Bush Weighs In on Debate Over Stock-Option Rules

By STEPHEN LABATON

WASHINGTON, April 9 — As Congress prepares to rewrite the nation’s accounting rules, President Bush has offered his view about the appropriate way to figure the cost of stock options used to compensate top executives.

In an interview today in The Wall Street Journal, Mr. Bush took issue with a proposal supported by Alan Greenspan, chairman of the Federal Reserve, that would force companies to record such options as expenses, like other forms of compensation. Instead, Mr. Bush said, he would simply require that companies add exercised options to the number of shares outstanding when calculating a company’s per-share earnings.

"I think once options earn the money that they ought to be calculated in the dilution of — yes, be part of the — that they ought to be dilutive in their earnings-per-share calculations," Mr. Bush volunteered in response to a question about changes in corporate governance.

"Alan Greenspan is very smart," he said. "I hate to get into a debate with him, but my view is, is that it achieves both objectives. One, what are the true earnings of the company? And two, what is the dilutive effect of options in the money?"

With a wave of corporate lobbying aimed at preserving the current system of accounting for options, the administration has waded cautiously into the arcane debate.

Last month, the administration unveiled a plan to revise corporate and accounting rules, including a proposal that executives be forced to forfeit any gains from stock sales that might have been obtained through fraudulent or improper conduct.
But the administration's plan said nothing about the accounting treatment of options, the source of more than half of most top executives' compensation last year. Options give their holders the right, but not obligation, to buy shares in the future at a set price, typically the price of the stock when the option is granted. If share prices rise above the exercise price, an executive can use the option to buy the stock and sell the shares immediately, pocketing the difference.

Critics have raised two main objections to the current handling of options. First, unlike other forms of pay, they do not appear as an expense on a company's income statement — and, therefore, can inflate a company's earnings. Moreover, the stock that is granted dilutes the value of shares held by other stockholders.

The notion of recalculating the way exercised options affect the corporate bottom line has garnered support not only from Mr. Greenspan, but from a bipartisan group of lawmakers who have recently introduced legislation. They include Democratic Senators Carl Levin of Michigan, Mark Dayton of Minnesota and Richard J. Durbin of Illinois, and Republican Senators Peter G. Fitzgerald of Illinois and John McCain of Arizona. The legislation is also supported by many of large institutional investors and pension funds.

But any change in the accounting for options faces an uphill battle. Industry groups have formed a coalition to promote options compensation and beat back new restrictions or accounting rules. Technology companies in particular, but many other companies as well, have long relied upon stock options as a central component of their compensation plans.

The debate, which has arisen regularly over the years, has re-emerged with particular vigor after a number of large corporate collapses, including the tumble of both Enron (news/quote) and Global Crossing into bankruptcy protection. Both corporations had issued huge option packages for their executives. In each case, some executives exercised their options to sell shares just before the stocks plummeted in value, leaving many other shareholders with staggering losses.

In recent weeks, other lawmakers and policy makers have begun to float a variety of proposals for changing stock-option compensation. Democratic Senator Joseph I. Lieberman, who successfully blocked earlier attempts at tightening the accounting rules for options,
proposed last week that companies be provided tax incentives to offer options to their lower paid employees.

Harvey L. Pitt, the chairman of the Securities and Exchange Commission, proposed last week that all option plans for top executives be subject to approval by shareholders and that options be awarded only by a panel of outside directors. Mr. Pitt also suggested that executives be required to demonstrate "sustained, long-term growth and success" before being permitted to exercise the options.

In testimony two weeks earlier, Mr. Pitt told lawmakers that he was "exceedingly reluctant to reopen the issue" of the accounting treatment of options.

"The one place where I would take exception with Chairman Greenspan is I don't think that the nonexpensing of options caused what happened in Enron," he added.