OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON THE ACCOUNTING TREATMENT
OF EMPLOYEE STOCK OPTIONS

TUESDAY, JUNE 3, 2003

Mr. Chairman, we meet today to examine an issue of great interest to me: the accounting treatment of stock options. This issue has caused significant controversy for more than a decade, and the Financial Accounting Standards Board's recent decision to revisit this matter has rekindled a fiery debate.

Without question, stock options have played an important and crucial role in the ongoing success of many American businesses. Many entrepreneurial companies have used stock options not only to compensate their executives, but also to improve the performance of their employees. The issuance of these stock options has helped millions of average workers to share in the success of the companies for which they work. In addition, stock options have permitted start-up businesses with little capital to attract and retain first-rate employees.

Despite this success, we have not properly accounted for stock options on corporate financial statements. Employee stock options are a type of compensation, just like a salary or a bonus. Because compensation is an expense and because expenses influence earnings, employee stock options should be counted against earnings and subtracted from income.

My opinion is shared by many others, including such respected financial experts as Warren Buffett, Alan Greenspan, and Joseph Stiglitz. Additionally, all of the major accounting firms now support the expensing of stock options. Furthermore, the Investment Company Institute, the Council for Institutional Investors, and the Conference Board's Commission on Public Trust and Private Enterprise have each called for the expensing of stock options.

Support for the expensing of stock options is also growing in corporate America with 276 companies having adopted or in the process of adopting fair value expensing of stock options. Respected corporations like Coca-Cola, Home Depot, General Motors, General Electric, Dow Chemical, Wal-Mart, and Amazon.com are among the companies announcing in recent months that they would start to treat stock options as expenses.

As we consider this issue today, I would strongly encourage my colleagues to protect the independence of the Financial Accounting Standards Board. When the Board last studied this matter a decade ago, meddling by some on Capitol Hill resulted in a retreat from an original proposal to require stock option expensing. This retreat allowed companies to continue hiding the true cost of stock options and contributed to the recent tidal wave of accounting scandals.

To protect against similar incidents in the future and safeguard the public interest, we incorporated into the Sarbanes-Oxley Act a provision granting the Financial Accounting Standards Board an independent funding stream. The active consideration of the Broad-Based Stock Option Plan Transparency Act by the 108th Congress, however, would threaten this enhanced independence, intervening in the Board's ability to make unbiased decisions and disrupting an objective process for reasons other than sound financial reporting.

In addition, such congressional action would completely undermine a recent decision by the Securities and Exchange Commission finding that the Board "must use independent judgment in setting standards and should not be constrained in its exploration and discussion of issues." In making this announcement, the Commission wanted to ensure that the Board develops its accounting standards free from bias in order to have the maximum credibility in the investing community. I wholeheartedly agree with this judicious decision.

As the Financial Accounting Standards Board proceeds with this matter, I also expect that its experts will pay special attention to the proper method for valuing stock options so that investors may evaluate apples against apples, and oranges against oranges. Valuation methodologies have advanced greatly in recent years. Although it remains a difficult task, these advances should help to ensure that the Board can identify a suitable model for valuing stock options across all companies. America's capital markets can remain the strongest in the world only when the rules are clear, corporate activity is transparent, and the data is comparable.

In closing, Mr. Chairman, stock options are expenses and we must fix this obvious problem as quickly as possible. The Financial Accounting Standards Board must therefore proceed systematically in this matter with diligence and without political interference.