Chapter 19
Share-Based Compensation and Earnings Per Share
Part 1: Share-Based Compensation

Student Learning Outcomes

• Account for
  ▪ Stock award plans
  ▪ Stock options
  ▪ Employee share purchase plans
• Part 2 – Basic Earnings Per Share
• Part 3 – Diluted Earnings Per Share: Exercisable Securities
• Part 4 – Diluted Earnings Per Share: Convertible Securities

Goals

• Company goals are to provide
  ▪ Compensation to designated employees
  ▪ Performance incentive
• Accounting goals are to
  ▪ Determine the fair value of compensation
  ▪ Expense the compensation over the periods in which the participants perform services
Stock Award Plans

- Grant of shares of stock to executives
- Generally restricted and subject to forfeiture if the employee does not remain with the company for a specified time period
- Compensation – market price at the grant date of unrestricted shares of the same stock
- Accrued as compensation expense over the restricted period

Stock Option Plans

- Give employees the option to purchase
  - Specified number of shares of the company's stock
  - Specified price
  - During specified period.
- Fair value is accrued as compensation expense over the service period for which participants receive the options

Recognizing Fair Value of Options

- Accounting parallels accounting for restricted stock
- Option Pricing Model Variables
  - Exercise price of option
  - Expected term of option
  - Current market price of stock
  - Expected dividends
  - Expected risk-free rate of return
  - Expected volatility of stock
Stock Option Plans with Performance or Market Conditions

- Performance target
- Probability that performance target will be met
  - Not probable ➜ No compensation is recognized.
  - Probable ➜ Compensation is recognized

Employee Share Purchase Plans

- Permit employees to buy shares directly from employer
- Usually considered to be compensatory ➜ Compensation expense is recorded as the difference between fair value of stock purchased and the discounted purchase price that employees receive

For Example

Employees may buy 100 shares of no par stock for $8.50 per share. The current market price is $10.00.

Compensation expense = $1.50 ($10.00 - $8.50)
Cash (100 x $8.50) 850
Compensation expense (100 x $1.50) 150
Common stock (no par) 1,000
Next Step

• Part 2 – Basic earning per share
• Part 3 – Diluted earnings per share – exercisable securities
• Part 4 – Diluted earnings per share – convertible securities