salaries and bonuses), to promote employee ownership of the company, or to align employee and corporate interests (by linking the employee's compensation to the company's long-term financial success).<sup>61</sup>

When applying Opinion No. 25, the "compensation cost" or "expense" of a stock option is measured by its intrinsic value, which is the difference between a stock's market price and its exercise price on the measurement date.<sup>62</sup> The measurement date, "is the first date on which both (1) the number of shares that an individual employee is entitled to receive and (2) the...[exercise] price, if any, are known."<sup>63</sup> Moreover, the plan's expense "generally is recognized over the equity award's vesting period. Compensation [cost or] expense associated with

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preting APB\_Opinion\_No\_25 (last visited Sept. 23, 2003) [hereinafter *Ernst & Young Summary*]. For an list of criteria, see *id.* at paras. 14–17.

59. See generally Terry Grant & Conrad S. Ciccotello, *The Stock Options Accounting Subterfuge*, STRATEGIC FIN. MAG., Apr. 2002, at 37, 41 [hereinafter, *Subterfuge*].

60. *Id.* at para. 13. For a list of criteria, see *id.* at paras. 14–17. Compensatory stock options affect corporate financial statements in 3 ways: (1) as options are exercised, the number of shares issued and outstanding increases, diluting the per share price; (2) the cash payment of the exercise price to the company generally is reflected in the annual report under the section entitled "Cash Flows from Financing Activities;" and (3) the company receives a tax deduction upon each exercise of a compensatory stock option. Tilson, *supra* note 20, at para. 2.

61. *Ernst & Young Summary*, *supra* note 58, at para. 13.

62. Conrad S. Ciccotello & C. Terry Grant, *Employee Stock Option Accounting Changes*, J. OF ACCOUNTANCY, Jan. 1995, at 72 [hereinafter *Accounting Changes*].

63. *Ernst & Young Summary*, *supra* note 58, at para. 18.

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awards that immediately are vested or attributable to past services is recognized when granted.”<sup>64</sup>

From 1972 until 1993, Opinion No. 25 governed disclosure of compensatory stock options in profit and loss statements.<sup>65</sup> Among other things, Opinion No. 25 provided that a stock option plan could be categorized either as compensatory or non-compensatory.<sup>66</sup> Under a compensatory plan, the company can grant either a *fixed* or *variable* award.<sup>67</sup>

A stock option grant is *fixed* if both the number of underlying shares an employee can purchase and the exercise price are determined at the grant date.<sup>68</sup> Under a fixed grant, because the employee’s equity-based compensation is pre-determined, so long as her option continues to vest (i.e. as long as the grantee keeps her job), she will be able to exercise her stock option regardless of her actual employment performance.<sup>69</sup> Assuming the company’s stock increases in value from the grant date, the employee will be able to exercise her option and realize a profit.<sup>70</sup>

Conversely, a stock option grant is *variable* if either the number of underlying shares an employee can purchase or the exercise price is determinable only after the grant date.<sup>71</sup> For example, under a variable stock option grant, the number of shares granted to an employee could be contingent on realizing a performance target (such as going public, achieving a certain level of efficiency or improving a certain technology) or the stock market price maintaining a certain price per share.<sup>72</sup> Because a variable grant can be tailored to the accomplishment of a specific employee, it is commonly known as a “performance-based” option grant.<sup>73</sup>

When the grant’s measurement date and grant date occur simultaneously, the compensation cost is determinable or “fixed”

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64. *Id.*

65. Financial Accounting Standards, *supra* note 3.

66. *Ernst & Young Summary*, *supra* note 58, at para. 11.

67. *Id.*

68. Rouse & Barton, *supra* note 6, at 68. *Ernst & Young Summary*, *supra* note 58, at para. 1.

69. Lepkowski, *supra* note 18, at sub-heading Incentive Stock Options.

70. *See id.*

71. Rouse & Barton, *supra* note 6, at 68.

72. *Id.*

73. Accounting Changes, *supra* note 62, at 72.

at the grant date, and thus, the issuance is a fixed stock option grant.<sup>74</sup> Therefore, when a company grants a fixed stock option at an exercise price that is equal to the market price of the underlying stock on the grant date, the company does not recognize any compensation expense on its financial statement.<sup>75</sup> However, when a company grants a variable stock option, it must estimate and accrue the option's expense from the period between the grant date and the ultimate measurement date.<sup>76</sup>

Due to the tax implications of Opinion No. 25, fixed option grants are more favorable than variable grants because fixed grant compensatory stock options have no intrinsic value when granted. Thus, the company incurs no expense.<sup>77</sup> Furthermore, although a variable option grant can be exercised only if the stated target is met, making it less valuable to the grantee than a fixed option grant, the variable grant is more expensive for the issuing company than the fixed grant because the variable grant likely will cause a compensation expense to be charged to the company.<sup>78</sup> As commentators Rouse and Barton point out, the preferred tax treatment given to the fixed option grant "seems counterintuitive."<sup>79</sup> Accordingly, the FASB began studying stock compensation in an effort to resolve these discrepancies.<sup>80</sup>

## *B. SFAS 123 Accounting for Stock-Based Compensation*

### 1. The Draft Proposal

Opinion No. 25 inadvertently encouraged companies to issue fixed compensatory stock options with an exercise price equal to the market price on the grant date, thereby intentionally creating a grant with no intrinsic value.<sup>81</sup> After years of debate over the growing need for clarity or "transparency" of compensatory stock options on financial statements, and in light of the increased use of fixed stock options as compensation for senior

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74. *Id.* at para. 19; Rouse & Barton, *supra* note 6, at 68.

75. *Ernst & Young Summary*, *supra* note 58, at para. 20.

76. *Accounting Changes*, *supra* note 62, at 72.

77. Rouse & Barton, *supra* note 6, at 68.

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

executives, the FASB reversed its opinion on the compensatory stock option carve-out for employees and directors.<sup>82</sup> The FASB stated publicly that all compensatory stock option grants should be accounted for as an expense to the issuing company.<sup>83</sup> In reaching this conclusion, the FASB recognized that because compensatory stock options were being used regularly as a significant percentage of senior executives' compensation packages, increased corporate disclosure was needed to provide investors with the requisite information to make sound investment decisions.<sup>84</sup>

In 1993, the FASB issued its Exposure Draft of SFAS 123 Accounting for Stock-Based Compensation ("FASB Exposure Draft") to close the loophole created by Opinion No. 25.<sup>85</sup> The FASB Exposure Draft required companies to recognize all grants of compensatory stock options as expenses in their income statements.<sup>86</sup> Moreover, the FASB Exposure Draft required the expense to be measured using the fair value of the option's underlying stock at the grant date, instead of its intrinsic value as required by Opinion No. 25.<sup>87</sup> The FASB adopted the fair value method because, although the intrinsic value method would be much easier to calculate, it believed that fair value better represented an option's true value. Under the fair value method,

compensation cost is measured at the grant date and is recognized over the service period (typically the vesting period).

