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The Other Shoe Has Dropped: FASB & Options

By Hank Boerner

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FOR SUBSCRIPTIONS OR CHANGE OF ADDRESS, CONTACT: NIRI–IR Update, 8020 Towers Crescent Drive, Suite 250, Vienna, VA 22182, Phone: (703) 506-3570, FAX: (703) 506-3571, e-mail: showard@niri.org

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PLEASE SEND QUERIES OR SUBMISSIONS TO:
Laura Bernstein, Editor
Phone: (540) 955-3696, e-mail: irupdate@niri.org

ADVERTISING AND REPRINTS:
Melissa S. Jones, Production Manager, NIRI, 8020 Towers Crescent Drive, Suite 250, Vienna, VA 22182. Phone: (703) 404-2065, FAX: (703) 404-2066, e-mail: missy3578@aol.com

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The Other Shoe Has Dropped: FASB & Options

Sarbanes-Oxley legislation stopped just short of mandating the expensing of stock options, but it did strengthen the role of the Financial Accounting Standards Board. (Now, only FASB and the SEC can establish accounting rules.) FASB is at work on a stock options project that the board hopes will lead to "convergence" with International Accounting Standards Board standards.

Patricia McConnell, accounting and tax research director at Bear Stearns, said the FASB review and rule-making project will lead to mandatory expensing of employee stock options under the fair value method. New rules could go into effect as early as 2004.

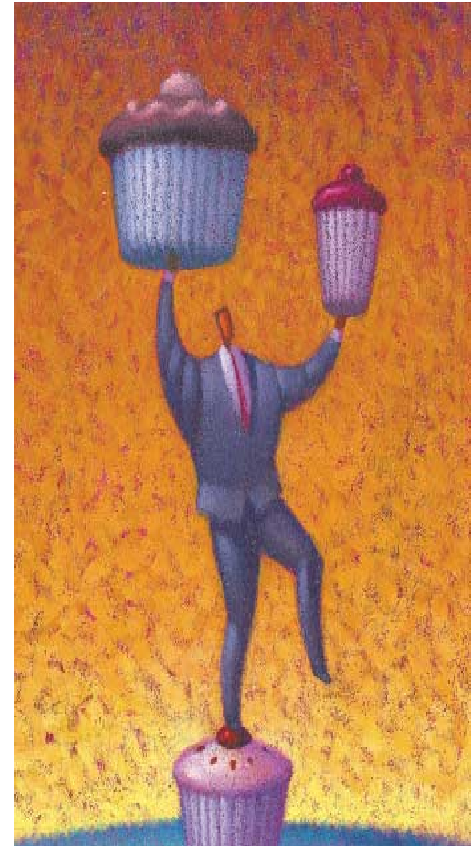
Also, FASB has another project designed to enhance disclosure on benefit pension plans. McConnell advised that companies are likely to be disclosing more details on funding and the expected rate of return on plan assets, and may be required to issue quarterly disclosures.

Separately, the IASB is working on IAS 19, a proposed pension fund accounting rule; the combination of the IASB initiative and investor unrest about pension concerns could move FASB along on pension accounting issues. ***More convergence.*** FASB's next step could be opening a review project on accounting for employee benefits in 2004.

The potential impact of options expensing? David Zion, Credit Suisse First Boston's equity researcher for accounting and taxation, believes that if fair value accounting of employee stock options had been required in 2001, earnings for the S&P 500 would have dropped by about 21% that year. Earnings would have been cut more than half for 31 companies, and another 13 would have seen earnings disappear altogether.

White Heat: Focus on CEO Compensation

If there is one perennial issue in shareholder-issuer relations that is sure to inflame passions on both sides, it is CEO compensation. Each published story about CEO comp triggers debate. For example, John Snow, former CEO of CSX Corporation, is assured $2.47 million per year for life in retirement benefits from the company. In his new job as Secretary of the Treasury, Snow is responsible for overseeing the Bush administration's proposed plan to allow companies to switch from traditional, fixed-benefit retirement plans to "cash-balance" pension plans. This could save employers millions annually. It could also, according to the Government Accounting Office, cause pension benefits to drop by half for older retirees. And this issue will likely pit senior management against their rank and file and retiree corps — becoming a



second perennial compensation-related issue for CEOs and boards to wrestle with.

With the 1990s stock market boom fading into memory, shareholders are again focusing on CEO compensation. Issues include cash payments, options and retirement packages. At General Electric's recent annual meeting, shareholders almost passed (39%) a proposal to require shareholder approval for severance agreements that exceed 2.99 times the executive's base pay plus bonus, in the wake of revelations about former Chairman Jack Welch's severance package.

Fortune magazine featured the head of a pig — "OINK" — with the headline, "CEO Pay Is Still Out of Control" on a recent cover. The feature story by Jerry Useem focused on CEOs who "didn't suffer" along with the rest of us, receiving generous comp packages

as the performance of their company lagged. The magazine also focused on CEO pensions ("Wait till you see what they get when they retire!").

The senior-level compensation issue (including goodbye retirement packages) is one that bears close watching by IROs, because the details are usually filtered through stories written by reporters who are paid at levels closer to clergy than CEOs. There is little receptivity for explanations as to why the comp packages must be competitive to attract top performers. And the "greed" either portrayed or implied in the coverage creates generally negative perceptions of the company involved. All this can complicate the IRO's mission to "tell a good story" about his or her organization!

The issues of CEO compensation and stock option plans — especially for senior executives — are closely aligned. Rep. David Dreier (R-CA) has said he doesn't like mandatory expensing of options, believing it will do nothing for rank-and-file employees. In Dreier's opinion, mandated expensing would lead to fewer stock-based plans, but corporate executives would still get their options. And expensing options would take a "big bite" out of corporate earnings, with the potential to further depress the market. Dreier is chair of the powerful House Rules Committee, which could have a say in shaping the final rule.

— Hank Boerner