Statement of Congressman Michael N. Castle

Capital Markets Subcommittee Hearing on H.R. 3574, The Stock Option Accounting Reform Act

March 3, 2004

Thank you Chairman Baker and Ranking Member Kanjorski for holding this hearing before the Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee today. In recent years, the Financial Services Committee has held a number of hearings that have brought attention to corporate accounting scandals. I commend your continued commitment to corporate accountability. Having recently passed the one year anniversary of the Sarbanes-Oxley Corporate Accountability bill, I believe it is important to remain on track in our mission to reform corporate accounting. A key step in this process is to support an honest accounting standard that would require all employee stock option compensation to be shown as an expense on corporate financial statements.

It has been estimated that, in aggregate, employee stock options now account for 15 percent of all shares outstanding at U.S. publicly traded corporations. In 2000 alone, companies on the Standard & Poor's 500-stock index awarded a staggering $126 billion in stock options - which is more than Ireland's 2002 gross domestic product.

Unfortunately, current rules allow corporations not to count options issued to employees as an expense on corporate income statements. This omission has led to a variety of stock option abuses linked to excessive executive compensation, inflated company earnings, dishonest accounting, and corporate misconduct. In addition, the present system has encouraged earnings manipulation as a means of bolstering stock price to cash in on options. Such dishonest accounting "tricks" have led to corporate scandals such as the Enron debacle and have hurt our nation's economy by damaging investor confidence in financial statements. In order to protect investors, we must fully disclose employee stock options and accurately portray companies' financial status.

In response, the Financial Accounting Standards Board (FASB), which is the governing board that sets accounting principles, has again decided that employee stock options should be considered an expense on corporate financial statements. Although FASB was prevented from setting standards for expensing stock options in 1994, it has since become even more apparent that expensing is necessary. As a Member who is dedicated to closing the loopholes that have hindered investors from accurately analyzing corporate performance, I believe requiring a uniform standard for the expensing of stock options it the right thing to do. Currently, over 480 U.S. companies, including corporate giants such as Coca-Cola, General Motors, General Electric, and Wal-Mart voluntarily expense stock options. Others, however, especially in the high tech industry, have refused to expense until they are required to do so. FASB's decision will require all companies to use the same stock option valuation methodology and will erase the accounting disparities that arise between companies who voluntarily expense and those who do not.

I understand that critics of the FASB requirement are concerned that companies will eliminate broad based stock option plans, thus hurting average workers. As you know, H.R. 3574 would require expensing for only a company's top five corporate officers and delay implementation until the completion of a study by the Secretaries of Commerce and Labor. However, many successful companies that offer broad-based stock option plans to their workforce have already determined that they can expense employee stock options without having to end this form of compensation. Furthermore, a survey conducted by the U.S. Bureau of Labor Statistics found that in 2000, only 1.7 percent of non-executive workers actually received any stock options. Assuming any changes would even take place, most workers would not be affected by the honest accounting.

Companies who voluntarily expense have already begun to demonstrate that it yields more accurate earnings numbers, restores investor confidence, and can be accomplished without eliminating the benefits for rank-and-file employees. While H.R. 3574 would delay the implementation of FASB requirements, I strongly believe we must act now to increase discipline within the system and strengthen investor confidence by ending the special treatment that stock options have enjoyed for decades. Presently, FASB is preparing for a ninety-day public comment period on a draft rule, which will be thoroughly reviewed so as to make necessary modifications. FASB is planning to issue a final standard for the expensing of employee stock options in November.

As a Committee, it has been our goal to bring corporate accountability to our nation's financial system. Any diversion from this course would be a step backward. The omission of any stock option expense in a company's financial statement, combined with the inclusion of this expense in the company's tax return, will only lead to overstated earnings. The only way to level the playing field in corporate America and strengthen the accuracy of financial statements is to require all employee stock option compensation be shown as an expense on corporate financial statements.