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# H. R. 3574

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IN THE SENATE OF THE UNITED STATES

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Read twice and referred to the Committee on Banking, Housing, and Urban  
Affairs

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## AN ACT

To require the mandatory expensing of stock options granted  
to executive officers, and for other purposes.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

1 **SECTION 1. SHORT TITLE.**

2       This Act may be cited as the “Stock Option Account-  
3 ing Reform Act”.

4 **SEC. 2. MANDATORY EXPENSING OF STOCK OPTIONS HELD**  
5 **BY HIGHLY COMPENSATED OFFICERS.**

6       Section 13 of the Securities Exchange Act of 1934  
7 (15 U.S.C. 78m) is amended by adding at the end the  
8 following:

9       “(m) MANDATORY EXPENSING OF STOCK OP-  
10 TIONS.—

11           “(1) NAMED EXECUTIVE OFFICER.—As used in  
12 this subsection, the term ‘named executive officer’  
13 means—

14           “(A) all individuals serving as the chief ex-  
15 ecutive officer of an issuer, or acting in a simi-  
16 lar capacity, during the most recent fiscal year,  
17 regardless of compensation level; and

18           “(B) the 4 most highly compensated execu-  
19 tive officers, other than an individual identified  
20 under subparagraph (A), that were serving as  
21 executive officers of an issuer at the end of the  
22 most recent fiscal year.

23       “(2) IN GENERAL.—Subject to paragraph (4),  
24 every issuer of a security registered pursuant to sec-  
25 tion 12 shall show as an expense in the annual re-  
26 port of such issuer filed under subsection (a)(2), the

1 fair value of all options to purchase the stock of the  
2 issuer granted after December 31, 2004, to a named  
3 executive officer of the issuer.

4 “(3) FAIR VALUE.—

5 “(A) IN GENERAL.—The fair value of an  
6 option to purchase the stock of the issuer that  
7 is subject to paragraph (2) shall—

8 “(i) be equal to the value that would  
9 be agreed upon by a willing buyer and sell-  
10 er of such option, who are not under any  
11 compulsion to buy or sell such option; and

12 “(ii) take into account all of the char-  
13 acteristics and restrictions imposed upon  
14 the option.

15 “(B) PRICING MODEL.—To the extent that  
16 an option pricing model, such as the Black-  
17 Scholes method or a binomial model, is used to  
18 determine the fair value of an option, the as-  
19 sumed volatility of the underlying stock shall be  
20 zero.

21 “(4) EXEMPTIONS.—

22 “(A) SMALL BUSINESS ISSUERS.—This  
23 subsection shall not apply to an issuer, if—

24 “(i) the issuer has annual revenues of  
25 less than \$25,000,000;

1 “(ii) the issuer is organized under the  
2 laws of the United States, Canada, or Mex-  
3 ico;

4 “(iii) the issuer is not an investment  
5 company (as such term is defined under  
6 section 3 of the Investment Company Act  
7 of 1940 (15 U.S.C. 80a-3));

8 “(iv) the aggregate value of the out-  
9 standing voting and non-voting common  
10 equity securities of the issuer held by non-  
11 affiliated parties is less than \$25,000,000;  
12 and

13 “(v) in the case of an issuer that  
14 meets the criteria in clauses (i) through  
15 (iv) and is a majority-owned subsidiary,  
16 the parent of the issuer meets the require-  
17 ments of this paragraph.

18 “(B) DELAYED EFFECTIVENESS.—The re-  
19 quirements of this subsection shall not apply to  
20 an issuer before the end of the 3-year period  
21 beginning on the date of the completion of the  
22 initial public offering of the securities of the  
23 issuer, and shall only apply to an option to pur-  
24 chase the stock of an issuer granted after such  
25 date.

1           “(5)     VOLUNTARY     EXPENSING.—Notwith-  
2     standing the requirements of this subsection, issuers  
3     may elect to expense the fair value of all officer and  
4     employee stock options in the annual report of such  
5     issuer under subsection (a)(2), in accordance with  
6     the expensing alternative of Statement of Financial  
7     Accounting Standards Number 123, and any such  
8     issuer making such election in the annual report for  
9     a fiscal year shall not be subject to paragraphs (2)  
10    through (4) of this subsection for such fiscal year.”.

11 **SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IM-**  
12 **PACT STUDY.**

13       (a) PROHIBITION.—Section 19(b) of the Securities  
14    Act of 1933 (15 U.S.C. 77s(b)) is amended by adding at  
15    the end the following:

16           “(3)   PROHIBITION ON EXPENSING STAND-  
17    ARDS.—

18               “(A) IN GENERAL.—The Commission shall  
19           not recognize as ‘generally accepted’ any ac-  
20           counting principle relating to the expensing of  
21           stock options unless—

22                       “(i) it complies with the requirements  
23                       of subparagraph (B); and

24                       “(ii) the economic impact study re-  
25                       quired under section 3(b) of the Stock Op-

tion Accounting Reform Act has been completed.

