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Methodology of the Financial Statement Recognition
of Stock Compensation Expense:
The Effect of the Enron and WorldCom Scandals

Statement of Financial Accounting Standards (SFAS) No. 123 offers a company two methods of recording stock compensation expense when an employee is offered the stock option: the intrinsic method and the fair value method. Use of the fair value method records stock compensation at the actual price it is sold. Most companies use the intrinsic method which allows companies to set the exercise price of stock equal to the market price, therefore creating no expense for stock compensation. Though the Financial Accounting Standards Board (FASB) has advised against using the intrinsic method in the past, Congress has allowed companies to continue using this method, and now looks to the FASB as a source of blame for wrongdoing since the Enron and WorldCom scandals. The purpose of this research was to determine how many companies have switched from the intrinsic value method to the fair value method since the scandals of Enron and WorldCom, and the material effects of stock compensation expense in financial statements. For this project, an extensive study of 2001 and 2002 financial statements of 42 companies who have announced their intent to switch methods was conducted. The study determined that stock compensation expense was immaterial for 74% of the 42 companies. Therefore, most of the companies have switched or plan to switch from the intrinsic method to the fair value method. The study exemplified one effect the Enron and WorldCom scandals had on accounting practices and illustrated the influence the government has on accounting standards.