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82. Alan Levinsohn, *Stock-Option Accounting Battle Resumes After Seven-Year Détente*, STRATEGIC FIN., June 2002, at 63.

83. *Id.* The FASB based its opinion on the fact that compensatory stock options are issued to employees as compensation for services rendered to the company. *Id.* Christine A. Botosan and Marlene A. Plumlee, in their study on the effects of stock option expense, studied one hundred companies named by Fortune Magazine as "America's Fastest-Growing Companies" and found that: (1) for a majority of its sample companies, the impact of stock option expense is material; (2) within the next three to five years, stock option expense would "become even more economically significant" and (3) there is a segment of the corporate population that currently is not in compliance with SFAS 123. Christine A. Botosan & Marlene A. Plumlee, *Stock Option Expense: The Sword of Damocles Revealed*, ACCOUNTING HORIZONS, Dec. 2001, at 312, 325.

84. Rouse & Barton, *supra* note 6, at 68.

85. *Subterfuge*, *supra* note 59, at 41.

86. *Id.*

87. FASB *Issues Proposal on Stock Option Compensation*, J. OF ACCOUNTANCY, Sept. 1993, at 23.

Fair value is determined using an option pricing model (such as Black-Scholes or a binomial pricing mode) that takes into account the grant date, the exercise price, the expected life of the option, the current price of the underlying stock, its expected volatility, expected dividends on the stock, and the risk-free interest rate over the expected life of the option.<sup>88</sup>

By requiring companies to use the fair value method instead of the intrinsic value method, the FASB Exposure Draft required companies to capture on the income statements the increase in value that option grantees would recognize over their option's vesting period.<sup>89</sup>

## 2. The Proposal as Adopted

Public response to the FASB Exposure Draft was unambiguous and overwhelmingly negative.<sup>90</sup> The U.S. business commu-

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88. Wiedman & Goldberg, *supra* note 50, at 6. Additionally, under the GAAP, "most exchange transactions" are stated based on the clearer of the fair value of the consideration given or of the item received. However, Opinion No. 25 used the intrinsic value method instead of fair value because it was generally accepted that the underlying stock value was too difficult or tenuous to calculate. Rouse & Barton, *supra* note 6, at 69. For a description and analysis of the binomial pricing mode, see Stefan Winter, *Tax and accounting implications of sequential stock options grants*, Research Report 2001-1, University of Wuerzburg, Faculty of Business and Economics, Chair of Business Administration, Personnel, and Organization, at 7-8 (Mar. 2001). An option pricing model is a mathematical formula used to determine the theoretical fair value of an option. *Option Pricing Models*, at sub-heading Option pricing models, Australian Stock Exchange, at [http://www.asx.com.au/markets/14/PricingModels\\_AM4.shtml](http://www.asx.com.au/markets/14/PricingModels_AM4.shtml) (last visited Sept. 23, 2003). The two most widely used option pricing models are the Black-Scholes option pricing model and the binomial option pricing model. The binomial pricing model was developed by Cox, Ross and Rubinstein and published in 1979. *Id.* at The binomial pricing model. For a summary of the binomial model, see *id.* The Black-Scholes formula was developed by economists Fischer Black and Myron Scholes in 1973. In 1997, Black, who had died in 1995, and Scholes were awarded the Nobel Prize in Economics for their options-pricing model. *Bottom Line*, *supra* note 18. For a description of both of the Black-Scholes Pricing Model and Binomial Model, see *Option Pricing Models and the "Greeks"*, Peter Hoadley's Options Strategy Analysis Tools, at <http://www.hoadley.net/options/BS.htm#Binomial> (last visited Sept. 23, 2003).

89. Rouse & Barton, *supra* note 6, at 69.

90. Botosan & Plumlee, *supra* note 83, at 313. For example, Thomas M. Foster, Vice President and Controller of Phelps-Dodge Corp. said, "Like most accountants, I think the FASB's efforts are a waste of time. It shouldn't try to develop noncash charges that essentially don't provide financial statement

nity came out in force to renounce the FASB Exposure Draft as detrimental to industry and to the economy for the same reason that the FASB saw the need to act: expensing compensatory stock options could reduce the profit reflected on a company's financial statement by a significant percentage and, in turn, force a change in the manner and degree of compensation to employees and senior executives.<sup>91</sup>

Opposition to the FASB Exposure Draft was threefold. Companies argued that the new measure was extremely subjective,<sup>92</sup> accountants argued that the theories behind the technical changes were too difficult to comprehend,<sup>93</sup> and both agreed that the FASB Exposure Draft would have an adverse impact on small, start-up companies.<sup>94</sup> In one prominent complaint, the American Institute of Certified Public Accountants ("AICPA")

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users with any useful information." *Lieberman Legislation*, *supra* note 9, at 16. The FASB received over one thousand, seven hundred comment letters on the FASB Exposure Draft, many of them before the draft was released to the public. Botosan & Plumlee, *supra* note 83.

91. Rouse & Barton, *supra* note 6, at 70. For example, had America Online, Inc. applied the FASB Exposure Draft rules in 1992, it would have reduced AOL's earnings of 40 cents per share by at least 25%. Roula Khalif, *If It Ain't Broke...*, FORBES, Apr. 12, 1993, at 100. Had the FASB Exposure Draft measure been applied in 2000, Cisco Systems, Inc.'s earnings would have been reduced by 40% and WorldCom, Inc.'s earnings would have been reduced by 14%. Geoffrey Colvin, *Losing the Good Fight*, FORTUNE, Apr. 15, 2002, at 75. Colvin also points out that Cisco's per share price is down 79%, and WorldCom's per share price is down 84%, after which he asks whether reporting lower earnings "would have been a bad thing." *Id.* In 2001, application of the FASB Exposure Draft would have reduced the Standard & Poor's 500-stock index earnings-per-share in excess of 24%. Duncan Hughes, *Now the Fed Enters Standards Battle*, ACCOUNTANCYAGE.COM, July 25, 2002, para. 10, at <http://www.accountancyage.com/Analysis/1130141>.

92. Khalif, *supra* note 91.

93. Rouse & Barton, *supra* note 6, at 70. "Opponents to recognition of stock-based compensation expense also believe that the value of employee stock options cannot be measured reliably because existing option value estimation technology is not suitable for employee options, which have unique characteristics, and estimation of option values requires exercise of substantial management discretion." David Aboody, Mary E. Barth and Ron Kasznik, *SFAS 123 Stock-Based Compensation Expense and Equity Market Values*, July 2001, at 2.

