



**Summary of House Financial Services
Subcommittee on Capital Markets, Insurance and
Government-Sponsored Entities Hearing
on FASB Stock Option Expensing Proposals**

April 21, 2004

Courtesy of the Benefits Group of Davis and Harman

The House Financial Services Subcommittee on Capital Markets, Insurance and Government-Sponsored Entities held a hearing on April 21 to review the effect of FASB's stock option proposal on the U.S. economy and jobs. The Subcommittee received testimony from Jeff Thomas (Altera Corporation), Kevin Hassett (American Enterprise Institute), Douglas Kruse (Rutgers University), Phil Smith (Taser International), Robert Grady (Carlyle Venture Partners), George Scalise (Semiconductor Industry Association), and Douglas Holtz-Eakin (Congressional Budget Office).

[Testimony is available online here.](#)

Overview

The tenor of this hearing was very different from the hearing held yesterday in the Senate Governmental Affairs Committee. Twenty-five of the Capital Markets Subcommittee members have joined Subcommittee Chairman Baker (R-LA) in introducing H.R. 3574, the Stock Option Accounting Reform Act. The bill requires public companies to expense stock options granted to their top five executives, but exempts small businesses from this requirement until 3 years after an initial public offering. The legislation also requires the Department of Commerce and the Department of Labor to conduct a joint study of the economic impact of mandatory expensing. A companion bill was introduced in the Senate by Senator Enzi (S. 1890) and discussed during the Senate hearing. Six other members of the full House Financial Services Committee are cosponsors of H.R. 3574.

Member Statements and Positions

Full Committee Chairman Oxley (R-OH) was present for much of the hearing and outlined some of the arguments that have been made for and against the FASB proposal. However, he did not share his views about the proposal nor did he signal his position on the Baker bill.

Subcommittee Chairman Baker used his opening statement to comment on an article that appeared earlier this week in the Wall Street Journal. According to Mr. Baker,

the article detailed a conference call during which FASB Chairman Herz urged large investors to lobby Congress in support of the FASB proposal. Chairman Baker criticized FASB for arguing that Congress shouldn't interfere in their process while at the same time FASB is urging others to lobby Congress on its behalf. Mr. Baker said that if the information in the article is correct, then FASB has opened the door for political discussion.

A number of the Subcommittee members who have cosponsored H.R. 3574 attended the hearing, and were very critical of the FASB stock expensing exposure draft.

Congressman Ose (R-CA) argued that no method exists which can accurately value stock options, yet FASB is moving toward a system that would require such valuation. Congressman Royce (R-CA), Congressman Hinojosa (D-TX), and Congressman Scott (D-GA) expressed concern that the FASB proposal would result in the loss of stock options as a form of compensation. Such options, they said, are an important recruiting tool for start-up companies.

Congressman Crowley (D-NY) said that the FASB proposal is about more than accounting; it also deals with economic policy, which he argued should be left to Congress to address. Congressman Shadegg (R-AZ) pointed out that even FASB couldn't come up with just one system for valuing stock options, and said that investors will be even more confused if the exposure draft is adopted because companies will not be using comparable valuation methods. Congressman Lynch (D-MA) was concerned that rank-and-file employees would be most harmed by the FASB proposal. He discussed the provision in H. R. 3574 regarding mandatory expensing of stock options granted to senior executives, and asked whether it might be better to require expensing for a fixed percentage of stock options each year, rather than using a set number of individuals.

Congresswoman Velazquez (D-NY) talked about the negative consequences that FASB's proposal would have on job growth, and said that it is unclear that the rule will result in better disclosure.

Congressman Frank (D-MA) struggled to reconcile his two different views regarding the FASB proposal. On the one hand, he does not think it appropriate for Congress to interfere with a process which has been established to allow experts to set impartial standards, particularly in an area as complex as accounting. On the other hand, he strongly disagrees with the FASB proposal which he believes will damage the hi-tech industry. He vaguely described an alternative which he plans to introduce later this week. The legislation will direct the SEC to promulgate rules to address situations where top executives sell their stock and that action results in a large drop in the company's stock prices.

Ranking Subcommittee member Kanjorski (D-PA) expressed concern about Congress interposing its position on a board that has been structured and dedicated to make certain decisions. Although his inclination is to support institutions such as FASB, he is concerned about the effect of FASB's proposal on technology companies. He would like to consider if there are other methods of providing transparency to investors. He therefore asked Subcommittee Chairman Baker to schedule another hearing so that FASB and the SEC could testify. Later in the hearing, Congressman Frank notified Mr. Baker that the Democrats would invoke rule 11 and formally request this hearing.

Witness Testimony

Of the seven witnesses who appeared before the Subcommittee, only CBO Director Doug Holtz-Eakin testified that the FASB proposal would be unlikely to have a significant effect on the economy while providing needed transparency to investors. CBO's analysis of the proposal also concluded that the fair value of employee stock options may be estimated as reliably as many other expenses.

The other six witnesses addressed specific problems with the FASB proposal and generally urged support of H.R. 3574.