Opening Statement
Congressman Ed Royce (CA-40)
3 June 2003
The Accounting Treatment of Employee Stock Options

Thank you -- Chairman Baker -- for the opportunity to share my views with the subcommittee today on the topic of accounting treatment of employee stock options. I would like to commend Chairman Oxley and Chairman Baker for bringing the important topic of stock options to light through this hearing, and I look forward to engaging in an in-depth and ongoing dialogue with my colleagues -- with the benefit of insight and testimony from our distinguished witnesses -- to ensure that Congress pursues a path that is most helpful to future growth of the U.S. economy.

As someone who believes in free markets, I think that transparency and risk-taking are pivotal to a healthy, vibrant economy. The U.S. economy has been the world's driving economic force over the last two decades because investors from around the world recognize the U.S. is a place with sound laws that encourage economic activity and a free people willing to take risks to create wealth. This is evidenced by the fact that the U.S. economy accounts for an astounding 32% of the world's GDP -- and that since 1995 the U.S. has accounted for about 60% of the cumulative growth in world GDP. Furthermore, about 75% of the world's total foreign exchange reserves are held in U.S. dollar-denominated assets.

I believe that stock options have been an integral part of the success in the American economic system. Millions of people have benefited from obtaining equity ownership in their employing firm through stock options. In my home state of California, there are many companies, large and small, that offer stock options to employees throughout the ranks.

Currently there is a great debate as to whether or not stock options should be expensed on a company’s income statement. After studying this issue closely, I am concerned that expensing options through the Black-Scholes Model, or any other binomial model under consideration, does more harm than good in the effort to achieve transparency in our capital markets. Even vocal proponents of expensing stock options acknowledge that Black-Scholes is flawed at best -- and instead of that approach -- publication of shareholder-value dilution in financial statements will more objectively reflect how stock option grants impact investors' shareholdings. Are we really making financial statements more precise and accurate if firms are forced to adjust their actual earnings by inputting non-cash charges derived through a flawed model in their income statement?

The Broad-Based Stock Option Plan Transparency Act of 2003, H.R. 1372, legislation sponsored by Chairman Drier and Rep. Eshoo, would increase and improve “plain English” disclosure of stock options on companies’ financial statements and detail the stock options granted and outstanding to top executives. Additionally, the proposed legislation would prohibit the SEC from recognizing any FASB ruling requiring firms to expense stock options in their income statement for a period of three years. In that three-year period, the SEC would be required to study proposals to expense stock options.

I believe that this is the prudent step for Congress to take on this matter because it protects the entrepreneurial spirit behind stock options while increasing transparency of their use in financial statements. This committee has made tremendous efforts to increase transparency and confidence in our free market system over the last 18 months. We must act to ensure that the marketplace rests on solid fundamentals.

I thank the Chairman for his time, and for bringing this issue to the attention of this subcommittee. I would like to take this opportunity to thank our witnesses for taking the time to share their insights on the topic of expensing stock options. Finally, I look forward to working with my colleagues to reach the best solution for the future and health of the U.S. economy. I yield back the balance of my time.