94. *Accounting Changes*, *supra* note 62, at 73-77. For an example and analysis on how the FASB Exposure Draft would affect small versus large companies, see *id.* at 37-39. See also Lyn Perlmuth, *Hanging Tough on Stock Options*, INSTITUT'L INVESTOR, Nov. 1994, at 172.



submitted a public response letter to the FASB Exposure Draft claiming, among other things, that the amended disclosure policies would not provide any additional transparency to the investing public and that the disclosure policy provided for in Opinion No. 25 continued to produce reliable results.<sup>95</sup>

Furthermore, in response to the public outcry from individuals and organizations lobbying for business interests, both the U.S. Senate and the House of Representatives entered the debate. Several members of Congress supported a "Sense of Congress Resolution" against the FASB Exposure Draft.<sup>96</sup> Additionally, Senator Joseph Lieberman of Connecticut introduced S. 1175, the Equity Expansion Act of 1993,<sup>97</sup> a bill that would require the Securities and Exchange Commission ("SEC") to overrule the FASB Exposure Draft, effectively revoking the FASB's rule-making authority.<sup>98</sup> Although S. 1175 never came to a vote on the Senate floor,<sup>99</sup> the bill had sufficient support to pass.<sup>100</sup>

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95. *AsSEC Comments on FASB's Stock Option Proposal*, J. OF ACCOUNTANCY, Mar. 1994, 9. Walter Schueltze, then the SEC's chief accountant, in his address to the American Institute of Certified Public Accountants ("AICPA"), noted that initially, most major accounting firms backed expensing stock options, and that he found the recent reversal troubling. Schueltze pointed out that the change of heart, "left members of the public with the impression [that] the switch was in response to a fear of losing clients or other forms of retaliation." *Schueltze Wary over CPA Independence on Stock Option Proposal*, J. OF ACCOUNTANCY, Mar. 1994, 9.

96. Grace Hinchman, *Fasten Seat Belts: Bumpy Ride for Stock Option Accounting*, FIN. EXECUTIVE, Sept. 2001, at 68, available at [http://www.fei.org/magazine/articles/9\\_2001\\_washington.cfm](http://www.fei.org/magazine/articles/9_2001_washington.cfm). The resolution was introduced by Representative Anna Eshoo of California and former Senator Bill Bradley of New Jersey. *Id.* A "Sense of Congress Resolution" merely articulates Congress' opinion, but has no statutory authority. *Id.*

97. Equity Expansion Act of 1993, S. 1175, 103d Cong. (1993).

98. *Lieberman Legislation*, *supra* note 9, at 15. Lieberman argued that the FASB Exposure Draft, if adopted, would be detrimental as a matter of public policy. *Id.* Lieberman was joined by members of both political parties in condemning the FASB Exposure Draft and promoting S. 1175. *Id.*

99. The bill never came to a vote because the FASB caved into political pressure and revised the FASB Exposure Draft to remove the expensing requirement. *See Hinchman*, *supra* note 96.

100. *Id.* More than 60 Senators supported S. 1175. *Id.* Representative Nancy Johnson of Connecticut and Representative Lewis Payne of Virginia submitted H.R. 2759, a companion bill to S. 1175. *Lieberman Legislation*, *supra* note 9, at 15.

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However, a small but distinguished minority supported, and continue to support, the principles set forth in the FASB Exposure Draft. During the initial controversy, Senator Carl Levin of Michigan and Representative John Bryant of Texas vocally opposed S. 1175.<sup>101</sup> Additionally, as far back as 1985, Warren Buffet, CEO and Chairman of the Board of Directors of Berkshire Hathaway Inc.,<sup>102</sup> made clear his position that compensatory stock options should be expensed.<sup>103</sup> He explained that, among other things, “it is both silly and cynical to say that an important item of cost should not be recognized simply because it can’t be quantified with pinpoint precision.”<sup>104</sup>

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101. Senator Carl Levin and Representative John Bryant sent a letter to their fellow members of Congress urging them to support the FASB Exposure Draft. Their letter said, “[i]t is time to bring stock options under the rules of ordinary compensation.” *Lieberman Legislation*, *supra* note 9, at 15–16. Senator Levin also stated that “[compensatory] stock options are the only kind of compensation that companies can deduct from their taxes as an expense but don’t have to include in their books as an expense.” Perlmuth, *supra* note 94.

102. Berkshire Hathaway Inc. is an Omaha-based holding company with more than \$2 billion in holdings and owns thirty-six subsidiaries, including property and casualty insurance and reinsurance businesses like GEICO Corporation and General Re Corporation, and other businesses as diverse as Benjamin Moore and Dairy Queen. BERKSHIRE HATHAWAY INC., 2001 ANNUAL REPORT, Inside Cover, 72, available at <http://www.berkshirehatway.com/2001ar/2001ar.pdf>. The company also maintains significant holdings (approximately 10%) in several multinational corporations, including American Express Company, The Coca-Cola Company, The Gillette Company, H&R Block, Inc., Moody’s Corporation, The Washington Post and Wells Fargo and Company, as well as other insurance and reinsurance companies. *Id.* at Inside Cover. Warren Buffet took over Berkshire Hathaway in 1965. At that time, stock was trading at \$18 per share. Today, Berkshire Hathaway stock trades at more than \$70,000 per share. John Price, *The Return of the Buffetteers*, Warren Buffet Meets Sherlock Homes, reprinted with permission from INVESTOR J., (Aug. 1998), available at <http://www.sherlockinvesting.com/articles/buffetteers.htm> (last visited Sept. 23, 2003).

103. 1985 Annual Letter from Warren E. Buffet to the shareholders of Berkshire Hathaway Inc. (Mar. 4, 1986), at <http://www.berkshirehathaway.com/letters/1985.html>.

104. 1992 Annual Letter from Warren E. Buffet to the shareholders of Berkshire Hathaway Inc. (Mar. 1, 1993), at <http://www.berkshirehathaway.com/letters/1992.html> [hereinafter 1992 Annual Letter]. In his 1992 annual letter, Buffet, addressing Berkshire Hathaway’s stockholders, stated,

It seems to me that the realities of stock options can be summarized quite simply: If options aren’t a form of compensation, what are they? If compensation isn’t an expense, what is it? And, if expenses

The FASB claimed to be beyond the sway of political pressure,<sup>105</sup> yet it appears that in fear of losing its autonomy and authority, the FASB succumbed to it, nonetheless.<sup>106</sup> When SFAS 123 was adopted in October 1995<sup>107</sup> in its final form, it did not require companies to recognize options as expenses in their financial statements. Instead, it permitted companies to choose between recognition of options as an expense on financial statements and disclosure of such options in footnotes.<sup>108</sup> Moreover, SFAS 123 does not require calculation and disclosure of “the annual charge for stock option expense”<sup>109</sup> by using “the total fair value of options granted during the year. Instead, firms amortize the total fair value over the period(s) in which the related services are rendered.”<sup>110</sup>

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shouldn't go into the calculation of earnings, where in the world should they go?

*Id.*

105. Diana Willis, FASB Project Manager, stated that although the FASB would take the controversy into account, “[p]olitics is not a factor in the board's deliberations.” Perlmuth, *supra* note 94. *But see* Hinchman, *supra* note 96 (noting that Dennis Beresford, former Chairman of the FASB, admitted that the FASB's decision not to require companies to expense compensatory stock options was heavily influenced by its fear of congressional intervention). James Lensing, former Vice Chairman of the FASB, stated that the FASB had not changed its opinion of the need for companies to expense compensatory stock options, but the FASB's concern over being overruled by Congress forced the FASB to abandon its policy. *Id.*

106. Botosan & Plumlee, *supra* note 83.

107. Haksu Kim, *Statement of Financial Accounting Standards 123*, Pacific Inv. Research, Inc., at <http://www.fawpir.com/standard/sfas123.htm> (last visited Sept. 23, 2003).

