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Proposed amendment counters expensing rule

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Special to the Austin Business Journal

Jamie Rhodes is on a mission to save an endangered species.

Which endangered species? The stock option.

Rhodes, CEO of Austin-based Perceptive Sciences Corp., is one of many voices in the high tech community battling against a proposed accounting rule change by the Financial Accounting Standards Board (FASB). He argues it would adversely affect the Central Texas economy.

The FASB's proposed amendment would require all forms of share-based payments to employees, including employee stock options, to be treated the same way as other forms of compensation. Just like salaries and bonuses, companies would be required to show employee stock options as expenses on their ledgers.

Stock options are a form of employee incentive and compensation in which an employee is given an option to purchase shares at a certain price, usually at or below the market price at the time the option is granted for a specified period of years.

The FASB formally announced this proposed rule change on March 31 in what it says is a "response to requests from investors and many other parties to improve the current accounting standards relating to employee stock compensation in financial statements."

If approved, the proposed change would be in effect for the fiscal years following Dec. 15.

Since 1973, the FASB has established standards of financial accounting and reporting that are officially recognized as the final authority by the Securities and Exchange Commission and the American Institute of Certified Public Accountants.

Recently, Rhodes joined 70 other CEOs of high tech and biotech companies from across the country on a trip to Washington D.C. to urge lawmakers to pass the Stock Option Accounting Reform Act (S. 1890 and H.R. 3574), which would mandate only expensing stock options owned by the top five executives in a corporation. The bill also calls for exempting small businesses from expensing options and allows newly public companies to delay expensing for top executives in the first three years.

"Entrepreneurs want to be able to share the success of their companies with all the people who come to work with them," Rhodes says. "With a startup, you don't have the cash to pay bonuses. But when you give everyone a piece of the company, after everyone works hard and the company is successful, there is a reward for everyone."

Rhodes was one of the earliest employees of National Instruments in the 1970s and experienced firsthand how stock options can enhance one's personal finances. He says stock options also created legions of "Dellionaires."

"Dell has created thousands of Dellionaires who all buy cars, houses, toys, boats and things that help move the economy along," he says. "Our whole area is better off for the fact that Dell shared the riches with those people who worked hard for the company."

However, in light of corporate accounting scandals such as Enron and Global Crossing, many leading figures in corporate America say expensing stock options is long overdue. Companies such as IBM Corp. and Microsoft Corp. often have expressed to media outlets their support of FASB's proposed rule change.

But many Austin entrepreneurs say such established companies are in a vastly different financial position than a startup. They say those companies are in a different league when it comes to attracting talented employees.

"It's widely known that stock options are a major component of the compensation packages used to attract the best talent," says Kent Nutt, director of marketing programs for Austin-based Conformative Systems, a startup developer of XML processing software. "They're one of the major reasons you're willing to take the risk of a startup. Stock options are routinely offered in lieu of higher salaries, with the implicit promise of a financial payoff with an acquisition or IPO."

As a founding investor in more than 30 companies, high tech entrepreneur and venture capitalist Rob Adams of Austin echoes the belief that requiring high tech companies to expense stock option will certainly impact the Austin economy.

"The current structure is a real boon to the Austin economy," he says. "Based on the significant part of the population employed in high technology, an industry that uses stock options aggressively, they create wealth for the residents, and, more importantly, create a class of talented people who will opt for stock options over cash compensation.

"Clearly, any accounting for their value will reduce a company's ability to grant them to the degree they currently do."

Elaine Wetmore is the former CEO and is the current treasurer of the Austin Entrepreneurs Foundation, a charitable organization funded largely through stock options from more than 100 local companies.

She says she doesn't think the organization's mission will be affected severely by the proposed FASB rule change. However, Wetmore says she does think there will be negative effects on Austin's economy if the Stock Option Accounting Reform Act isn't passed.

"Many companies here like Vignette [Corp.] and Crossroads [Systems Inc.] have been very successful through IPOs, and through acquisitions like the purchase of Waveset [Technologies Inc.] by Sun Microsystems [Inc.]," she says. "But expensing of stock options may cause some of these companies to cut back on the granting of equity ownership. The downstream effects could be substantial if people don't have that extra discretionary income to buy things, build things, or donate to causes."

Wetmore was previously CFO and vice president of Tivoli Systems Inc. She personally benefited from her stock options when IBM purchased Tivoli Systems in March 1996 for $743 million.

The tech community in Austin -- and in other places like California's Silicon Valley -- is tracking the reform act's progress as it makes its way through the halls of Congress. Some companies already are preparing to deal with the accounting change.

"A lot of companies are exploring the alternative of initiating restricted stock grants, as opposed to stock options," says Russell Norwood, first vice president of Merrill Lynch's Private Banking and Investment Group in Austin. "From an accounting perspective, restricted stock grants will not have the same adverse balance sheet impact as expensing stock options."

On June 15, the legislation drew closer to a vote when the House Financial Services Committee voted 45-13 to approve the bill. The bill was sent to the full House for a vote and has backing from leaders of both sides of the aisle in the House, but similar legislation in the Senate has had less momentum.

Rhodes is happy to have the support of many lawmakers, such as House Rep. Lamar Smith, R-Texas.

"Passage of this legislation should be an essential ingredient in our efforts to create more jobs and growth in the high tech sector of our economy," Smith says.

"It would be a huge mistake to discourage this critical tool to recruit and retain high tech workers in America just as many of our international competitors are increasing the use of stock options to gain competitive advantage."

Still, Rhodes says he isn't giving up until the possible extinction of stock options is out of the woods.

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