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Instead of fighting option expensing, tech should influence the rules

By Donald Delves

The technology industry is lobbying Congress in a last-ditch effort to preserve most-favored-accounting status for stock options. This comes as the Financial Accounting Standards Board is proposing accounting rules that could cost technology companies millions of dollars in expense for stock options that, under the old rules, are free.

Instead of making this desperate end-run to Congress, the technology community would be advised to engage the board in a debate over how -- not whether -- options should be accounted for.

When you cut through the rhetoric, tech companies have two well-worn arguments:

- It is unfair to incur an expense for options at the time they are granted. The stock price could go down, and the options never be exercised. Conversely, the stock price could go up and create a huge gain for employees and a huge economic cost to shareholders. In either case, the actual cost to shareholders bears little resemblance to the accounting board's accounting cost.

This is absolutely correct. However, the answer is not to abandon the expense, but to consider another method of calculating it.

A simple solution is to make the option expense the same as the tax expense. For tax purposes, the company records an expense -- and the employee records income -- only when the option is exercised. The amount of the expense is the spread between the exercise price and the market price. Simple! This is a much more accurate measurement of the economics of the whole transaction -- after all, nothing of any real economic consequence happens until an option is exercised.

- Technology companies see themselves as different, especially in their use of options, compared to mainstream companies. Most technology companies grant options to all of their employees, and that is why they work so hard and creatively. If tech companies have to expense their options, they will be forced to grant fewer of them; people will leave or not work as hard; their stock price will fall; America will lose its competitive edge; and California will presumably fall into the Pacific.

Technology companies have a persuasive argument -- if they are courageous enough to make it. Unlike mainstream American companies, many are truly human capital organizations. Their people are their most valuable asset. In recognition of this value, they have shared ownership rights -- in the form of stock options -- with most or all of their employees.

Tech companies could make a convincing case that granting options is not a compensation event and does not belong on the income statement at all. Rather, it is a capital transaction -- an exchange of an equity interest for human contributions of innovation, creativity, management and hard work. That transaction would be recorded primarily on the balance sheet.

Such an argument could revolutionize accounting and force the accounting board to consider the very different economic realities of the employee-employer relationship in today's modern corporation.

To be heard by the accounting board and the rest of the business community, the tech community must argue on the accounting board's terms. It must acknowledge that options do have a cost, but engage in the debate over when and how the expense is determined.

DONALD DELVES is the principal of Chicago-based The Delves Group, and author of ``Stock Options & the New Rules of Corporate Accountability'' (McGraw-Hill). He wrote this column for the Mercury News.

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