108. Botosan & Plumlee, *supra* note 83. *See* SFAS No. 123, para 11. From 1995 until the aftermath of Enron and WorldCom, almost without exception, companies opted for footnote disclosure over expense recognition. *Id.* at 312. For a description of the Enron and WorldCom accounting troubles, see *infra* notes 132 and 133, respectively.

109. Botosan & Plumlee, *supra* note 83, at 313.

110. *Id.* at 313. *See* SFAS No. 123, para. 30. SFAS 123

encourages [companies] to recognize [options'] expense in reported net income, but allows them to continue using the intrinsic value method prescribed by [Opinion No.] 25 for recognition purposes. [Companies] using [Opinion No.] 25 must provide footnote disclosures of pro forma net income and earnings per share computed using the fair value method.

*Id.* at para. 11. For a summary of SFAS No. 123, see Financial Accounting Standards Board Summary of Statement No. 123, at <http://www.fasb.org>

## IV. INTERNATIONAL ACCOUNTING COMMUNITY REACTION

A. *History and Composition of the International Accounting Standards Board*

Since the inception of the International Accounting Standards Committee (“IASC”) in 1973, the international community has had its own accounting standard-setting body.<sup>111</sup> In the early 1990s, the IASC focused much of its attention on internal restructuring to create a more comprehensive international standard-setting body. In 1993, an interim group known as G4+1 formed in order to continue reviewing accounting issues and to set standards for use by the international community while the IASC was in the process of restructuring.<sup>112</sup> Recently, the IASC restructured its membership, revised its constitution,<sup>113</sup> and in 2001, took the form of the International Accounting Standards Board (“IASB”),<sup>114</sup> at which time, G4+1 disbanded.<sup>115</sup> The IASB is a London-based, privately-funded, independent body, the goal of which is to create a universal, comprehensible and enforceable set of accounting standards.<sup>116</sup>

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/st/summary/stsum123.shtml (last visited Sept. 23, 2003). See Kim, *supra* note 107.

111. See IASC Chronology, *supra* note 11. The state accountancy agencies of Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, Ireland, and the U.S. formed the IASC. *Id.* Over the next twenty-five years, states continued to join the IASC as it created a set of accounting standards to be used universally. These standards have become widely used outside the U.S. See generally *id.* However, the U.S. never adopted the IASC standards. Instead, it continues to follow the GAAP set by the FASB.

112. G4+1 is an association of the accounting standards-setting bodies of each of Australia, Canada, New Zealand, the United Kingdom, and the U.S. *IASC Involvement with G4+1 Projects*, IAS Plus, Deloitte Touche Tohmatsu, Para. 1, at <http://www.iasplus.com/agenda/g4.htm> (last visited Nov. 7, 2002). The IASC contributed to G4+1 projects, in its capacity as an observer. *Id.* at para. 3. For a summary of G4+1’s objectives and goals, see *G4+1*, Financial Accounting Standards Board, at <http://www.fasb.org/IASC/G4+1.shtml> (last visited Nov. 7, 2002).

113. IASC Chronology, *supra* note 11, at sub-heading 2000.

114. *Id.* at sub-heading 2001.

115. Since the IASB was ready to begin formally, G4+1 agreed to disband at its January 30, 2001 meeting. *IASC Involvement with G4+1 Projects*, *supra* note 112, at para. 1.

116. About Us, Mission Statement, International Accounting Standards Bureau, at <http://www.iasc.org.uk/cmt/0001.asp?n=57&s=1400100&sc={A29E>

Before it disbanded, G4+1 reviewed compensatory stock option disclosure policies and published its findings in *Accounting for Share-Based Payments* ("G4+1 Study").<sup>117</sup> Among other things, the study concluded that companies should recognize an expense in their financial statements for all transactions for goods and services with employees and suppliers in consideration for stock options, "with a corresponding charge to the income statement when those goods or services are consumed."<sup>118</sup> It also determined that the expense should be calculated using the fair value of the option's underlying stock,<sup>119</sup> which should be calculated using an option pricing model (such as Black-Scholes or the binomial method).<sup>120</sup> Further, it specified that the measurement date should be the vesting date (and not the grant date),<sup>121</sup> and the vesting date should be the date the option becomes unconditionally exercisable.<sup>122</sup>

### *B. IASB Decides to Expense Compensatory Stock Options*

In an effort to hold itself out as a truly independent standard-setting organization and to slay the toughest dragons first,<sup>123</sup> the

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CA6C-5273-428A-8D42-DF0E2776131A)&sd=314418309 (last visited Sept. 23, 2003) [hereinafter IASB Mission Statement]. Among others, the member states of the European Union and Australia follow IASB standards. T.R. Reid, *Options Must Be Treated as Expenses, Global Panel Says*, WASH. POST, July 17, 2002, at E4.

117. Discussion Paper, G4+1 Position Paper: Accounting for Share-Based Payment, International Accounting Standards Committee (2000), available at <http://www.iasc.org.uk/docs/g4sp00/g4sp00.pdf>. *G4+1 Study Share-Based Payments (Stock Compensation)*, IAS Plus, Deloitte Touche Tomatsu, at <http://www.iasplus.com/agenda/g4share.htm> (last visited Sept. 23, 2003) [hereinafter *D&T on G4+1*]. Accounting for Share-Based Payments was published in 2000. *Id.* at sub-heading Published.

118. *Id.*

119. *Id.* at para. 1.

120. See *supra* note 88.

121. *D&T on G4+1*, *supra* note 117, at paras. 1–2.

122. *Id.* at para 3. G4+1 made its draft public for commentary and feedback. For a summary of the comment letters submitted by the five major accounting firms, see *G4+1 Discussion Paper – "Share-based Payments" Summary of "Big 5" Comment Letters*, at <http://www.fei.org/advocacy/download/G41CommentLettermary.pdf#xml=http://fei.org.master.com/texis/master/search/mysite.txt?q=%22sharebased+compensation%22&order=r&id=70683809c2d02f1&cmd=xml> (last visited Sept. 23, 2003).

123. Rob Urban, *International Accounting Board Fighting to Restore Confidence*, CALGARY HERALD, June 30, 2002, D9, available at <http://www.kellogg>.

