One, Two, Three... Crunch Time – Stock Option Expensing and SFAS 123

Companies are grappling with the expensing of stock-option pay, which are often a substantial part of compensation packages. The accounting rules that recently went into effect requiring companies to report the cost of options bring considerable challenges to CFOs and their teams.

Historically, accounting rules permitted companies to report little compensation expense because the expense could be based on the “intrinsic value” of the option on the date of grant – the difference between the market price of the stock and the option exercise price. For “at-the-money” options, intrinsic value is zero and no compensation expense had to be recorded.

With Statement Financial Accounting Standards (SFAS) #123 – “Accounting for Stock-based Compensation”, FASB now requires expensing based on the fair value of the options granted. This can have a significant impact on income. A recent study by Bear, Stearns estimates that 2003 operating income of the S&P 500 would have been 8 percent lower using SFAS #123.

Many Boards of Directors and managements use Newbury Piret Companies, Inc.’s (“Newbury Piret”) stock option valuation reports in connection with contemplated transactions involving employee option grants. You can contact Ron Adams CPA at (617) 367-7300 x 115, or Alan Fullerton at (617) 367-7300 x 105 to discuss your specific situation and valuation needs.