

## **Case 18-7c**

### **Fashion Inc.**

Fashion Inc. (“Fashion” or “the Company”), an SEC registrant, is a fashion retailer that sells men’s and women’s clothing and accessories. As an incentive to its employees, the Company established a compensation incentive plan in which a total of 100,000 options was granted on January 1, 20X0. On that date (the grant date), Fashion’s stock price was \$15 per share.

The significant terms of the incentive plan are as follows:

- The options have a \$15 “strike” or exercise price (the price the employee would pay to purchase a share of stock if the options vest).
- For the options to vest, the following must occur:
  - The employee must continue to provide service to the Company throughout the entire explicit service period of five years (i.e., a five-year “cliff-vesting” award).
  - The Company must achieve annual sales of at least \$20 million during the fifth year of the explicit service period.
  - The Company’s share price must increase by at least 25 percent over the five-year explicit service period.
- In addition, if the Company achieves sales of at least \$25 million during the fifth year of the explicit vesting period, the strike price of the options will decrease from \$15 to \$10.
- The options expire after 10 years following the grant date.
- The options are classified as equity awards.

#### **Additional Facts:**

- Assume it is probable at all times that 100 percent of the employees that receive the awards will continue to provide service to the Company as employees for the entire five-year explicit service period and that the five-year explicit service period is determined to be the requisite service period.
- On the grant date, Fashion’s management determined that it is probable that the Company’s sales in year 5 will be \$30 million, and therefore it is probable on the grant date that sales are greater than or equal to at least \$25 million.
- The grant-date fair value of the options assuming a strike price of \$15 is \$8 per option. The grant-date fair value assuming a strike price of \$10 per option is \$12 per option.