FASB to Mandate Expensing Stock Options

The FASB decided today, April 22, to require all companies to expense the value of employee stock options. Companies will be required to measure the cost according to the fair value of the options.

The FASB tentatively decided in principle to measure employee equity-based awards at their date of grant. Under Statement 123, the value of the award is determined at the date of grant, and compensation cost is adjusted for actual forfeitures and the actual outcomes of performance-based awards—a modified grant-date model. In contrast, the IASB’s exposure draft would not permit such adjustments. Instead, it would require up-front estimates of the likelihood of forfeitures and of meeting the performance targets and would include their estimated value in the grant-date measurement. The FASB will later determine the extent to which its final Statement will permit adjustments for actual forfeitures and actual performance outcomes. The decision will affect the amount of compensation cost recognized over the employee service period.

(2) IASB, ED 2, Share-based Payment, November 2002.
Mandating expensing options and requiring a form of grant-date model are the first key decisions in the stock-compensation project put on the FASB’s agenda last month. One of the next major issues is how the cost of employee stock options should be measured—in other words, how to determine their fair value. Statement 123 requires use of an option-pricing model to determine fair value, such as the Black-Scholes model, and provides guidance on adjusting some of the input factors. This valuation approach has received significant criticism.

The FASB is committed to work with the IASB in order to achieve maximum convergence on stock-based-compensation accounting, which will affect the timing of the FASB’s project. The FASB plans to issue an exposure draft later this year that could become effective in 2004. Until a new Statement is issued, the provisions of Statement 123 remain in effect.

Companies should not treat the statements in this presentation about potential requirements as if they are what the FASB will finally adopt. The FASB and IASB projects described above have not yet resulted in standards, and the related issues are still under consideration. Companies should consult the final FASB Statement and their accounting and legal advisors.