

Case 05-9

Spend More

On January 1, 20X1, Spend More (the Company) issued to certain employees 1,000,000 equity-settled stock option awards. The employees will vest in differing numbers of options depending on the cumulative amount of net income the Company earns over the succeeding four fiscal years following the date of grant, and their continued employment with the Company. The exercise price of the awards is \$31.50, which was the Company's closing share price on the NASDAQ National Market on the date of grant. The Company accounts for the share-based payment awards based on the provisions of ASC 718, *Compensation – Stock Compensation*. The fair value-based measure of each award, which was determined based on the Black-Scholes-Merton option pricing model was \$8 at the date of grant.

In order to align the employees' performance with the performance of the Company, the Board of Directors of the Company included the following provision in each of the awards:

Subject to Section 5.2(a) of the Spend More 20X1 Stock Option Plan, the employee will vest in the awards in various percentages (refer to vesting schedule below) based on the amount of cumulative net income earned by the Company in the succeeding four-year period:

<u>Performance Condition</u>	<u>Percent Vested</u>
Greater than \$15 million, up to \$20 million	25%
Greater than \$20 million, up to \$23 million	50%
Greater than \$23 million, up to \$27 million	75%
Greater than \$27 million	100%

Based on its most current financial forecasts, the Company believes it is probable it will earn cumulative net income greater than \$20 million, but not more than \$23 million in the succeeding four-year period. As a result, the Company will base its estimate of compensation cost on 50 percent of the awards vesting (assuming no forfeitures).

Required:

- Issue 1: *How much compensation cost would the Company have to record for the year ended December 31, 20X1, in accordance with the principles of ASC 718, Compensation – Stock Compensation?*

Additional Facts:

Assume the same facts in Issue 1 except that the Spend More 20X1 Stock Option Plan allowed employees to pay for the exercise of the stock options using the stock they will receive upon exercise of their awards, or by tendering options with an intrinsic value equal to the exercise price (net-share settlement).

- Issue 2: *How much compensation cost would the Company have to record for the year ended December 31, 20X1, in accordance with the principles of ASC 718, Compensation – Stock Compensation?*

Additional Facts:

Assume the same facts in Issue 1 except that the Spend More 20X1 Stock Option Plan permits settlement of the awards in cash instead of the Company's own shares. The Company has concluded, and its auditor has agreed, that the awards are liability awards since they will be settled in cash. The fair value-based measure of each liability award at December 31, 20X1, is \$12.

The awards essentially would meet the definition of a cash-settled stock appreciation right (SAR). SARs are awards enabling employees to receive cash, stock, or a combination of cash and stock, in an amount equivalent to any excess of the market value of a stated number of shares of the employer's stock over a stated price (i.e., exercise price). If the SAR is payable only in cash, or payable in cash at the election of the employee, accrued compensation should be recorded as a share-based liability. Since the value of the SAR is based on the market appreciation of the Company's stock, total compensation cost is unknown for a SAR until it is exercised.

Issue 3: *How much compensation cost would the Company have to record for the year ended December 31, 20X1, in accordance with the principles of ASC 718, Compensation – Stock Compensation?*