ASPE
At a Glance

Section 3870 - Stock-based Compensation and Other Stock-based Payments

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Effective Date
Fiscal years beginning on or after January 1, 2011

Scope

Applies to:
- Transactions, including non-reciprocal transactions, in which an enterprise grants shares of common stock, stock options, or other equity instruments, or incurs liabilities based on the price of common stock or other equity instruments.

Does not apply to:
- Equity instruments granted by an acquiring enterprise as part of the purchase consideration in a business combination that are accounted for in accordance with Section 1582, *Business Combinations*.
- Related party transactions, other than stock-based compensation plans with a principal shareholder that are accounted for in accordance with Section 3840, *Related Party Transactions*, (management compensation arrangements are excluded from the scope of Section 3840 and thus, management stock compensation arrangements are included in this Section).
- Contracts and obligations for stock-based payments in which the entity receives or acquires goods or services under a contract within the scope of Section 3856, *Financial Instruments*.

Definitions

Stock option
- A contract that gives the holder the right, but not the obligation, either to purchase or sell a certain number of shares of stock at a predetermined price for a specified period of time.

Grant date
- The date at which an enterprise and an employee have a mutual understanding of the terms of a stock-based compensation award.

Measurement date
- For transactions with employees it is the date at which the stock price that enters into measurement of the fair value of an award of employee stock-based compensation is fixed. Paragraphs 3870.14-.17 provide guidance for determining the measurement date for transactions with non-employees.

Vest
- To earn the right to. An employee's award of stock-based compensation becomes vested at the date on which the employee's right to receive or retain shares of stock or cash under the award is no longer contingent on the employee remaining in the service of the enterprise or the achievement of a performance condition (other than the achievement of a target stock price or specified amount of intrinsic value). Typically, an employee stock option that is vested also is immediately exercisable.

Transactions with Non-Employees

- Reciprocal transactions where an enterprise obtains goods and services by either granting equity instruments or by incurring liabilities to the supplier (other than an employee) in amounts based on the price of the enterprise's stock must be accounted for based on the fair value of the consideration received, or the fair value of the equity instruments or liabilities incurred, whichever is more reliably measurable.
- In situations where an enterprise grants equity instruments or incurs liabilities to non-employees based on the price of the enterprise's stock, by way of a non-reciprocal transfer, these transactions must be accounted for using the fair value of the equity instruments issued or liabilities incurred.

Measurement Date

- To measure the fair value of the equity instruments issued in exchange for the receipt of goods and services from non-employees, an enterprise uses the stock price and other measurement assumptions at the earliest of the following dates:
  - The date when a commitment for performance by the counterparty to earn the equity instruments is reached (a performance commitment);
  - The date when the equity instruments are granted if they are fully vested and non-forfeitable on that date; or
  - The date when the counterparty's performance is complete. Performance is considered complete when the counterparty has delivered / purchased the goods or services, even though on that date, the quantity or all the terms of the equity instruments may still be dependent on other events.
- For a non-reciprocal transfer, the measurement date is the later of:
  - The date when the detailed terms of the transfer are set; and
  - The date when the enterprise is committed to the transfer.

Point and Method of Recognition

- An asset, cost, or sales discount must be recognized (or the previous recognition reversed) in the <u>same</u> period(s) and manner (i.e. capitalized vs. expense) as if the enterprise had paid cash for the goods or services or used cash rebates as a sales discount instead of paying with / using the equity instruments.
- If a stock option that the counterparty has the right to exercise expires unexercised, an asset, cost, or sales discount that has been recognized <u>cannot</u> be reversed.
- When the quantity and terms of the equity instrument are known or are dependent on other conditions, paragraphs 3870.20-.23 provide guidance on the how the equity instruments are measured prior to, at, and subsequent to the measurement date.

