Forced Options Expensing Looms In '04

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Canadian companies will be forced to expense the cost of employee stock options beginning in 2004, according to proposals recently unveiled by a national accounting body.

The Accounting Standards Board is recommending new rules that will no longer enable companies to simply disclose the cost of options in footnotes to their financial statements. Instead, all options will have to be recorded as a business expense on corporate income statements, enabling investors to quantify the impact of stock-based compensation on the bottom line. "I think it gets rid of this false impression that these things are free," said Paul Cherry, chairman of the ASB. "It holds companies accountable for the fair value of these instruments."

The ASB issued a call for public comments on the new regulations last week, and said it expects to formally amend the standards in the second quarter of 2003. The rules will take effect Jan. 1, 2004.

The Canadian efforts mirror similar actions by the International Accounting Standards Board, which issued its own proposal on expensing options last month.

U.S. accounting authorities have indicated they will review the IASB recommendations before deciding how they will proceed on the contentious issue.

"I think it's a good thing, but it opens up a whole other area that investors need to get an understanding of," said **Anthony Scilipoti**, an executive vice-president with **Veritas Investment Research Corp**. in Toronto.

"It finally just puts it out on the face [of the income statement], and investors can now decide do they include it or exclude it from their analysis."

Numerous companies, goaded into action after a series of corporate accounting scandals in the United States, have stepped forward and announced they would voluntarily begin expensing options to provide investors with greater transparency.

Major institutional investors in Canada and the United States, along with such market celebrities as Warren Buffett, have been calling for mandatory expensing to identify the possible dilutive effect of options on corporate balance sheets and to present a more concise financial picture.

But critics of the proposed rules, particularly in sectors that rely on options to woo and retain employees, have argued that including stock compensation on the balance sheet would hurt their ability to compete and would unfairly taint their earnings. Others have argued that the industry lacks a standard model for calculating the value of options, so the rules will serve only to confuse investors.

Mr. Cherry said he expects to receive criticism from the high-tech industry, traditionally a heavy user of employee options, but insisted it is "highly unlikely" the ASB will abandon its recommendation that companies expense all employee options.

"Someone can make their salary disappear by going the stock option route, which is something we want to get rid of," he said.

Mr. Cherry added that despite not having a standard accounting method for expensing options, companies still will have to use a model that represents the so-called "fair value" of non-cash compensation and accounts for a list of specific factors, such as market volatility.

The ASB said it eventually intends to harmonize its rules on options accounting with either U.S. or international standards, once they are in place.