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# AN ANALYSIS AND COMPARISON OF BANKERS' PERCEPTIONS OF STOCK OPTIONS IN 1999 AND 2005

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## ABSTRACT

*Research to date on accounting for stock options has focused the analysis on a single group of corporate stakeholders, stockholders. This paper reports the results of a survey administered to another group of stakeholders, creditors. Commercial bankers were surveyed regarding the accounting treatment for stock options and the perceived impact of stock options on financial statements, firm valuation, and the loan decision. A unique aspect of our study is that we surveyed bankers during two distinct periods. We first surveyed bankers in 1999, well after the debate surrounding SFAS 123 (FASB, 1995), but before the resurgence of the debate leading up to SFAS 123(R) (FASB, 2004). We surveyed again in 2005, as companies were implementing SFAS 123(R). This allows us to comment on the impact of public debate preceding the rule revision on the perceptions of a group of well-informed financial statement users.*

*We find bankers in both periods view stock options as compensation. The method of accounting does not matter if relevant information is disclosed. More experienced loan officers from 1999, and those who deal with stock options frequently from 2005, are less negative than others about the impact of stock options on shareholder interest in company assets.*

## INTRODUCTION

Twenty years ago employee stock options accounted for approximately 7% of total shares outstanding; today this percentage is nearly double, and in high-tech industries option grants typically constitute a quarter of shares outstanding. Further, in 1982, *Directors & Board* conducted a roundtable of 20 top executives on whether a chief executive was worth \$1 million in annual compensation (only a few CEOs had broken the barrier). Two decades later, the vast majority of chief executives receive at least \$1 million, with some receiving much more. During the 1990's, the combination of generous options grants and a raging bull market created huge paydays for the nation's executives (Rock, 1998).

Most research to date on accounting for stock options has been capital markets-based. There are no research results focusing on other stakeholders' perceptions of the information content of GAAP disclosures. The objective of this paper is to report the results of a survey designed to elicit responses from commercial bankers regarding the accounting treatment for stock options and the perceived impact of stock options on the financial statements and firm valuation.

A unique aspect of our study is that we conducted the survey during two distinct time periods. The first survey was conducted in 1999, well after the debate surrounding SFAS 123 (FASB, 1995), but before the resurgence of the debate leading up to SFAS 123(R) (FASB, 2004). Our second survey was conducted in 2005, as companies were implementing SFAS 123(R). Survey participants in both groups are remarkably similar as to their years of lending experience, familiarity with employee stock options and the frequency in which they review financial statements of companies that issue stock options. This allows us to comment on the potential impact of the public debate leading to the rule revision on the perceptions of a group of reasonably well-informed financial statement users. We also employ two scenarios, one of a publicly traded company and one of a privately held company, in both surveys.

We find bankers in both periods believe that stock option distributions represent compensation to the recipients, in both scenarios, although fewer respondents believe that the stock options of a private company represent compensation. Participants in both surveys also report that the method of accounting does not matter if relevant information is disclosed. Overall, survey participants respond that shareholders' interest in the company's assets has decreased as a result of the distribution of stock options. More experienced loan officers from 1999, and those who deal with stock options frequently from 2005, are less negative than others about the impact of stock options on shareholder interest in company assets.

The paper is organized as follows. The second section presents the accounting rules for stock options. In the third section, prior research on the information content of stock options is presented. The research methodology is presented in the fourth section, followed by the results in the fifth section. Finally, the conclusions are provided.

## **ACCOUNTING RULES FOR STOCK OPTIONS**

Before the issuance of SFAS No. 123, APB Opinion No. 25 dictated that the accounting for stock options use the intrinsic-value method. Under this method, value is measured as the difference between the stock price and the exercise price on the date of the grant. Hence, compensation expense is the excess of the market price of the stock over the option price on the measurement date. The measurement date is the date both the number of shares to be issued and the option price are known to the firm. This is normally the grant date (these types of plans are known as fixed stock options). If the option price equals or exceeds the market price on the measurement date, no compensation expense results. Frequently, the option's exercise price is set equal to the current

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stock price, so the options are deemed to have a zero value, and no compensation expense is recorded (Williams, 1995).

