

Fed Chairman Stays Firm on Idea That Options Should Be Expensed

By Alan Murray
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(PFD File)

Alan Greenspan may be the most respected figure in Washington, but eyes roll and heads shake when the Federal Reserve chairman talks about the need to count stock options as a corporate expense. And he won't stop talking about it.

President Bush disagrees, respectfully. "Alan Greenspan is very smart. I'd hate to get into a debate with him on it," he said Monday in an interview in the Oval office. Securities and Exchange Commission Chairman Harvey Pitt disagrees, too. Only a handful of members of Congress back his cause -- either because they are incurable mavericks, like Senator John McCain, or because they've reached the limits of their political ambitions.

The political calculus here is clear. The tech companies have taken the lead in lobbying against expensing options, for the simple reason that they have the most to lose. They use options instead of cash to pay bills, and their earnings would get clobbered if they were forced to treat those options as cash. Companies such as Yahoo and Novell would see their profits turn into huge losses, according to an analysis by Bear Stearns.

But the tech companies aren't alone. The lobbying coalition battling this issue won't provide a complete list of its members, but includes groups such as the Business Roundtable, representing many of the nation's largest corporations. Old-line companies don't have as much at stake as the tech firms, but what they have at stake is very dear to them -- the compensation of their chief executives. The average CEO at one of the nation's largest companies has been earning about \$2 million a year in cash compensation, but an additional \$10 million to \$15 million in options.

That means any politician who takes on this issue runs the risk of alienating every major corporate underwriter of his or her campaign. And that means there is virtually no chance Congress will adopt proposals calling for the expensing of stock options in the post-Enron, post-Arthur Andersen legislation that it begins to mark up this week.

Yet Mr. Greenspan keeps talking about it. In the end, he may get his way.

The Fed chairman's determination is driven first by his conviction that he's right. Options are a form of compensation, they do have value at the time they are issued, and that value can be reasonably approximated by a widely accepted method known as Black-Scholes. He doesn't buy the argument President Bush made in the interview Monday: that you can deal with the problem simply by counting the options as shares in the earnings per share calculation.

Moreover, the ferocity of the opposition only strengthens the Fed chairman's conviction. There was a time when Mr. Greenspan might have argued that it doesn't matter whether the value of options is subtracted from corporate earnings, as long as it is included elsewhere in the company's financial reports -- as it now is. Let analysts and investors do their own math.

But if accounting doesn't matter, then why do corporate bigwigs raise such a ruckus over proposals to expense options? The assault on the Financial Accounting Standards Board when it took up this issue a few years back was dazzling in its ferocity -- so much so that the FASB abandoned its own convictions and backed down. The frantic effort in Washington during the past few weeks to counter Mr. Greenspan's arguments has been equally intense.

An earlier debate over whether to account for changes in retirees' health-care liabilities in earnings holds a key to Mr. Greenspan's thinking. Opponents of that change also argued it was irrelevant. It didn't matter whether such costs were reflected on the income statement, they said, so long as they were fully disclosed elsewhere. But business lost that battle, and the result was that companies suddenly got serious about holding down health-care costs. The accounting adjustment led to a profound change in corporate behavior.

Mr. Greenspan clearly thinks the loose accounting for options in the 1990s also may have had real effects -- fooling investors into paying excessive prices for technology stocks, and thus contributing to the boom, as well as the bust. For him, the issue isn't just one of accounting, but one of financial stability.

Moreover, while the political winds are blowing gale force against him, Mr. Greenspan may win this battle in the end -- thanks partly to the efforts of his predecessor as Fed chairman, Paul Volcker. Mr. Volcker was instrumental in launching the International Accounting Standards Board, which is attempting to harmonize global accounting. That group already has announced plans to take on the options issue, and in a working paper it has "tentatively agreed that, in principle" options grants should be recognized in financial statements.

The Volcker group's final recommendations won't be binding. But they will likely prod the FASB to wade back into the fray, and impose the same standard without requiring congressional action. With the Fed chairman on the FASB's side, and with Congress's will to resist weakened by the Enron-Andersen scandal, expensing of stock options is likely to become the rule.