

The FASB Has (Finally) Spoken

By now you've either heard the news or seen the draft.

The Financial Accounting Standards Board (FASB) released its long-awaited exposure draft detailing how employee stock options will be recognized on financial statements. Rather than using methods that allow little or no compensation costs to show up on income statements, companies will have to find the "fair value" of employee stock options and recognize that value as an expense.

The FASB claims this new valuation and reporting requirement will bring clarity, comparability and credibility to financial statements. Improved financial statements will help unsophisticated investors know more about companies before they buy stock. Also, the board believes that executive pay scandals can be avoided because investors will finally know the real cost of executive pay packages.

Strong arguments have been made on both sides. Proponents contend that many corporate profits are overstated now because compensation costs are not properly recognized. Thus, if companies are forced to properly value and recognize the employee compensation costs, investors and shareholders will have a better idea of how healthy the company is.

Critics say the valuation method will actually distort financial statements because the recommended "binomial" method requires a complex and dizzying array of assumptions and inputs that will create an accounting free-for-all. Further, recognizing the employee options as a cost will result in the rank-and-file losing this compensation tool. Compensation professionals will have to devise new ways to attract, retain and motivate key rank-and-file employees.

Given the arguments on both sides, what advice would you give FASB? What results do you foresee because of the accounting change? What's your perspective?

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What's Your Perspective on the FASB's Exposure Draft?

Prepare for Unexpected Results

This initiative is not needed, as many investors already factor in the stock option “expense” into their investment analysis. Simply moving the information from one part of the financial reports to another will not really help the informed investor. Given the risk inherent in any investment decision, investors should always be mindful of the footnotes, not just what is readily observable in the statements. The FASB move is another case of killing an ant with a sledgehammer. The results will not be what the FASB expects.

With respect to denying lower-level employees the opportunity to receive equity (stock) as a form of compensation, most employees would prefer cash over the market risk of stock. A recent WorldatWork survey supports the fact that cash is king and any other form of compensation has less value to the employee for the same company expense. We will comply with all regulations, but we don't necessarily have to like them.

— Ron Liggett

Manager, Compensation, O'Charley's Inc.

Where's the Clarity and Sensibility?

Given how long this topic was researched and debated, I was expecting a new standard that was far more thoughtful and equitable.

Examples include the prescribed treatments of reload options and market-based performance grants. These tools

are strongly and directly aligned with shareholder interests, but are to be subject to what amounts to an accounting “tax” that discourages their use, if not eliminating their viability completely.

“The FASB move is another case of killing an ant with a sledgehammer.”

I agree with the op-ed piece in the March 31 issue of *The Wall Street Journal*, in which Craig R. Barrett, CEO of Intel, states that, “the accounting standards board is supposed to set clear, sensible accounting rules.” The exposure draft is much further from that objective than I expected. Shareholders and employees should hope that the balance of the governance process — the comment period and public hearings — will work as designed, resulting in a more balanced final standard.

— Martin Van Walsum, CPA, CCP

Director, Global Compensation and Executive Benefits, Barnes Group Inc.

Limited Impact for Execs

Based on what I can see, the critics of expensing are correct. It will very well reduce or eliminate stock options and foster restricted stock. However, this will have limited impact on executive pay, as shown by the increase in cash compensation and the conversion of plans to restricted stock.

I do not necessarily agree that the accounting rules on performance for restricted stock will be changed that easily. The same political pressures that caused the shift to restricted stock in the first place are still around. The expensing of options will hurt the total compensation opportunities for the rank-and-file because most will lose their options and not all will be replaced with restricted stock.

— Donald H. Sabathier, CCP, CBP, SPHR

*Vice President, Human Resources
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Just Highlight It

Why not just value the stock grant at the market rate, multiplied by the number of shares as they become vested? Obviously the grant is not worth anything until it is vested. Then, multiply that value by the volatility of the stock. Continue providing the value in the annual report and the proxy statement. Give it more notoriety in the reports. Don't hide them in footnotes. Make it a separate and distinct paragraph so all can see.

— Stanley Schmuckler

President, The Valley Forge Consulting Group