Between 1985 and 1988, the FASB conducted research into the applicability of various stock option pricing models for employee stock option plans. However, in 1988, the FASB tabled the stock options project. In early 1991, the business press created a public controversy over excessive executive compensation. Senator Carl Levin introduced a bill calling for the SEC to require corporations to reduce their earnings by the estimated present value of all stock options granted to its executives. In response to public interest in executive compensation, the FASB, in 1992, voted to revive the stock option accounting project (Fraser, et al. 1998).

In 1993, the FASB issued an Exposure Draft, "Accounting for Stock-Based Compensation." The exposure draft proposed new requirements for measuring and reporting expenses related to employee stock option plans. The exposure draft required firms to determine compensation expense based on the fair value of the stock option plan at the date of grant. The impetus for the FASB's need to change the way in which stock options were accounted for was best expressed by FASB Vice-Chairman James J. Leisenring in hearings before the Senate Banking, Housing, and Urban Affairs Subcommittee on Securities. Leisenring told subcommittee members that, under APB No. 25, transactions with substantially the same economic effects often received drastically different accounting treatments. He said that a change in the way in which stock options are accounted for was necessary because existing standards were biased and lacked credibility. Thus, the exposure draft was designed to require companies to account for stock options in the same manner (Rouse and Barton, 1993).

The FASB experienced tremendous opposition from politicians, businesses and CPAs to the exposure draft because companies no longer could give important executive officers compensation without recording an expense. The greatest opposition to the standard focused on such issues as (1) its negative impact on net income, (2) the fact that net equity would be unaffected, (3) dilution already is reflected in earnings per share, (4) the costs of implementing the standard are greater than the benefits (Rouse and Barton, 1993), (5) the standard may impose competitive disadvantages on some firms (especially high technology and start up firms), (6) the inability of firms to measure the compensation well enough to include it as an expense in the income statement, and (7) new motives may emerge for executives to make sub-optimal decisions based on accounting rather than economic consideration (Fraser, et al. 1998).

Leisenring argued that with the exception of fixed employee stock options, all transactions in which equity instruments are issued are recognized in the financial statements. Moreover, all other forms of compensation, including salaries, pensions, restricted stock, and health care benefits are measured and recognized as costs in financial statements. Thus, the proposed standard would level the playing field. The FASB disputed the measurement argument on the grounds that companies already used several measurements in accounting that were much more difficult than the one called for in the accounting for stock options (Rouse and Barton, 1993).

In spite of the above arguments made by the FASB in support of its proposed accounting for stock options, it could not convince opponents to support the notion of requiring expense recognition. Thus, in mid-1994 the FASB announced it would not require 1994 financial statements to show a valuation for options granted that year. Further, on October 23, 1995, the FASB issued SFAS No.123, *Accounting for Stock-Based Compensation*. The standard encouraged firms to recognize the estimated cost of employee stock options as a charge to earnings but allowed the alternative of disclosing the estimated cost in the footnotes and leaving the expense off the income statement.

In 2002, following several major accounting scandals, many companies began to voluntarily switch from the intrinsic value method to the fair value method. In response to the concern of many companies of the “ramp up” effect of the transition method stipulated in SFAS 123, the FASB issued SFAS 148 *Accounting for Stock-Based Compensation – Transition and Disclosure*. Within the statement, the FASB allowed additional transition methods and attempted to make the presentation and disclosure of stock options more comparable across firms. At this point, however, the fair value method was “preferred,” but not required.

In 2003, members of Congress developed the Stock Option Accounting Reform Act. It was a direct challenge to FASB and an attempt to mandate how companies should account for share-based compensation. In the midst of the debate over this act, the FASB issued Statement no. 123(R) in December, 2004. SFAS 123(R) eliminated the intrinsic value method with pro-forma data in a footnote as an acceptable disclosure method. While the standard did not address several controversial topics, such as acceptable valuation models, it required all companies to follow the fair value method and accrue compensation expense at the issue date of the options (Eaton and Prusyk, 2005). Our second survey was sent out shortly after the issuance of SFAS 123(R).

