3. Employee Stock Options

The problem: Employee stock options are a common tool used by companies to motivate their employees. Given that the 1993 SNA does not provide guideline to this issue, the question raised is whether stock options should be considered as compensation of employees and therefore as a cost to employers. Experts at the OECD meeting on national accounts in October 2002 arrived at the consensus to include employee stock options in compensation of employees. Further harmonisation with international business accounting standards is required.

AEG recommendation:

- Include all ESOs in compensation of employees (wages and salaries in kind), irrespective of whether they will be settled in new or re-purchased shares.
- Record ESOs in the accounts at vesting date or (as a practical alternative) spread across the grant to vesting date period.
- Value ESOs at market price, or using a suitable option pricing model.
- Record ESOs in the financial accounts as financial derivatives.

Statistics Finland’s comment:

Employee stock options were of great importance in Finland during 1999 – 2002. In 2000 income from ESOs measured at exercise date were 2% of wages and salaries of the whole economy.

In Finland income from ESOs have not been included in wages and salaries in national accounts. The main reason has been that our business accounting has not expensed ESOs and they have not been included in the business accounting data. Instead ESO incomes have been included in personal tax data which is the main source for wages and salaries of the whole economy. For national accounts and some other statistics ESOs have been removed from the data. In tax data ESOs are valued at exercise date at market value.

The AEG’s first recommendation is acceptable if bookkeeping standards will change and ESOs will be recognized as an expense. However, in national accounts it is very important that income from ESOs will be recorded as a separate sub-category of compensation of employees. Their nature compared to the normal types of compensations is totally different depending on share prices and not on wage negotiations or individual performance. Their nature is also different compared to normal wages and salaries in kind and employees often are free to choose at vesting date how to spend ESO (either to keep or sell it).

From the theoretical point of view ESOs should be recorded between grant date and vesting date in order to fulfil the accrual principle because work has been done during that time. As the report comments this will also decrease the volatility of ESO recording compared to recording at vesting date only. But otherwise than the AEG paper says, because the vesting time is normally several years, spreading is not very practical from the point of view of national accounts compilation: time series...
over the vesting period should be corrected afterwards when the correct market price is known at vesting date.

Using the pure vesting date recording often results very volatile figures. If ESOs are recorded separately this may help to explain and understand the volatility.

In financial accounts an unvested ESO is a contingent asset only and not the asset to be recorded in financial accounts.

Discussion with balance of payments expert is necessary because of cross-border ESOs.