Preserving Partnership Capitalism through Stock Options for America's Workforce

Senate Dirksen Office Building - Room 106
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Prepared Remarks for
Grace L. Hinchman, Senior Vice President, Financial Executives International

"Mr. Chairman and Members of the Roundtable, thank you for this opportunity to participate in this important discussion on behalf of Financial Executives International (FEI). My name is Grace Hinchman and I am Senior Vice President for FEI.

FEI is a professional association of 15,000 corporate CFOs, Treasurers and Controllers, and has been actively involved in the debate over stock option accounting for quite some time. Since the debate began in the early 90's, one fundamental problem has gone unresolved. That is --- finding a valuation model that can accurately determine the fair value of employee stock options on the day they are granted.

Employee stock options are uniquely difficult to value because they have features that make them substantially different from publicly traded stock options:

1. Employee stock options have vesting requirements,
2. Unlike publicly traded shares, employees stock options have forfeiture provisions,
3. Employee stock options have non-transferability provisions, and are subject to corporate "black-out" periods -- or specific times during the year when employees cannot exercise their options
4. In addition, employee stock options are subject to "early exercise behavior" or a tendency for employees to cash in their options shortly after the vesting requirement has passed

Our research affiliate, Financial Executives Research Foundation, recently published a study comparing alternative valuation models. There are copies of this study available at the back of the room.

This study analyzed data from employee stock option grants issued by eleven major U.S. companies and valued those grants using five different valuation models ranging from the Minimum Value Model, which produced the lowest expense valuations to the Black-Scholes model, which produced the highest expense values. The valuations produced by the other models fell somewhere in between. As this study shows, there still is no one accurate and reliable valuation model that will provide comparable results among different companies. In other words, there is no silver bullet for valuation at this point.

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The current U.S. standard for reporting employee stock options, FAS 123, permits a company the flexibility to either expense the value of employee stock options or disclose that value in the footnotes to the financial statements. Today management is entrusted with deciding which method -- expensing or disclosure -- is most meaningful to its shareholders. FEI believes the flexibility built into the current FAS 123 should be retained until a reliable valuation method has been developed.

Some FEI member companies have announced that they will voluntarily expense the value of employee stock options; while others continue to disclose their stock options expense in a footnote waiting for a more accurate and reliable valuation model. Regardless of whether the choice is to expense or disclose under FAS 123, FEI believes that a better way to calculate the value of employee stock options is urgently needed.

Open forums such as this Roundtable provide an excellent opportunity to debate the merits of current and future accounting rules. The FASB, as we all know, is charged by the SEC to establish the accounting rules of U.S. GAAP. Although FEI may disagree from time to time with the FASB on specific issues, we value and support the FASB's open and deliberative process. FEI urges Members of Congress to respect the private-sector standards setting process and encourage a focused FASB-led debate on determining the correct valuation model for employee stock options.

This concludes my remarks. Thank you for allowing FEI the opportunity to participate in today's Roundtable."