### **PRIOR RESEARCH**

Dechow, et al., (1996) employed three research approaches to evaluate the nature and extent of the predicted economic consequences of accounting for stock-based compensation. First, they examined the attributes of firms lobbying against the 1993 exposure draft. Second, they examined the attributes of firms using employee stock options under the original financial reporting rules. Third, they examined stock price reactions to announcements concerning SFAS No. 123. They found that, controlling for size and industry, top executives of firms submitting comment letters opposing mandatory expensing receive a greater proportion of their compensation from options, receive higher levels of total compensation, and are at firms that use options relatively more intensively for top-executive compensation than for other employees. Further, they found no systematic support for the assertions that expensing stock options would increase firms’ costs of capital, and no evidence was found that investors reacted to news concerning expensing of stock

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options. That is, the stock market did not act as if expensing stock options would have negative economic consequences for high-growth firms making extensive use of employee stock options.

Aboody (1996) also reported that the FASB's method for recognizing compensation expense would not increase (and may even reduce) the informativeness of reported earnings. On the other hand, Fraser et al (1998) reported results inconsistent with Dechow, et al. (1996) when they found that the shareholder returns for large, well-established firms fell when the FASB stock option proposal was announced and recovered when the proposal was withdrawn. However, returns of small start-up firms and firms that offer employer options to non-executives were unaffected by the announcements. Botosan and Plumlee (2001) found that the compensation expense, if reported under the fair value method, would have a material impact on manager performance measures. They also predicted that stock option expense would increase over the next several years. Balsam, O'Keefe and Weidemer (2007) found that corporations were reducing their use of stock options in favor of alternative forms of compensation because of manager's concerns that the reporting requirements under SFAS 123(R) would adversely affect stock price and hinder raising capital.

To date, the impact of stock option accounting and the associated public debate has focused on implications to investors. A fundamental objective of accounting information, however, is to provide information useful to investors *and* creditors (SFAC No. 1, 1978). Accounting research studies on bankers' perceptions have been limited. For the most part they have focused on such issues as new audit reports (Geiger 1994), accountant involvement in forecasts (Strawser 1994), the effect of recognition versus disclosure of unfunded postretirement benefits on lenders' perceptions of debt (Harper, et al. 1991), the impact of pension disclosure rules on perceptions of debt (Harper, et al. 1987) and non-GAAP financial statements (Baker 1990).

## **RESEARCH METHODOLOGY**

We study the perceptions of bankers to borrowers who issue stock options. Specifically, we are concerned with how bankers interpret the impact of stock options on the client and on their loan decision. We are also concerned with bankers' views of the importance of the disclosure method, as that has been a major part of the public debate on the accounting for stock options. Executive level loan officers make an excellent pool from which to draw our sample, as they see financial statements from several different types of companies and they are reasonably sophisticated financial statement users.

Data were collected from executive level loan officers using a scenario involving a company issuing a series of options where the exercise price is equal to the market value of the stock on the date of grant. The first data set was collected in 1999; the second data set was collected in 2005, following the passage of SFAS 123(R). These samples allow us to examine not only bankers' perceptions of stock options, but also how perceptions toward stock options were influenced by the public debate surrounding stock options and the subsequent issuance of SFAS 123(R).

Subjects were told of the acceptable disclosure methods in effect at the time of the survey. For the 1999 survey, this was based SFAS 123; for the 2005 survey, this was based on SFAS 123(R). They were also told the major differences between the fair value method and the intrinsic method of reporting. We explained that under the intrinsic value method, the company must still include a footnote disclosure of pro-forma net income and earnings per share data as if the fair value had been used.

We then asked the participant's perceptions of the following.

- (Q1) Has the company provided compensation through the distributions?
- (Q2) Have the shareholders' interests in the net assets of the company changed due to the distributions?
- (Q3) What is the effect of the distributions on the company value?
- (Q4) What is the importance of the stock option distributions on making bank lending decisions or evaluating compliance with loan covenants with respect to the company?
- (Q5) Does the method of accounting for stock options matter if all relevant information is disclosed in the footnotes?

