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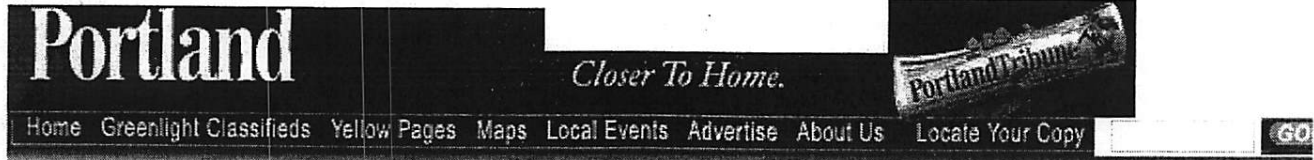

New rules might help stock market

Investment portfolios and the economy itself are now being consumed by a lack-of-confidence wildfire.

Surprisingly, most of these investment losses are concentrated in fewer than 10 companies, the biggest being Microsoft Corp. At its peak, Microsoft had a total market value of roughly $700 billion. Today, that value is $240 billion, representing a decline of roughly $460 billion.

The biggest holders of Microsoft stock are now federal and state public pension systems, including teachers, custodians, police and firefighters. That smoke you see is therefore not only your 401(k) but also the tax dollars you paid to fund these pensions.

Understanding Microsoft's dramatic impact — and from there the needed reforms in the financial market — is important to everyone.

I believe that the most important reform involves stock options. Stock options are an excellent free market-based tool, yet in some years more than 75 percent of all wages at Microsoft were paid to employees simply by printing up new stock and distributing it in lieu of paying cash wages.

The IRS does not care whether a company pays wages in stock or cash; both receive a full tax deduction. But much of the controversy swirling around Wall Street this summer is over how companies handle stock options. Because of a loophole, wages paid in stock are not required to be charged to a company's financial statement.

The Federal Reserve Bank similarly has excluded wages paid in stock from key inflation statistics — for example, the employment cost index. How would you like to be negotiating a raise with your employer when your boss is citing the ECI figures, and you know full well that this statistic is artificially low because of this anomaly?

If the government reports higher overall inflation that results from including stock option wages in the inflation statistics, the financial markets then will demand higher interest rates. Correspondingly, banks will charge more on loans and pay higher rates on deposits.

The good news is that higher rates paid for deposits might persuade more investors to focus on overall portfolio balance — including conservative, less risky alternatives — rather than rushing to speculative stocks, as occurred with Nasdaq in 1999. This also might encourage more companies to use caution when taking on debt — and thereby avoid the debacles created at MCI/Worldcom and Enron resulting from excessive bank debt.

Stock option wages should therefore be included in all key wage statistics to help guide the Federal Reserve Bank's inflation and interest-rate policies. Even Federal Reserve Board Chairman Alan Greenspan is now openly calling for the full expensing of stock options in addition to greater understanding of key accounting issues at the Federal Reserve Bank.

Regarding auditors, I agree with Norm Meonske, a distinguished Kent State University professor of accounting, who advocates that the Statement on Auditing Standards rule-setting authority be taken away from the American Institute of CPAs and be given to an independent, separately funded entity such as the Financial Accounting Standards Board.

It does not make sense to have an industry lobbying group such as the AICPA establishing rules on auditor independence, scope of service, ethics and peer reviews.

The once proud "Big Eight" accounting firms are now the "Final Four," and practical measures to stimulate meaningful competition must also be addressed. Parish & Co. advocates limiting any one firm to auditing no more than 10 percent of the companies identified in the Standard and Poor's 500 Index, thereby creating a "Big 10."

We can restore investor confidence, but first we must clean our free-market windows and generate more competition among large accounting firms. Only then will a valid scorecard that rewards genuine winners on the job and in the investment markets be possible.

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