AMENDMENT IN THE NATURE OF A SUBSTITUTE
TO H.R. 3574
OFFERED BY MR. OXLEY

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Stock Option Accounting Reform Act”.

SEC. 2. MANDATORY EXPENSING OF STOCK OPTIONS HELD
BY HIGHLY COMPENSATED OFFICERS.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

“(m) MANDATORY EXPENSING OF STOCK OPTIONS.—

“(1) NAMED EXECUTIVE OFFICER.—As used in this subsection, the term ‘named executive officer’ means—

“(A) all individuals serving as the chief executive officer of an issuer, or acting in a similar capacity, during the most recent fiscal year, regardless of compensation level; and
“(B) the 4 most highly compensated executive officers, other than an individual identified under subparagraph (A), that were serving as executive officers of an issuer at the end of the most recent fiscal year.

“(2) In general.—Subject to paragraph (4), every issuer of a security registered pursuant to section 12 shall show as an expense in the annual report of such issuer filed under subsection (a)(2), the fair value of all options to purchase the stock of the issuer granted after December 31, 2004, to a named executive officer of the issuer.

“(3) Fair value.—

“(A) In general.—The fair value of an option to purchase the stock of the issuer that is subject to paragraph (2) shall be—

“(i) equal to the value that would be agreed upon by a willing buyer and seller of such option, who are not under any compulsion to buy or sell such option; and

“(ii) shall take into account all of the characteristics and restrictions imposed upon the option.

“(B) Pricing model.—To the extent that an option pricing model, such as the Black-
Scholes method or a binomial model, is used to
determine the fair value of an option, the as-
sumed volatility of the underlying stock shall be
zero.

“(4) EXEMPTIONS.—

“(A) SMALL BUSINESS ISSUERS.—This
subsection shall not apply to an issuer, if—

“(i) the issuer has annual revenues of
less than $25,000,000;

“(ii) the issuer is organized under the
laws of the United States, Canada, or Mex-
ico;

“(iii) the issuer is not an investment
company (as such term is defined under
section 3 of the Investment Company Act
of 1940 (15 U.S.C. 80a–3));

“(iv) the aggregate value of the out-
standing voting and non-voting common
equity securities of the issuer held by non-
affiliated parties is less than $25,000,000;
and

“(v) in the case of an issuer that
meets the criteria in clauses (i) through
(iv) and is a majority owned subsidiary,
the parent of the issuer meets the requirements of this paragraph.

“(B) NON-REGISTRANTS.—An issuer whose securities are not registered pursuant to section 12 shall not be required to expense any option to purchase the stock of such issuer issued to its employees or members of its board of directors.

“(C) DELAYED EFFECTIVENESS.—The requirements of this subsection shall not apply to an issuer before the end of the 3-year period beginning on the date of the completion of the initial public offering of the securities of the issuer, and shall only apply to an option to purchase the stock of an issuer granted after such date.”.

SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IMPACT STUDY.

(a) PROHIBITION.—Section 19(b) of the Securities Act of 1933 is amended by adding at the end the following:

“(3) PROHIBITION ON EXPENSING STANDARDS.—

“(A) IN GENERAL.—The Commission shall not recognize as ‘generally accepted’ any ac-
counting principle relating to the expensing of stock options unless—

“(i) it complies with the requirements of subparagraph (B); and

“(ii) the economic impact study required under section 3(b) of the Stock Option Accounting Reform Act of 2003 has been completed.

“(B) REQUIREMENTS.—A standard referred to in subparagraph (A) shall require that—

“(i) if an option to purchase the stock of an issuer that is subject to the requirements of section 13(m) of the Securities Exchange Act of 1934 is exercised—

“(I) any expense that had been reported under that section 13(m) with respect to such option shall be recomputed as of the date of exercise and shall be equal to the difference between the price of the underlying stock and the exercise price; and

“(II) to the extent the recomputed amount differs from the amount previously reported under sec-
tion 13(m) with respect to such option, the difference shall be reported in the fiscal year in which the option is exercised as a reduction or increase, as the case may be, of the total expense required to be reported under that section 13(m) during that fiscal year;

“(ii) if an option to purchase the stock of an issuer that is subject to the requirements of section 13(m) of the Securities Exchange Act of 1934 is forfeited or expires unexercised, any expense that had been reported under that section 13(m) with respect to such option shall be reported in the fiscal year in which the option expires or is forfeited as a reduction of the total expense required to be reported under that section 13(m) during that fiscal year; and

“(iii) to the extent that any reduction required under clause (i) or (ii) exceeds total option expenses for any fiscal year, such excess shall be reported as income
with respect to options to purchase the
stock of the issuer.”.

(b) Economic Impact Study.—The Secretary of
Commerce and the Secretary of Labor shall conduct and
complete a joint study on the economic impact of the man-
datory expensing of all employee stock options, including
the impact upon—

(1) the use of broad-based stock option plans in
expanding employee corporate ownership to workers
at a wide range of income levels, with particular
focus upon non-executive employees;

(2) the role of such plans in the recruitment
and retention of skilled workers;

(3) the role of such plans in stimulating re-
search and innovation;

(4) the effect of such plans in stimulating the
economic growth of the United States; and

(5) the role of such plans in strengthening the
international competitiveness of businesses organized
under the laws of the United States.

SEC. 4. IMPROVED EMPLOYEE STOCK OPTION TRANS-
PARENCY AND REPORTING DISCLOSURES.

(a) Enhanced Disclosures Required.—Not later
than 180 days after the date of enactment of this Act,
the Commission shall, by rule, require each issuer filing
a periodic report under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)) to include in such report more detailed information regarding stock option plans, stock purchase plans, and other arrangements involving an employee acquisition of an equity interest in the company. Such information shall include—

(1) a discussion, written in “plain English”, in accordance with the Plain English Handbook published by the Office of Investor Education and Assistance of the Commission, of the dilutive effect of stock option plans, including tables or graphic illustrations of such dilutive effects;

(2) expanded disclosure of the dilutive effect of employee stock options on the issuer’s earnings per share;

(3) prominent placement and increased comparability and uniformity of all stock option related information;

(4) the number of outstanding stock options;

(5) the weighted average exercise price of all outstanding stock options; and

(6) the estimated number of stock options outstanding that will vest in each year.

(b) DEFINITIONS.—As used in this section:
(1) COMMISSION.—The term “Commission” means the Securities and Exchange Commission.

(2) ISSUER.—The term “issuer” has the meaning provided in section 2(a)(7) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a)(7)).

(3) EQUITY INTEREST.—The term “equity interest” includes common stock, preferred stock, stock appreciation rights, phantom stock, and any other security that replicates the investment characteristics of such securities, and any right or option to acquire any such security.