IASB agreed to pick up where G4+1 left off in creating an international, definitive set of accounting standards to deal with disclosure of compensatory stock options.<sup>124</sup> In September 2001, the IASB adopted the G4+1 Study, incorporating it into its own summary (“IASB Summary”), in which it reviewed the project’s history and the findings of G4+1.<sup>125</sup> The IASB Summary made preliminary determinations on disclosure requirements for stock-based compensation in financial statements,<sup>126</sup> which it solidified in its exposure draft, released on November 7, 2002 (“IASB Exposure Draft”).<sup>127</sup> As part of its analysis, the IASB noted that while few countries had an accounting standard for share-based payments, without exception, those countries that had considered the issue concluded that compensatory stock options should be expensed.<sup>128</sup>

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northwestern.edu/news/hits/020630ch.htm. Urban notes that some politicians and accountants believe that the FASB, “relies too much on specific rules, which allow companies to violate the spirit of accounting standards and still comply with GAAP.” *Id.* Kimberly Crook of the IASB has stated that the although the FASB deems expensing stock options the appropriate disclosure method, such disclosure is not compulsory in the U.S., “because the Americans have made this a political issue, not an accounting question.” Reid, *supra* note 116.

124. *IASB Summary*, *supra* note 13. The IASB released its exposure draft on November 7, 2002. *Projects in Progress*, Int’l Accounting Standards Bureau, at sub-heading Timetable, at <http://www.iasc.org.uk/cmt/0001.asp?s=1506247&sc={A54F497F-149B-4F27-99A3-F0F9CC72CC19}&n=66> (last visited Sept. 23, 2003).

125. See IASB Observer Notes, June 21, 2001, at <http://www.iasc.org.uk/docs/acpapers/200206/0206ob05.pdf>.

126. *IASB Summary*, *supra* note 13.

127. See *IASB Exposure Draft*, *supra* note 12.

128. *Id.* at 1. As part of its review, the IASB considered each of the G4+1’s draft policy entitled “Accounting for Share-Based Payment,” the German Accounting Standards Committee’s draft accounting standard entitled “Accounting for Share Option Plans and Similar Compensation Arrangements,” the Danish Institute of State Authorized Public Accountants’ Discussion Paper entitled “Accounting Treatment of Share-Based Payment,” SFAS 123 and the Canadian Accounting Standards Board’s accounting standard entitled “Stock-based Compensation and Other Stock-based Payments.” *Id.* at 1–2. For a summary of each analysis, see *id.*

Therefore, it is not surprising that the IASB, like its predecessors, plans to require companies to recognize compensatory stock options as an expense on their financial statements,<sup>129</sup> which will be measured using the fair value of an option's underlying stock as of the grant date.<sup>130</sup> The IASB also proposed that all companies, both public and private, be required to calculate the expense of their compensatory stock options using the fair value method.<sup>131</sup>

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129. IASB Exposure Draft, *supra* note 12, at 19. *IASB Summary*, *supra* note 13, at 4. For a detailed analysis of the IASB Summary, see IASB Technical Agenda Project Share-Based Payment, IAS Plus, Deloitte Touche Tohmatsu, at <http://www.iasplus.com/agenda/share.htm> (last visited Sept. 23, 2003) [hereinafter *Technical Agenda*]. The IASB reviewed the disclosure approach adopted by SFAS 123, but rejected it as an inadequate alternative for recognition. *Id.* at sub-heading Recognition vs. disclosure.

130. IASB Exposure Draft, *supra* note 12, at 16; IASB Summary, *supra* note 13, at 4. See *Technical Agenda*, *supra* note 129, at sub-heading Fundamental Decisions. Before adopting the grant date as the measurement date, the IASB considered using each of the grant date, service date ("the date at which the employee performs the services necessary to become unconditionally entitled to an option"), vesting date and exercise date. *Id.* at sub-heading Measurement date. The IASB also met with Myron Scholes, the Nobel Prize winning co-drafter of the Black-Scholes valuation method, after which the IASB agreed with Scholes that, "it is possible to reliably estimate [sic] the fair value of share options." *Id.* at sub-heading Reliable measurement. However, the IASB does not plan to require companies to use a particular valuation method. *Id.* at sub-heading Valuation method.

131. IASB Exposure Draft, *supra* note 12, at 16. *Technical Agenda*, *supra* note 129, at sub-heading Fundamental Decisions. By choosing the fair value measurement base, the IASB rejected each of the historical cost, intrinsic value and minimum value bases. *Id.* at sub-heading Measurement bases.

*C. Reaction to the IASB's Plan to Require Expensing Stock Options*

In the wake of corporate accounting scandals like Enron<sup>132</sup> and WorldCom<sup>133</sup> that consumed international attention beginning in 2001, and in anticipation of the IASB's proposed option disclosure requirements, public debate again has turned to corporate transparency and the expensing of compensatory stock options. Unlike in the early 1990s, public response appears to be more balanced. While U.S. companies generally continue to hold their ground by insisting that an expensing requirement would damage corporate financials severely and impact employee compensation choices, both national and international support for the IASB plan has grown.<sup>134</sup>

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132. Enron, Inc. is a Houston-based energy trading company, which filed for bankruptcy protection after disclosing, among other things, that over the last five years, it falsely reported its earnings. Oliver Willis, *EnronGate*, at <http://www.oliverwillis.com/enrongate/> (last visited Nov. 7, 2002). For continuing updates on the Enron scandal, along with a link to all public documents filed in connection with the ongoing investigations and suits, see FindLaw Special Coverage Enron, Findlaw.com, at <http://news.findlaw.com/legalnews/lit/enron/> (last visited Sept. 23, 2003); See Stephanie J. Burke, *The Collapse of Enron: A Bibliography of Online Legal, Government and Legislative Resources*, at <http://www.llrx.com/features/enron.htm> (last visited Sept. 23, 2003). *But see* Public Comment Letter from the International Employee Stock Option Coalition ("IESOC") to David Tweedie, IASB Chairman (Dec. 31, 2001) (in which the IESOC calls for the IASB to adopt the SFAS 123 model), at [http://www.americanbenefitscouncil.org/issues/other/iesoc\\_1214.pdf](http://www.americanbenefitscouncil.org/issues/other/iesoc_1214.pdf) [hereinafter IESOC Comment Letter]. However, the IESOC is largely comprised of U.S. corporations and organizations. For a complete list of its members, see *id.*

133. WorldCom Corp. is a Clinton, Mississippi-based long-distance telecommunications company that was forced by the SEC to restate downwardly its financials. The SEC filed fraud charges against the company after an internal audit proved "that almost \$4 billion of expenses in 2001 and \$797 million in the first quarter of 2002 were wrongly listed on company books as capital expenses, thus not reflected in its earnings results." MSNBC News, *SEC Files Fraud Charges Against WorldCom* (June 26, 2002), at <http://stacks.msnbc.com/news/772330.asp?cp1=1#BODY>. See Jake Ulick, *WorldCom's Financial Bomb*, CNNMONEY, June 26, 2002, at <http://money.cnn.com/2002/06/25/news/worldcom/>.