Transactions with Employees

Employees

- An employee of an enterprise is an individual that an enterprise exercises or has the right to exercise sufficient control over to establish an employer-employee relationship as determined by law.
- Refer to paragraph 3870.08 for additional guidance on employees.

Recognition and Measurement

- The <u>fair value</u> of the equity instrument must be used to measure and recognize equity instruments awarded to employees and the cost of the services received as consideration.
- When equity instruments are granted or otherwise transferred directly to an employee by a principal shareholder, this is stock-based employee compensation and is accounted for by the entity in accordance with this Section, <u>unless</u> the transfer is for a purpose that is clearly not compensation.
- When an employee stock purchase plan meets <u>all</u> the following criteria set out below, it is <u>not</u> compensatory, and as a result, the discount from market price <u>reduces</u> the proceeds from issuing the related shares of stock:
  - <u>No</u> option features are incorporated in the plan, <u>other than</u>:
    - Employees are permitted a short period of time, not longer than 31 days, to enroll in the plan after the purchase price has been fixed; and
    - The purchase price is based solely on the stock's market price <u>at</u> the date of purchase and employees are permitted to cancel participation <u>before</u> the purchase date and can obtain a refund of the amounts they previously paid.
  - The discount from the market price is <u>not</u> in excess of the <u>greater</u> of:
    - A per-share discount that would be reasonable in a recurring offer of stock to shareholders or others; or
    - The per-share amount of stock issuance costs that are avoided by not having to raise a substantial amount of capital by a public offering.
      - A discount from the market price that is <u>less than or equal to</u> five percent is considered to be in compliance with this criteria and does not require further justification.
  - <u>Substantially all</u> full-time employees that meet limited employment qualifications may participate on an equitable basis.

Measurement Objective and Date

- The purpose of the measurement process is to <u>estimate the fair value</u>, based on the stock price at the grant date, of stock options or other equity instruments that employees become entitled to when they have provided the required service <u>and</u> satisfied any other conditions necessary to earn the right to benefit from the instrument.
- Paragraph 3870.30 provides guidance on the effect restrictions may have on the fair value estimate.

Awards That Call for Settlement by Granting Equity Instruments

- The fair value of a share of <u>non-vested stock</u> that is awarded to an employee must be measured at the market price (or estimated market price, if the stock is not publicly traded) of a share of the same stock as if it were vested and issued on the grant date.
  - <u>Non-vested stock</u> is shares of stock that cannot currently be sold because the employee to whom the shares were granted has not yet satisfied the vesting requirements necessary to earn the right to the shares.
- The fair value of a shared of <u>restricted stock</u> awarded to an employee (i.e. a share that will be restricted <u>after</u> the employee has a vested right to it), must be measured at its fair value, which is the same amount as a share of similarly restricted stock granted to non-employees.
  - <u>Restricted stock</u> refers to shares of stock for which sale is contractually or governmentally restricted for a given period of time.
- The fair value of an option estimated at the grant date is <u>not</u> subsequently adjusted for changes in the risk-free interest rate, the price of the underlying stock or its volatility, dividends on the stock, or the life of the option.
- In most cases it is possible to make a reasonable estimate of the fair value of most stock options and other equity instruments at the date they are granted. However, in unusual circumstances, when this is not possible, stock-based compensation is measured in accordance with paragraph 3870.36.

Determining Fair Value

- To estimate the fair value of a stock option (or its equivalent) an option pricing model is used, such as the Black-Scholes or a binomial model, which takes into account the following as of the grant date:
  - The exercise price;
  - The option's expected life (unless there is an absence of reliable evidence on a stock option's expected life, when its contractual life is to be used);
  - The current price of the underlying stock;
  - It's expected volatility, which can be determined using the calculated value method. Calculated value is a measure of the value of a share option or similar instrument determined by substituting the historical volatility of an appropriate industry sector index for the expected volatility of an entity's share price in an option-pricing model. Refer to paragraphs 3870.A11-.A16 for guidance on expected volatility.
  - Expected dividends on the stock (except as outlined in paragraphs 3870.50-.51); and
  - The risk-free rate of interest for the expected term of the option. When an entity grants options on its own stock, the rate currently available on zero coupon Canada government bonds with a remaining term that is equal to the options is used as the risk-free interest rate.

