

**AMENDMENT IN THE NATURE OF A SUBSTITUTE
TO H.R. 3574
OFFERED BY MR. BAKER**

Strike all after the enacting clause and insert the following:

1 SECTION 1. SHORT TITLE.

2 This Act may be cited as the “Stock Option Account-
3 ing Reform Act”.

**4 SEC. 2. MANDATORY EXPENSING OF STOCK OPTIONS HELD
5 BY HIGHLY COMPENSATED OFFICERS.**

6 Section 13 of the Securities Exchange Act of 1934
7 (15 U.S.C. 78m) is amended by adding at the end the
8 following:

9 “(m) MANDATORY EXPENSING OF STOCK OP-
10 TIONS.—

11 “(1) NAMED EXECUTIVE OFFICER.—As used in
12 this subsection, the term ‘named executive officer’
13 means—

14 “(A) all individuals serving as the chief ex-
15 ecutive officer of an issuer, or acting in a simi-
16 lar capacity, during the most recent fiscal year,
17 regardless of compensation level; and



1 “(B) the 4 most highly compensated execu-
2 tive officers, other than an individual identified
3 under subparagraph (A), that were serving as
4 executive officers of an issuer at the end of the
5 most recent fiscal year.

6 “(2) IN GENERAL.—Subject to paragraph (4),
7 every issuer of a security registered pursuant to sec-
8 tion 12 shall show as an expense in the annual re-
9 port of such issuer filed under subsection (a)(2), the
10 fair value of all options to purchase the stock of the
11 issuer granted after December 31, 2004, to a named
12 executive officer of the issuer.

13 “(3) FAIR VALUE.—

14 “(A) IN GENERAL.—The fair value of an
15 option to purchase the stock of the issuer that
16 is subject to paragraph (2) shall be—

17 “(i) equal to the value that would be
18 agreed upon by a willing buyer and seller
19 of such option, who are not under any
20 compulsion to buy or sell such option; and

21 “(ii) shall take into account all of the
22 characteristics and restrictions imposed
23 upon the option.

24 “(B) PRICING MODEL.—To the extent that
25 an option pricing model, such as the Black-



1 Scholes method or a binomial model, is used to
2 determine the fair value of an option, the as-
3 sumed volatility of the underlying stock shall be
4 zero.

5 “(4) EXEMPTIONS.—

6 “(A) SMALL BUSINESS ISSUERS.—This
7 subsection shall not apply to an issuer, if—

8 “(i) the issuer has annual revenues of
9 less than \$25,000,000;

10 “(ii) the issuer is organized under the
11 laws of the United States or Canada;

12 “(iii) the issuer is not an investment
13 company (as such term is defined under
14 section 3 of the Investment Company Act
15 of 1940 (15 U.S.C. 80a-3));

16 “(iv) the aggregate value of the out-
17 standing voting and non-voting common
18 equity securities of the issuer held by non-
19 affiliated parties is less than \$25,000,000;
20 and

21 “(v) in the case of an issuer that
22 meets the criteria in clauses (i) through
23 (iv) and is a majority owned subsidiary,
24 the parent of the issuer meets the require-
25 ments of this paragraph.



1 “(B) DELAYED EFFECTIVENESS.—The re-
2 quirements of this subsection shall not apply to
3 an issuer before the end of the 3-year period
4 beginning on the date of the completion of the
5 initial public offering of the securities of the
6 issuer, and shall only apply to an option to pur-
7 chase the stock of an issuer granted after such
8 date.”.

9 **SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IM-**
10 **PACT STUDY.**

11 (a) PROHIBITION.—Section 19(b) of the Securities
12 Act of 1933 is amended by adding at the end the fol-
13 lowing:

14 “(3) PROHIBITION ON EXPENSING STAND-
15 ARDS.—

16 “(A) IN GENERAL.—The Commission shall
17 not recognize as ‘generally accepted’ any ac-
18 counting principle relating to the expensing of
19 stock options unless—

20 “(i) it complies with the requirements
21 of subparagraph (B); and

22 “(ii) the economic impact study re-
23 quired under section 3(b) of the Stock Op-
24 tion Accounting Reform Act of 2003 has
25 been completed.



1 “(B) REQUIREMENTS.—A standard re-
2 ferred to in subparagraph (A) shall require
3 that—

4 “(i) if an option to purchase the stock
5 of an issuer that is subject to the require-
6 ments of section 13(m) of the Securities
7 Exchange Act of 1934 is exercised—

8 “(I) any expense that had been
9 reported under that section 13(m)
10 with respect to such option shall be
11 recomputed as of the date of exercise
12 and shall be equal to the difference
13 between the price of the underlying
14 stock and the exercise price; and

15 “(II) to the extent the recom-
16 puted amount differs from the
17 amount previously reported under sec-
18 tion 13(m) with respect to such op-
19 tion, the difference shall be reported
20 in the fiscal year in which the option
21 is exercised as a reduction or increase,
22 as the case may be, of the total ex-
23 pense required to be reported under
24 that section 13(m) during that fiscal
25 year;



1 “(ii) if an option to purchase the
2 stock of an issuer that is subject to the re-
3 quirements of section 13(m) of the Securi-
4 ties Exchange Act of 1934 is forfeited or
5 expires unexercised, any expense that had
6 been reported under that section 13(m)
7 with respect to such option shall be re-
8 ported in the fiscal year in which the op-
9 tion expires or is forfeited as a reduction
10 of the total expense required to be reported
11 under that section 13(m) during that fiscal
12 year; and

13 “(iii) to the extent that any reduction
14 required under clause (i) or (ii) exceeds
15 total option expenses for any fiscal year,
16 such excess shall be reported as income
17 with respect to options to purchase the
18 stock of the issuer.”.

19 (b) ECONOMIC IMPACT STUDY.—The Secretary of
20 Commerce and the Secretary of Labor shall conduct and
21 complete a joint study on the economic impact of the man-
22 datory expensing of all employee stock options, including
23 the impact upon—

24 (1) the use of broad-based stock option plans in
25 expanding employee corporate ownership to workers



1 at a wide range of income levels, with particular
2 focus upon non-executive employees;

3 (2) the role of such plans in the recruitment
4 and retention of skilled workers;

5 (3) the role of such plans in stimulating re-
6 search and innovation;

7 (4) the effect of such plans in stimulating the
8 economic growth of the United States; and

9 (5) the role of such plans in strengthening the
10 international competitiveness of businesses organized
11 under the laws of the United States.