134. AIMR, the Association for Investment Management and Research, is an international, non-profit, professional society of fifty-eight thousand investment professionals, headquartered in Charlottesville, Virginia, with offices in Hong Kong and London. *Analysts Association AIMR Wants FASB to Follow IASB Plan to Require Companies to Expense Stock Option Costs*, July



Once again, particularly in the U.S., debate over expensing has amplified. This time, proponents of expensing include the notable addition of PricewaterhouseCoopers Chief Executive Officer, Samuel DiPiazza, Jr.<sup>135</sup> DiPiazza favors the adoption of international principles that will “mak[e] financial reporting more relevant to investors.”<sup>136</sup>

U.S. lawmakers, again, have attempted to legislate a resolution to stock option expensing. There has been an onslaught of bills submitted to the House and Senate.<sup>137</sup> Most notably, Sena-

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17, 2002, at para. 10, at [http://www.aimr.org/pressroom/02releases/02fasb\\_stockopt.html](http://www.aimr.org/pressroom/02releases/02fasb_stockopt.html). In July 2002, AIMR's Senior Vice President, Patricia Doran Walters, reiterated the organization's long-held stance that although most corporations would prefer to continue under SFAS 123 and its international progeny, AIMR strongly affirms its belief that stock options should be expensed. *Id.* at paras. 2–3. In its September 2001 international survey of financial analysts and portfolio managers, AIMR found that among its respondents: (1) 88% agreed that stock option plans are forms of compensation to the grantees; (2) 83% agreed that, “the accounting method for employee stock options should require recognition of an expense in the income statement;” and (3) 81% acknowledged that they consider stock options when appraising a company's performance and establishing its value. *Id.* at para. 7. For a breakdown of AIMR's survey results, see *Survey on Accounting for Stock Options*, at [http://www.aimr.com/advocacy/02commltr/02sharebsd\\_c.html](http://www.aimr.com/advocacy/02commltr/02sharebsd_c.html) (last visited Sept. 23, 2003). *But see* IESOC Comment Letter, *supra* note 132, (requesting that the IASB adopt SFAS 123 as its disclosure policy). The IESOC is a Washington D.C.–based organization comprised largely of U.S. corporations and organizations. For a list of the IESOC's members see *id.* See also Corey Rosen, Update for January 7, 2002, sub-heading Opposition to IASB Accounting Proposal, IRS Withholding Proposal Grows, The National Center for Employee Ownership, at <http://www.nceo.org/columns/cr103.html> (last visited Sept. 23, 2003).

135. John S. McLenahan, *GAAP Goodbye? PwC's CEO wants to Scrap Rules-based Accounting for Global Guidelines*, INDUSTRYWEEK.COM, Aug. 2002, at 17.

136. *Id.* at 17–18. DiPiazza's belief in a global standard in lieu of GAAP, in part, stems from the fact that, “the current U.S. GAAP begins with a principle but then moves to dozens and dozens of rules and exceptions, all designed to appease somebody out there in the market.” *Id.* at 18.

137. A small sampling of current bills introduced into Congress in 2002 regarding stock options include: (1) Prevention of Stock Option Abuse Act, S. 2822, 107th Cong. (2002); (2) To amend the Internal Revenue Code of 1986 to clarify the treatment of incentive stock options and employee stock purchase plans, H.R. 2695, 107th Cong. (2001), (which would exclude ISO's and employee stock purchase plans from being considered as wages); (3) Stock Option Fairness and Accountability Act, S. 2760, 107th Cong. (2002); (4) Workplace Employee Stock Option Act of 2002, H.R. 5242, 107th Cong.

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tors Levin and McCain, together with Senators Fitzgerald, Durbin and Dayton, re-introduced S. 1940 entitled "Ending the Double Standards for Stock Options Act," which initially was introduced in 1997, but has gained wide exposure since February 2002.<sup>138</sup> Under current U.S. regulations, companies can treat stock options as an expense on tax returns, but refrain from treating them as an expense on their financial statements.<sup>139</sup> If passed, the Act would require companies to treat stock options uniformly in both their profit and loss statements and their tax returns.<sup>140</sup> Thus, if a company claims a tax deduction for a stock option expense on its tax return, it also must disclose the same expense in its financial statement.<sup>141</sup> However, the bill does not require that companies unilaterally expense stock options or dictate the accounting method by which companies must expense their options.<sup>142</sup> By tying the company's corporate tax deduction directly to the amount expensed on the company's financial statement,<sup>143</sup> the bill seeks to achieve

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(2002); (5) Rank and File Stock Option Act of 2002, S. 2877, 107th Cong. (2002); (6) Stock Option Accounting Reform Act, H.R. 5147, 107th Cong. (2002). To access bills on stock options, see the United States Senate official web site, at <http://www.senate.gov/index.htm> (last visited Sept. 23, 2003).

138. Ending the Double Standards for Stock Options Act, S. 1940, 107th Cong. (2002). See also Press Release, Senator John McCain of Arizona, McCain Cosponsors Ending Double Standards for Stock Options Act (Feb. 13, 2002), at <http://www.mccain.senate.gov/stockops.htm> [hereinafter McCain Press Release]. In 1993, Levin introduced a similar bill, S. 576 entitled "Corporate Executives Stock Option Accountability Act," which the Senate rejected by an eighty-eight to nine vote. *Senators Levin and McCain Introduce the "Ending the Double Standard for Stock Options Act"*, The Nat'l Ass'n of Stock Plan Professionals, Feb. 15, 2002, at <http://www.naspp.com/miscContent/02152002-StockOptionsDoubleStandard.htm>, at para. 3 [hereinafter *NASP on S. 1940*]; Alan Reynolds, *Stock Options and the Levin-McCain Double Standard*, The Institute for Policy Innovation, Apr. 2, 2002, at <http://www.ipi.org>; Lesli S. Laffie, *McCain-Levin Stock Options Bill*, THE TAX ADVISOR, Aug. 1997, at 472.

139. McCain Press Release, *supra* note 138, at para. 2.

140. *Id.*

141. *Id.*

142. *Id.* at para. 8.

143. *Expensing Stock Options - Not an Option*, Am. Electronics Ass'n, at [http://www.aeanet.org/governmentalaffairs/gaet\\_stockoptionsbasic.asp](http://www.aeanet.org/governmentalaffairs/gaet_stockoptionsbasic.asp) (last visited Nov. 7, 2002) [hereinafter *AeA on S. 1940*].

consistent, fair disclosure.<sup>144</sup> In April 2002, President Bush implicitly rejected S. 1940 by publicly supporting the continuance of FASB 123,<sup>145</sup> signaling that he is likely to veto it if passed.

It is worth noting that the bill's sponsors framed their argument in the context of the Enron scandal.<sup>146</sup> Both Senators Levin and McCain point out that between 1996 and 2000, Enron issued close to \$600 million in compensatory stock options, for which it earned \$600 million in tax deductions.<sup>147</sup> Levin and McCain argue that the crux of the Enron debacle is that the company received the benefit of a \$600 million tax deduction without disclosing the burden of \$600 million in lost profits.<sup>148</sup> Had Enron also reported the \$600 million as an expense on its

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144. McCain Press Release, *supra* note 138, at para. 7. In his press release, McCain stated,

[n]o other type of compensation gets treated as an expense for tax purposes, without also being treated as an expense on the company books. This double standard is exactly the kind of inequitable corporate benefit that makes the American people irate and must be eliminated. If companies do not want to fully disclose [sic] on their books how much they are compensating their employees, then they should not be able to claim a tax benefit for it.