The subjects were asked to answer the questions above assuming that a) the company is publicly traded and b) the company is privately held and is expected to eventually be taken public. Demographic questions were asked regarding:

- (D1) years of lending experience,
- (D2) familiarity with employee stock options,
- (D3) frequency in which a review is made of companies with employee stock option plans,

The participants for the 1999 sample were randomly selected from the population of loan officers included in *The Thompson/Polk Bank Directory* (also known as "The Bankers' Blue Book"). Every bank chartered in the US has an individual listing in the directory. In order for a subject to be included in the sample, the commercial lending officer must be employed by a US bank, and the bank must not be a branch bank. Holding companies and trust companies were also excluded. The

population after these deletions consisted of 8,843 chartered commercial banks. In 2005, participants were randomly selected from a list of 7,608 active commercial banks chartered in the US which we downloaded from FDIC website (<http://www2.fdic.gov/idasp/main.asp>). The 2005 list also excluded holding companies and trust companies.

An original mailing and two follow-up mailings were sent to each of the subjects. In order to determine whether response bias was potentially problematic, respondents were separated into early, middle and late categories in accordance with the three mailing dates. Analysis of demographics indicated no material differences across the three categories of respondents.

Table 1 reports data on the survey responses. After eliminating bad addresses, we had a net sample of 379 bankers in 1999 and 391 bankers in 2005. We gave the bankers the option of not participating in the survey, but requested information from them as to why. Approximately half of the 75 non-participants from the 1999 sample and approximately two-thirds of the non-participants in the 2005 sample stated that they were not familiar with stock options. This may have been the result of the nature of the borrowers in the bankers' portfolios. This also allowed us to collect information from only those bankers who believed they were familiar with the nature and purpose of stock options. Thus, the participants in the survey believe they are adequately informed concerning the impact executive stock options may have on one of their borrowers.

We feel we have a reasonable response rate and participation rate for our analysis. The survey response rate (total responses/the net sample) is 31 percent for the 1999 survey and 35 percent for the 2005 survey. Further, a little over one-third of the respondents believed they possessed the technical knowledge necessary to determine how the issuance of executive stock options affects their borrowers, how important that effect is to the loan decision, and how important is the method of disclosure. We had a participation rate (participant responses/total responses) of 36 percent in 1999 and 39 percent in 2005.

	1999	2005
Original sample	400	400
Undeliverable addresses	21	9
Net sample	379	391
Reasons given for Non-participation:		
Bank policy	7	15
No corporate accounts	0	1
Not familiar with stock options	36	54
No reason given	22	0
Other reasons	10	13

	1999	2005
Total non-participant responses	75	83
Participant responses	43	52
Total responses	118	135
Survey response rate		
(total responses/net sample)	31%	35%
Survey participation rate		
(participant responses/total responses)	36%	39%

Table 2 contains the demographics of the two samples. The most experienced respondent from each sample had 38 years of lending experience (D1); the least experienced in the 1999 sample had one year of experience, while the least experienced in the 2005 sample had 2 years of experience. The median years of experience from the 1999 sample is 15 years, and the median years of experience for the 2005 sample is 20 years. Thus, the respondents are fairly experienced loan officers, with the 2005 sample consisting of slightly more experienced subject than are in the 1999 sample. Most respondents consider themselves somewhat familiar with stock options (D2). The median self-assessment score is 3 on a scale of 10 for each sample (with 10 being highly familiar), however, as a group, the lenders do not view themselves as experts on the subject (the third quartile is 4 and the maximum self-assessment is 6 for both samples). This may be explained by the fact that many of the subjects do not frequently review the financial statements of companies with employee stock options (D3). The median score on a 10-point scale (10 being very frequently) is 3 for the 1999 sample and 2 for the 2005 sample. However, the maximum rating for both samples is 10, indicating that some bankers frequently deal with borrowers that issue stock options.

