CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 25, 2004

H.R. 3574
Stock Option Accounting Reform Act

As ordered reported by the House Committee on Financial Services on June 15, 2004

SUMMARY

H.R. 3574 would require publicly traded companies to include the value of a certain portion of stock options as an expense in the firm's annual financial reports. (This practice is known as "expensing stock options.") The bill's requirement would apply to the stock options granted to a company's chief executive officer and the four highest-paid executive officers. The bill would exclude certain small companies from this requirement.

Under the bill, the Securities and Exchange Commission (SEC) would create regulations for expensing stock options, and the Departments of Commerce and Labor would study the economic impact of implementing expensing of stock options for all of a company's employees. CBO estimates that implementing H.R. 3574 would not have a significant effect on spending subject to appropriation and would not affect direct spending or revenues.

H.R. 3574 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no significant costs on state, local or tribal governments.

H.R. 3574 would impose private-sector mandates as defined in UMRA on certain companies. Based on information from industry and government sources, CBO expects that the aggregate direct costs of complying with those mandates would fall below the annual threshold established by UMRA for private-sector mandates ($120 million in 2004, adjusted annually for inflation).

IMPACT ON THE PRIVATE SECTOR

Expensing of Stock Options Held by Executive Officers

Section 2 would impose a private-sector mandate on certain companies that grant some compensation through stock options. The provision would require such companies to recognize as an expense in their annual report to the SEC the fair value (as defined in the bill) of certain options to purchase stock granted to the chief executive officer and the four most highly compensated executives of the company. To recognize an expense means it is included in the calculation of reported net income. Current accounting standards require that firms recognize as an expense or disclose the fair value of all stock options they grant. Consequently, CBO expects that complying with this mandate would result in minimal additional cost.

Additional Disclosures in Periodic Reports

Section 4 would require the SEC to implement rules that would require certain companies to provide more detailed information specified in the bill regarding employee stock option plans in the periodic reports filed with the SEC. According to industry and government sources, most of this information is already required by the SEC in the periodic reports provided by firms. Therefore, CBO expects that the direct cost to comply with this mandate would be minimal.

Standards for Expensing Stock Options

Section 3 would prohibit the SEC from recognizing as "generally accepted" any accounting principle relating to the expensing of stock options unless it complies with certain requirements specified in the bill and an economic impact study required in the bill has been completed. If the SEC adopts the requirements in the bill for expensing stock options as generally accepted accounting principles, those requirements would be new private-sector mandates on certain companies that grant stock options. Such requirements are similar to current rules that companies follow regarding the expensing of stock options for income-tax purposes. Consequently, CBO expects that complying with such requirements would result in minimal additional cost to firms.

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