*Id.* See Press Release, Senator Carl Levin of Michigan, Summary of Levin-McCain-Fitzgerald-Durbin-Dayton Ending the Double Standard for Stock Options Act (Feb. 13, 2002) [hereinafter Levin Press Release]. This year, former SEC Chairman, Arthur Levitt, stated that one of his great regrets while serving as Chairman was failing to require that stock options be treated as an expense on corporate financial statements. *NASP on S. 1940*, *supra* note 138, at para. 3.

145. Levinsohn, *supra* note 82, at 64. President Bush stated, "I think once options are in the money, they ought to be calculated in the dilution, that they ought to be dilutive in their earnings-per-share calculations." *Id.*

146. McCain Press Release, *supra* note 139; Levin Press Release, *supra* note 144. For a description of the Enron scandal, see *supra* note 132.

147. McCain Press Release, *supra* note 138, at para. 3. McCain stated,

[t]he latest scandals involving the collapse of Enron highlight the problem of misleading annual statements and financial statements...[C]urrent rules allow companies such as Enron to disclose as little as possible. And this prevents investors, Wall Street analysts, corporate executives and auditors from properly understanding the bottom line of corporations.

*Id.* Senator Levin, stated in his press release, "The Enron fiasco has brought to light a long-festering problem in how some U.S. corporations use stock options to avoid paying U.S. taxes while overstating earnings." Levin Press Release, *supra* note 144, at para. 1.

148. See Levin Press Release, *supra* note 144.

financial statements, its reported profits would have been reduced by one-third.<sup>149</sup> Had Enron's profit margin been cut by one-third, its stock price also would have deflated,<sup>150</sup> perhaps reflecting a more accurate price per share.

Reaction to S. 1940 from the high technology business community largely continues to be negative. Many technology organizations have taken an active stand against the bill<sup>151</sup> and continue to support SFAS 123.<sup>152</sup> On the other hand, in light of the myriad of recent accounting scandals, and in an effort to rebuild investor confidence, major corporations voluntarily have begun to expense stock options.<sup>153</sup> However, many corporations still insist that, currently, no valuation method accurately captures the cost of stock options.<sup>154</sup>

Therefore, the FASB recently agreed to amend SFAS 123 to make it easier for companies to adopt expensing methods and to

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149. *Id.* at para. 1.

150. *See id.*

151. The American Electronics Association ("AeA") actively campaigned against S. 1940, and rejects the idea that stock option expensing had anything to do with the collapse of Enron. For a summary of its argument, see AeA on S. 1940, *supra* note 143. The Information Technology Association of America ("ITAA") also rejects both S. 1940 and the Enron implications made by Levin and McCain. Harris Miller, *An Enron 'Elixir' Would Try to Cure What Doesn't Ail Us*, May 1, 2002, at <http://www.ita.org/news/view/ViewPoint.cfm?ID=22>. Alan Reynolds, a senior fellow with the Cato Institute (<http://www/cato.org>) also rejects both the bill and the Enron connection. *See Reynolds, supra* note 138.

152. *AeA on S. 1940, supra* note 143, at para. 5. While opposition to S. 1940 has intensified in 2002, in 1997 in a letter to the Senate Finance Committee Chairman, the AICPA, rejected the bill. For a summary of AICPA's objections, see Laffie, *supra* note 138.

153. Reuven Brenner & Donald Luskin, *Another Option on Options*, WALL ST. J., Sept. 3, 2002, at A20. A small sample of companies that have chosen to recognize stock options as an expense on their financial statements include: The CocaCola Company, Ford Motor Co., The Gillette Company, HJ Heinz and The Washington Post. Hughes, *supra* note 91, at para. 4.

154. The Wall Street Journal, in its online list of companies that have chosen to expense, printed this warning:

Calculations come from the companies' data and use the Black-Scholes formula, which links the value of an option to such variables as the current share price, the exercise price, expected volatility in share prices and expected dividends. This formula doesn't give an accurate picture of the cost of stock options.

Hughes, *supra* note 91, at sub-heading Not Ideal.

provide clearer, more regular disclosure. On October 4, 2002, the FASB released an exposure draft of its proposed amendment to SFAS 123.<sup>155</sup> The three-pronged proposed amendment would (1) provide three transition methods for companies who chose to adopt SFAS 123's expensing option, (2) require clearer disclosure of the accounting methods used, and (3) require additional disclosures in each company's interim financial statements.<sup>156</sup> Currently, disclosure is required only in annual financial statements.<sup>157</sup>

## V. TOWARDS AN EFFECTIVE DISCLOSURE STANDARD

### A. Regulatory Issue v. Political Issue

The method of disclosure of option expense on financial statements should be determined based on standards that promote and protect accuracy and clarity, since the point of such disclosure is to provide the investing public with sufficient information to make well-informed investment decisions.<sup>158</sup> In the U.S., the FASB has promulgated the GAAP since the SEC charged it with this task in 1973.<sup>159</sup> Congress, by threatening to legislate around the FASB's proposed amendments to the GAAP, turned this regulatory issue into a political one.<sup>160</sup> Legislators who sided with the business community, like Senator Joseph Lieberman, effectively thwarted useful accounting reform.<sup>161</sup> In so doing, Congress exacerbated the growing option disclosure problem. Since that time, the stock market overinflated, and legislators, through their politically-motivated decisions on accounting reform, created an environment in which accounting disasters like Enron and WorldCom were possible.

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155. *Accounting for Stock Based Compensation – Transition and Disclosure, an amendment of SFAS 123*, FASB Exposure Draft, at ii, at [http://www.fasb.org/draft/ed\\_amend\\_st123.pdf](http://www.fasb.org/draft/ed_amend_st123.pdf) [hereinafter *FASB Exposure Draft*]; FASB News Release, FASB Issues Exposure Draft on Accounting for Stock Options, Amends Transition and Disclosure Provisions, Oct. 4, 2002, at <http://www.fasb.org/news/nr100402.shtml>.

156. *FASB Exposure Draft*, *supra* note 155, at ii.

157. *Id.*

158. Rouse & Barton, *supra* note 6, at 68.

159. See Financial Accounting Standards, *supra* note 3.

160. Hinchman, *supra* note 96. See *Lieberman Legislation*, *supra* note 9, at 15.

161. See generally *id.*

Ironically, in an attempt to preserve its regulatory role, the FASB chose to abandon this important regulatory reform. However, in so doing, it succumbed to the will of Congress, and lost its political independence.<sup>162</sup> By their very nature, accounting standards should be relatively static, changing only to clarify disclosure for investors. As business trends change, accounting standards also should be modified to reflect such change. This is precisely what the FASB intended when it adopted the FASB Exposure Draft.<sup>163</sup> The fact that Congress was willing to overrule the FASB to placate business interest groups shows that the U.S. accounting body has lost its power. That the FASB yielded to pressure from Congress is evidence that it is not an independent body.<sup>164</sup> In order to provide and ensure accurate disclosure for the investing public, disclosure standards must be purely regulatory, safe from the influence of political pressure. An argument can be made that if the U.S. adopts an international standard, it will cede authority over its own system. However, as both the corporate community and the investing public become more global in scope, the U.S. accounting system must as well.