Panel A: 1999 Data							
Variable Name	Max	Q3	Med	Q1	Min	N	SD
D1 Years of lending experience	38	20	15	10	1	42	9.1560
D2 Familiarity with employee stock options (0 = no familiarity; 10 = highly familiar)	6	4	3	2	0	43	1.6971
D3 Frequency in which financial statements with employee stock options are reviewed (0 = rarely; 10 = very frequently)	10	4	3	1	0	43	2.4382



Panel B: 2005 Data							
Variable Name	Max	Q3	Med	Q1	Min	N	SD
D1 Years of lending experience	38	25	20	10	2	54	9.1090
D2 Familiarity with employee stock options (0 = no familiarity; 10 = highly familiar)	6	4	3	2	0	53	1.5400
D3 Frequency in which financial statements with employee stock options are reviewed (0 = rarely; 10 = very frequently)	10	3	2	1	0	54	2.3506

From table 2, we can safely state that there are no major differences between the subjects of the 1999 study and the subjects of the 2005 study in the three demographic characteristics evaluated. This is important because our subsequent analysis discusses how the debate leading up to the issuance of SFAS 123(R) may have influenced bankers' perceptions of stock options. While many of the subjects did not view themselves as being highly familiar with stock options, as bankers they clearly meet the description of reasonably sophisticated financial statement users. Consequently, their perceptions of the impact and reporting of stock options is of value to standard-setters.

## RESULTS

Table 3 provides descriptive-level data on the responses of the 1999 and 2005 survey participants to both scenarios: a publicly traded company (panel A), and a privately held company (panel B).

Table 3: Descriptive Statistics								
Panel A: Responses for Publicly Traded Company								
Question	Year	Max	Q3	Med	Q1	Min	N	SD
Q1 Has the Company provided compensation through stock option distribution (Yes=1 No=-1)	1999	1	1	1	-1	-1	3	0.8830
	2005	1	1	1	1	-1	50	0.7010
Q2 Has the shareholders' interest in the assets of the Company changed as a result of the distribution of the stock options (Increase = 1 No change = 0 Decrease = -1)	1999	1	0	-1	-1	-1	43	0.7336
	2005	1	0	-1	-1	-1	53	0.6968

Table 3: Descriptive Statistics								
Q3. What is the effect of the stock distributions on Company value (Highly unfavorable = -7 Highly favorable =7)	1999	5	1	0	-1	-5	43	2.4036
	2005	7	3	0	-2	-5	54	2.8927
Q4. How important would the stock option distributions be in making lending decisions or evaluating compliance with loan covenants (Very unimportant = 0 Very important = 12)	1999	12	9	6	3	0	43	3.6184
	2005	11	8	5	2	0	54	3.4935
Q5. Does the method of accounting for stock options matter when all relevant information is disclosed in footnotes (Yes = 1 No = -1)	1999	1	1	-1	-1	-1	43	0.9983
	2005	1	1	-1	-1	-1	51	0.9653
Panel B Responses for Privately Held Company								
Question	Year	Max	Q3	Med	Q1	Min	N	SD
Q1 Has the Company provided compensation through stock option distribution (Yes=1 No=-1)	1999	1	1	1	-1	-1	42	1.0017
	2005	1	1	1	0	-1	49	0.9476
Q2 Has the shareholders' interest in the assets of the Company changed as a result of the distribution of the stock options (Increase = 1 No change = 0 Decrease = -1)	1999	1	0	0	-1	-1	42	0.6922
	2005	1	0	-1	-1	-1	50	0.6776
Q3. What is the effect of the stock distributions on Company value (Highly unfavorable = -7 Highly favorable =7)	1999	5	0	0	0	-3	42	1.8106
	2005	9	2	0	-1	-5	51	2.7282
Q4. How important would the stock option distributions be in making lending decisions or evaluating compliance with loan covenants (Very unimportant = 0 Very important = 12)	1999	12	9	7	3	0	42	3.6308
	2005	12	8	5	2	0	50	3.2950
Q5. Does the method of accounting for stock options matter when all relevant information is disclosed in footnotes (Yes = 1 No = -1)	1999	1	1	-1	-1	-1	43	0.9213
	2005	1	1	-1	-1	-1	48	0.9528

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Panel A shows that for a publicly traded company, on average, commercial loan officers from both samples believe that compensation is being provided through the distribution of stock options (Q1) and that its distribution has caused shareholders' interest in the assets of the company to decrease (Q2). On the other hand, respondents indicate that the distribution of the stock options has no impact on company value (Q3), on average.