“(B) REQUIREMENTS.—A standard referred to in subparagraph (A) shall require that—

“(i) if an option to purchase the stock of an issuer that is subject to the requirements of section 13(m) of the Securities Exchange Act of 1934 is exercised—

“(I) any expense that had been reported under that section 13(m) with respect to such option shall be recomputed as of the date of exercise and shall be equal to the difference between the price of the underlying stock and the exercise price; and

“(II) to the extent the recomputed amount differs from the amount previously reported under section 13(m) with respect to such option, the difference shall be reported in the fiscal year in which the option is exercised as a reduction or increase, as the case may be, of the total expense required to be reported under

1                   that section 13(m) during that fiscal  
2                   year;

3                   “(ii) if an option to purchase the  
4                   stock of an issuer that is subject to the re-  
5                   quirements of section 13(m) of the Securi-  
6                   ties Exchange Act of 1934 is forfeited or  
7                   expires unexercised, any expense that had  
8                   been reported under that section 13(m)  
9                   with respect to such option shall be re-  
10                  ported in the fiscal year in which the op-  
11                  tion expires or is forfeited as a reduction  
12                  of the total expense required to be reported  
13                  under that section 13(m) during that fiscal  
14                  year; and

15                  “(iii) to the extent that any reduction  
16                  required under clause (i) or (ii) exceeds  
17                  total option expenses for any fiscal year,  
18                  such excess shall be reported as income  
19                  with respect to options to purchase the  
20                  stock of the issuer.

21                  “(C) EXCEPTION FOR VOLUNTARY EX-  
22                  PENSING.—Nothing in this paragraph or in any  
23                  other provision of the Stock Option Accounting  
24                  Reform Act shall prevent the Commission from  
25                  continuing to recognize the expensing alter-

1 native of Statement of Financial Accounting  
2 Standards Number 123 as part of generally ac-  
3 cepted accounting principles for issuers that  
4 elect to expense the fair value of all officer and  
5 employee stock options in the annual report of  
6 such issuer pursuant to section 13(m)(5) of the  
7 Securities Exchange Act of 1934.’’.

8 (b) ECONOMIC IMPACT STUDY.—Not later than 1  
9 year after the date of enactment of this Act, the Secretary  
10 of Commerce and the Secretary of Labor shall conduct  
11 and complete a joint study on the economic impact of the  
12 mandatory expensing of all employee stock options, includ-  
13 ing the impact upon—

14 (1) the use of broad-based stock option plans in  
15 expanding employee corporate ownership to workers  
16 at a wide range of income levels, with particular  
17 focus upon non-executive employees;

18 (2) the role of such plans in the recruitment  
19 and retention of skilled workers;

20 (3) the role of such plans in stimulating re-  
21 search and innovation;

22 (4) the effect of such plans in stimulating the  
23 economic growth of the United States; and



1           (5) the role of such plans in strengthening the  
2           international competitiveness of businesses organized  
3           under the laws of the United States.

4 **SEC. 4. IMPROVED EMPLOYEE STOCK OPTION TRANS-**  
5 **PARENCY AND REPORTING DISCLOSURES.**

6           (a) **ENHANCED DISCLOSURES REQUIRED.**—Not later  
7 than 180 days after the date of enactment of this Act,  
8 the Commission shall, by rule, require each issuer filing  
9 a periodic report under section 13(a) or 15(d) of the Secu-  
10 rities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)) to  
11 include in such report more detailed information regarding  
12 stock option plans, stock purchase plans, and other ar-  
13 rangements involving an employee acquisition of an equity  
14 interest in the company. Such information shall include—

15           (1) a discussion, written in “plain English”, in  
16 accordance with the Plain English Handbook pub-  
17 lished by the Office of Investor Education and As-  
18 sistance of the Commission, of the dilutive effect of  
19 stock option plans, including tables or graphic illus-  
20 trations of such dilutive effects;

21           (2) expanded disclosure of the dilutive effect of  
22 employee stock options on the issuer’s earnings per  
23 share;

1           (3) prominent placement and increased com-  
2           parability and uniformity of all stock option related  
3           information;

4           (4) the number of outstanding stock options;

5           (5) the weighted average exercise price of all  
6           outstanding stock options; and

7           (6) the estimated number of stock options out-  
8           standing that will vest in each year.

9           (b) DEFINITIONS.—As used in this section:

10           (1) COMMISSION.—The term “Commission”  
11           means the Securities and Exchange Commission.

12           (2) ISSUER.—The term “issuer” has the mean-  
13           ing provided in section 2(a)(7) of the Sarbanes-  
14           Oxley Act of 2002 (15 U.S.C. 7201(a)(7)).

15           (3) EQUITY INTEREST.—The term “equity in-  
16           terest” includes common stock, preferred stock,  
17           stock appreciation rights, phantom stock, and any  
18           other security that replicates the investment charac-  
19           teristics of such securities, and any right or option  
20           to acquire any such security.

21   **SEC. 5. PRESERVATION OF AUTHORITY.**

22           Nothing in this Act shall be construed to limit the  
23           authority over the setting of accounting principles by any  
24           accounting standard setting body whose principles are rec-  
25           ognized by the Securities and Exchange Commission

- 1 under section 19(b)(1) of the Securities Act of 1933 (15
- 2 U.S.C. 77s(b)(1)).

Passed the House of Representatives July 20, 2004.

Attest:

JEFF TRANDAHL,

*Clerk.*