#### *B. National v. International Standard*

Since the business community has become increasingly global, with foreign companies registered on U.S. exchanges and vice versa and foreign investors investing in global markets, the need for a universal set of accounting standards has increased. But because stock option disclosure rules vary from country to country, it has become impossible for investors to compare corporate balance sheets and determine profit margins. Although investors should be able to compare financial statements on a line-by-line basis to evaluate their investment, in reality, they are comparing apples and oranges because they are looking at numbers derived from different accounting methods.

To alleviate this confusion, the global accounting community should adopt one set of standards, which all countries should agree to follow. The IASB was created by the international

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162. See Reid, *supra* note 116.

163. See IASB Exposure Draft, *supra* note 12.

164. See generally *id.*

community to accomplish this goal.<sup>165</sup> Finalizing and adopting the IASB Exposure Draft is a step in the right direction.

*C. Fair Value v. Intrinsic Value & Pricing Models*

As the FASB understood when it prepared the FASB Exposure Draft, Opinion No. 25's policy of using an option's intrinsic value to determine its expense provides a strong incentive for companies to issue at the money, fixed stock options, which have no compensation cost under GAAP.<sup>166</sup> By avoiding this expense on their financial statements, companies give away something of value for free.<sup>167</sup> While an at the money grant arguably can be deemed cost-free to the issuer as of the grant date, because it accrues value before it is exercised, it also has value on the grant date.<sup>168</sup>

When Opinion No. 25 was drafted, it provided an important incentive to businesses, enabling them to recruit and retain qualified personnel, and to adopt broad-based plans under which options are granted to all of its employees, and not just its executives.<sup>169</sup> However, through the successful implementation of Opinion No. 25, coupled with its inadvertent tax break, it provides for fixed, at the money grants.<sup>170</sup> Such options have become a substantial percentage of corporate compensation and now have a significant effect on the corporate balance sheet.<sup>171</sup>

Proponents of the intrinsic value method argue that determining an option's fair value is too difficult to accomplish and too inaccurate to be relied on,<sup>172</sup> when in fact, neither is the case. Both the Black-Scholes and the binomial pricing models provide accountants with manageable formulas to ascertain the option's fair value.<sup>173</sup> Moreover, while it is true that an option's fair value necessarily is an estimated value,<sup>174</sup> fair value provides a

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165. See IASB Mission Statement, *supra* note 116.

166. *Ernst & Young Summary*, *supra* note 58, at para. 20.

167. See *id.* at para. 13.

168. See *id.*

169. Johnson, *supra* note 14, at 148–49.

170. Rouse & Barton, *supra* note 6, at 68; See *Ernst & Young Summary*, *supra* note 58, at para. 13.

171. See Ellis, *supra* note 4, at 412–13.

172. Rouse & Barton, *supra* note 6, at 69.

173. See *D&T on G4+1*, *supra* note 117, at paras. 1–2.

174. Wiedman & Goldberg, *supra* note 50, at 6.

considerably more accurate valuation of an option's cost to the company than the intrinsic value method,<sup>175</sup> which typically provides no expense charge. Adoption of the intrinsic value method discourages companies from granting performance-based options that are better tailored to an individual employee's accomplishments,<sup>176</sup> and significantly inflates corporate profits on financial statements.<sup>177</sup> In order to provide accurate disclosure of profits and expenses on the financial statement, intrinsic value should be discarded in determining an option's expense to the issuing corporation. Rather, the fair value method should be used, employing either the Black-Scholes or the binomial pricing models.<sup>178</sup> The IASB wisely adopted the fair value approach because it more accurately reflects the true value of the compensatory stock option's cost to the company.

While the IASB Exposure Draft provides a clearer, more manageable valuation method, it also should pick one pricing model to determine fair value, like the Black-Scholes pricing model or the binomial model. Although both standards calculate an option's fair value,<sup>179</sup> when companies use different models, investors cannot compare financial option expense accurately because each model provides a slightly different end result. Given the primary importance of consistency and accuracy, one standard should be applied, and the choice of standard should be taken away from companies.

## VI. CONCLUSION

When the Accounting Principles Board drafted Opinion No. 25 in 1973, it was a rational accounting rule that encouraged companies, which traditionally granted compensatory stock options only to senior executives, to share the wealth with all of their employees,<sup>180</sup> and provided small companies with an incentive tool to attract qualified executives whom they otherwise could not afford to hire.<sup>181</sup> However, as compensatory stock op-

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175. *D&T on G4+1*, *supra* note 117, at para. 1.

176. *See Accounting Changes*, *supra* note 62, at 72.

177. *See Colvin*, *supra* note 91, at 75.

178. *D&T on G4+1*, *supra* note 117, at paras. 1–2.

179. *See id.*

180. Johnson, *supra* note 14, at 149–50.

181. *Id.* at 149.



tions became widely used and had a greater impact on the profit margins in financial statements,<sup>182</sup> accounting standard regulators should have revised the rules so that financial statements would have continued to reflect corporate operating expenses accurately. When the FASB attempted to effect this need to provide clear disclosure on corporate balance sheets, and provide transparency for investors, it was shut down by both the business community and by the U.S. Congress.<sup>183</sup> However, it is clear that neither the disclosure exemption adopted by Opinion No. 25, nor the voluntary disclosure policy set forth in SFAS 123 is sufficient to provide investors with the transparency they require and deserve when making investment decisions.<sup>184</sup> As it stands, the U.S. disclosure standard, even with the FASB's proposed amendments, deprives investors of adequate disclosure necessary to evaluate the relative attractiveness of their investments.<sup>185</sup>

On the other hand, the IASB, not beholden to any particular interest group, nor under the sole influence of any one political regime, has created a new standard, which comports with the internationally-recognized belief that stock options must be expensed in a manner that accurately reflects their true cost to companies.<sup>186</sup> The IASB Exposure Draft is a better standard than SFAS 123 because it properly treats compensatory stock options as an expense, and because the IASB is truly independent and international. Thus, the IASB is in a better position to promulgate unbiased accounting regulations. Once finalized, the FASB should adopt it in lieu of SFAS 123.

*Ellen J. Grossman\**

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182. Ellis, *supra* note 4, at 412–13.

183. *Lieberman Legislation*, *supra* note 9, at 15.

184. See Rouse & Barton, *supra* note 6.

185. See 1992 Annual Letter, *supra* note 104.

186. See *Survey on Accounting for Stock Options*, *supra* note 134.

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