The score for this question (Q3, regarding the impact on company value) for the third quartile of respondents, especially in 2005, indicates that a portion of the sample feel that the distribution of stock options has a positive impact on company value. It is possible that this group of respondents is thinking of the incentive effects on the employees receiving the stock options, or perhaps they feel that the company has been able to reduce cash outflows for compensation by substituting stock options, thus increasing company value.

Panel B shows that loan officers respond similarly to these questions when the scenario involves a privately held company. In both Panel A and B, there appears to be a more diverse range of opinion regarding the impact of stock options on company value (Q3) among the 2005 sample than in 1999.

The loan officers from both samples in both scenarios report that stock option distributions are of some importance in making bank lending decisions or in the evaluation of loan covenants compliance (Q4). (An alternative interpretation is that six represents the point of neutrality on a 12 point scale. No intermediate value labels were provided to participants, only the end-points of very unimportant = 0 and very important = 12.) Finally, they are of the opinion that the method of accounting for stock options does not matter if all relevant information is disclosed (Q5).

Table 4, panels A1 and B1, contain the correlations between the demographic variables and the 1999 sample of bankers' responses to questions for a publicly traded and privately held company, respectively. There is a significant negative relationship between lending experience (D1) and the commercial bankers' responses to questions regarding the impact of the stock option distributions on shareholders' interest in net assets (Q2) for both scenarios. There is also a significant negative relationship between experience and the response on company value (Q3) for publicly traded companies. Thus, the more experienced loan officers in the 1999 sample tend to find that the impact of stock options on shareholders' interest in net assets and on company value is negative to a greater extent than do less experienced loan officers.

There is also a significant negative relationship between the frequency with which bankers review the financial statements of companies with employee stock options (D3) and the importance they place on stock option distributions in making bank lending decisions or evaluating compliance with loan covenants (Q4) under the privately held company scenario in panel B1. This indicates that the more frequently a banker reviews the financial statements of companies with employee stock options, the less importance is attached to them in terms of making a loan decision or evaluating loan compliance.

The correlations between the demographic variables and the questions for the 2005 sample of bankers, shown in panels A2 and B2 of Table 4, are quite different than those from the 1999 sample. The loan officers' experience (D1) is no longer a factor in their evaluation of the impact of stock option distributions on shareholder interest (Q2) or company value (Q3), for either scenario. This may indicate that the high level of publicity and controversy surrounding stock options in the intervening years may have "leveled the playing field" between more- and less-experienced loan officers. For the privately held company scenario only, panel B2, more experience (D1) correlates significantly with the loan officers attaching less importance to a stock option distribution when making the lending decision (Q4), while a less-experienced loan officer would attach more importance to stock option distribution.

We also find, in Panel A2 of Table 4, that frequency (D3) is positively correlated with the impact of option distributions on the shareholders' interest in assets (Q2). Recall from Table 3 that the average response among all loan officers was that stock option distribution decreases the shareholders' interests in the assets of the scenario company. We therefore interpret this correlation in Table 4 to indicate that increased frequency of dealing with companies that issue stock options is related to a less-negative view of the impact of option distributions on the shareholders' interest in assets.

The last correlation of note in Table 4 is between the experience of the loan officer (D1) and the importance of stock distribution in making lending decisions or evaluating compliance with loan covenants (Q4) in the privately held company scenario. We find that more experienced loan officers place significantly less importance on stock option distributions than the overall average when making such decisions or evaluations.

