

ISSUE BRIEF

Corporate Accountability

Hundreds of thousands of working families have lost jobs, pensions and health care coverage because of corporate malfeasance. Last year's corporate governance reforms closed some loopholes and added new penalties for corporate fraud, but Congress must take further action to restore faith in business and investor confidence in capital markets.

The Sarbanes-Oxley bill enacted last year addressed conflicts of interest, accounting firm oversight and executive fraud and wrongdoing. Congress needs to take the next step by requiring the expensing of stock options, enacting legislation to deter "corporate inversions" and boosting worker protections during a corporate bankruptcy.

Stock options as executive compensation have dangers. Massive stock option grants to corporate executives explain why CEO pay is now more than 400 times the pay of average employees, according to *Business Week*. These option packages create an irresistible temptation for executives to manipulate short-term stock prices—with disastrous results for all those who invest in capital markets. While these options are worth huge amounts on their grant date, company income statements treat them as if they do not exist, and companies get a tax deduction when the options are exercised. At Enron, for example, this led to \$600 million in tax deductions never recorded as a cost to the company. Accordingly, stock options are not appropriate compensation for senior officers and executives. At a minimum, Congress should require the expensing of stock options; when a company gives something of value to its employees in return for their services, it is clearly a compensation expense belonging in the earnings statement.

Tax laws now encourage corporate tax avoidance. As the U.S. Treasury Department has found, current tax incentives encourage companies to dodge their tax responsibility by re-incorporating in places like Bermuda, a practice known as "corporate inversion." U.S. law requires U.S. companies to pay corporate income tax on both their domestic and international income. Tax-haven countries like Bermuda, however, only require their domestic companies to pay tax on income earned within their borders. Congress should enact legislation to ensure that U.S. companies pay their fair share of U.S. taxes and protect the interests of workers, shareholders and other corporate stakeholders.

Workers must be protected in corporate bankruptcies. Last year's bankruptcies broke records. And bankrupt companies hid more debt, lost more market capital and put more workers on the streets without being paid the money they were owed than in any year in recent history. Individuals whose lives were ruined by the behavior of the company that employed them were left with little after the banks and other preferred creditors got their share. Without an advocate to fight for them or a law to guarantee their rights, workers generally receive only \$4,650, the statutory cap—no matter how much they are owed in wages, severance, vacation and even employer contributions owed to an employee benefit plan such as a pension or health plan. Congress should increase the statutory cap for compensation owed to employees of bankrupt companies, raise the priority in bankruptcy of 401(k) plan beneficiaries who are victims of employer stock fraud or pension fraud and allow for recovery of excessive compensation paid just before a company files for bankruptcy.

SEC resources are inadequate. The federal Securities and Exchange Commission (SEC) is the investor's advocate in the capital markets, charged with reviewing public companies' financial disclosures and investigating and prosecuting frauds such as those at Enron and WorldCom. SEC

resources are inadequate to meet the agency's responsibilities and to retain qualified personnel. Congress should authorize a substantial increase in SEC funding.