<b>Table 4: Correlation between Demographic Variables and Questions*</b>				
Question/Demographic Variable		D1	D2	D3
		Experience	Familiarity	Frequency
<b>Panel A.1: Publicly Traded Company in 1999</b>				
Q1	Compensation	0.0878	0.0901	-0.1155
		(0.58)	(0.57)	(0.46)
Q2	Shareholder interest	-0.5150	0.0001	0.1335
		(0.00)	(0.99)	(0.39)
Q3	Company value	-0.3243	0.0521	0.2157
		(0.04)	(0.74)	(0.16)
Q4	Importance	-0.1464	-0.1201	-0.1318
		(0.36)	(0.44)	(0.40)
Q5	Accounting method	0.2339	0.1730	-0.0096
		(0.14)	(0.27)	(0.95)

<b>Table 4: Correlation between Demographic Variables and Questions*</b>				
Question/Demographic Variable		D1	D2	D3
		Experience	Familiarity	Frequency
<b>Panel A.2: Publicly Traded Company in 2005</b>				
Q1	Compensation	0.0401	-0.1703	0.0388
		(0.78)	(0.24)	(0.79)
Q2	Shareholder interest	0.0188	0.1671	0.2833
		(0.89)	(0.24)	(0.04)
Q3	Company value	0.0357	0.2258	0.0980
		(0.80)	(0.11)	(0.49)
Q4	Importance	-0.2392	-0.1969	-0.0992
		(0.08)	(0.16)	(0.48)
Q5	Accounting method	-0.0696	0.0244	0.0901
		(0.63)	(0.87)	(0.53)
<b>Panel B.1: Privately Held Company in 1999</b>				
Q1	Compensation	0.1881	-0.1155	-0.2218
		(0.24)	(0.47)	(0.16)
Q2	Shareholder interest	-0.3066	0.1032	0.2609
		(0.05)	(0.52)	(0.10)
Q3	Company value	-0.2198	-0.0017	0.1993
		(0.17)	(0.99)	(0.21)
Q4	Importance	-0.2508	-0.0759	-0.2986
		(0.11)	(0.63)	(0.05)
Q5	Accounting method	0.2211	0.1088	-0.0759
		(0.17)	(0.50)	(0.64)
<b>Panel B.2: Privately Held Company in 2005</b>				
Q1	Compensation	-0.0973	-0.2009	0.1025
		(0.51)	(0.17)	(0.48)
Q2	Shareholder interest	0.1223	0.0429	-0.0648
		(0.40)	(0.77)	(0.66)
Q3	Company value	0.003	0.0184	0.0161
		(0.98)	(0.90)	(0.91)
Q4	Importance	-0.3452	-0.1811	-0.0357
		(0.01)	(0.21)	(0.81)
Q5	Accounting method	-0.1247	0.0220	0.0492
		(0.40)	(0.88)	(0.74)
*Spearman correlation coefficients are presented (with p-values in parentheses)				

Table 5 contains the paired test of mean responses to the questions for public versus private companies. The results of the 1999 sample of bankers indicate that there is no significant difference between the mean responses for a publicly traded company and a privately held company except for two cases. The loan officers respond more positively to the question of whether stock options represent compensation (Q1) for publicly traded companies than for privately held companies. Also, although overall they respond negatively to the question of whether the method of accounting matters (Q5), they are less negative for publicly traded companies. In other words, the method of accounting matters more for publicly traded companies.

<b>Table 5: Paired Test of Means (Public – Private)</b>				
<b>1999 Survey</b>				
Variable	Mean	Standard Error	t-statistic	p-value
Q1 Compensation	0.19048	0.0702	2.71	0.01
Q2 Shareholder interest	-0.0952	0.0747	-1.27	0.21
Q3 Company value	-0.1667	0.3372	-0.49	0.62
Q4 Importance	-0.0952	0.4115	-0.23	0.82
Q5 Accounting method	0.0976	0.0469	2.08	0.04
<b>2005 Survey</b>				
Variable	Mean	Standard Error	t-statistic	p-value
Q1 Compensation	0.33333	0.10870	3.07	0.00
Q2 Shareholder interest	-0.06000	0.07230	-0.83	0.41
Q3 Company value	-0.07843	0.32160	-0.24	0.81
Q4 Importance	-0.08000	0.34030	-0.24	0.82
Q5 Accounting method	0.00000	0.05950	0.01	0.99

A plausible reason as to why bankers respond differently to Q1 and Q5 across the two scenarios is that while all stock options represent only potential value which is realized on sale or exercise, stock options for privately held companies are also conditioned on the company actually becoming publicly traded at some point in the future. It is possible that the 1999 sample of loan officers are more interested in the method of accounting for stock options in the publicly traded company scenario because they find stock options for privately held companies to be too speculative and conditional on future events to be valued as compensation.

The 2005 sample of bankers respond differently to the publicly traded and privately held scenarios only for Q1, whether stock options represent compensation. Significantly more participants report that stock option distributions represent compensation in the publicly-held company scenario than for a privately held company. We see no difference across scenarios for the

importance of accounting methods (Q5) in the 2005 sample, unlike the responses from the 1999 sample.

We compare the average responses of the 1999 participants to those from 2005 in Table 6. There are no significant differences between the means from the two samples in a pooled test assuming equal variances in the two groups. We find similar results when we assume unequal variances. The question on which the difference between the two samples most closely approaches significance is whether the distribution of stock options represents compensation (Q1), where it appears possible that participants in 2005 would have answered slightly more positively that stock options represent compensation than participants in 1999 if we had a larger sample and thus, more power to find a significant difference. However, for our sample, the effect is either too slight to overcome the limitations in power due to sample size, or there is simply no statistical difference.

Variable	Pooled t-statistic	p-value	Satterthwaite t-statistic	p-value
Q1 Compensation	1.41	(0.16)	1.39	(0.17)
Q2 Shareholder interest	-0.46	(0.65)	-0.46	(0.65)
Q3 Company value	0.37	(0.71)	0.38	(0.71)
Q4 Importance	-1.24	(0.22)	-1.23	(0.22)
Q5 Accounting method	-0.65	(0.52)	-0.65	(0.52)

\*2005 responses – 1999 responses

We think it worth noting that despite the substantial controversy surrounding stock options in both the public media and within accounting regulatory bodies during the years from 1999 to 2005, and the major revisions of accounting standards during that time, one group of financial statement users, loan officers, experienced very little change of opinion regarding the impact of stock options on the companies they evaluate.

## CONCLUSION

We examine bankers' perceptions of stock options. On average, for a publicly traded company, the results indicate that commercial loan officers believe that stock options are compensation to those who receive them. They are paid for by shareholders via a reduction in their interest in company net assets. Further, the granting of stock options does not translate into a change

in company value, which implies that the compensation represented by the stock options is for past performance and is reflected in the company's value.

Respondents from both samples feel that the accounting method for stock options does not matter if all relevant information is disclosed in the footnotes. Perhaps there are several reasons why they feel this way. First, with adequate disclosure, bankers are provided with information necessary to determine the cash flow effect(s) of stock options. Second, given that disclosures in the footnotes should adequately present all pertinent information regarding the stock options, financial statement users can make their own determination of the impact of the stock options on their decision variables. On the other hand, those who are of the opinion that the method of accounting does matter are probably concerned with such issues as consistency across all firms in terms of determining compensation costs, and in the case of comparing companies, subjective and difficult recalculations of earnings and company performance.

With respect to the privately held company, although respondents from both years, overall, feel that compensation is being provided through the distribution of stock options, this belief is significantly weaker than in the publicly traded company scenario. This response can be interpreted as acknowledgement that a private company must go public before the stock options have value; an event which may or may not happen. According to both sets of participants, stock option distributions have no impact on the shareholders' interest in the assets of the company or company value; however, the bankers surveyed in 2005 feel that stock options, even for a privately-held company, are paid for by shareholders. Bankers feel that the accounting method employed to account for stock options for a privately held company does not matter if all relevant information is disclosed.

For both publicly traded and privately held companies, our findings are consistent with Dechow, et al. and Aboody with regard to finding no support for the assertions that expensing stock options increases the cost of capital, because bankers feel that stock option distributions have no impact on company value. Further, there appears to be no reaction to expensing compensation, so long as all relevant information is disclosed.

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