Awards That Call for Settlement in Cash and Other Assets

- An entity measures compensation cost for awards (including modifications to awards) that call for settlement in cash or other assets, including stock appreciation rights, as:
  - The amount by which the market value of the shares of the entity's stock covered by the grant exceeds the option price or value specified, by reference to a market price or otherwise, subject to any appreciation limitations under the plan.
- An award of stock appreciation rights that requires settlement in cash is an indexed liability, and the measurement date is the settlement (exercise) date.
- When stock price changes after the service period change the amount of the liability, these changes are recognized as compensation costs in the period that the change occurs.
- Refer to paragraphs 3780.B52-.B60 (Illustrations BXIII-BXV) for application guidance on accounting for awards that result in an entity incurring a liability, including stock appreciation rights.

Recognition of Compensation Costs

Number of Instruments That Vest

- The total amount of compensation cost that is recognized for an award of stock-based employee compensation must be based on the number of instruments that eventually vest.
- Compensation cost cannot be recognized for awards that employees forfeit either:
  - Because they fail to satisfy a service requirement for vesting, such as for a fixed award; or
  - Because the enterprise does not achieve a performance condition, unless the condition is a target stock price or specified intrinsic value on which vesting or exercisability is conditioned.
    - For awards in this condition, compensation cost must be recognized for awards to employees who remain in service for the required period regardless of whether the target stock price or amount of intrinsic value is reached.
- If a vested employee stock option expires unexercised, compensation cost previously recognized is not reversed.
- The service period used for attribution purposes must be consistent with the assumptions used in estimating the fair value of the award if, performance conditions affect either:
  - The exercise price; or
  - The exercisability date of an employee stock option.
- When an award has a performance condition that determines the number of options or shares all employees receiving the award will be entitled to, measurement of the compensation cost must be based on the best estimate of the outcome of the performance condition. However, forfeitures by individual employees may either be:
  - Estimated at the grant date; or
  - Recognized only as they occur.
- Compensation cost must be adjusted for subsequent changes in the expected or actual outcome of service-related and performance-related conditions until the vesting date when compensation cost is estimated at the grant date for:
  - The number of instruments expected to vest based on performance-related conditions; and for
  - Those where vesting is contingent only on future service for which the enterprise chooses to estimate forfeitures at the grant date.
- The effect of a change in the estimated number of shares or options expected to vest is considered to be a change in an estimate. The cumulative effect of this change on current and prior periods must be recognized in the period of the change.

Period and Method of Recognition

- For a stock-based award to employees:
  - If the award is for future services:
    - Compensation cost must be recognized throughout the period that the related employee services are rendered, by a charge to compensation cost.
  - If the service period is not defined as the earlier or shorter period:
    - The service period is assumed to be the period from the grant date to the date that the award is vested and its exercisability is not dependent on continued employee service.
  - If the award is for past services:
    - The related compensation cost is recognized in the period when it is granted.
- When the award consists of equity instruments, the offsetting entry is charged to shareholders' equity.

Additional Awards and Modifications of Outstanding Awards

- The fair value of each award of equity instruments, including an award of reloaded options, must be measured <u>separately</u> based on:
  - Its terms; and
  - The current stock price; and
  - Related factors at the date it is granted.
- When a modification of the terms of an award makes it <u>more valuable</u>, the modification must be treated as if it were <u>an exchange</u> of the original award for a new award. The incremental value is recorded as additional cost and measured as the <u>difference between</u>:
  - The fair value of the modified option determined in accordance with the provisions of this Section; and
  - The value of the old option <u>immediately before</u> its terms are modified, determined based on the <u>shorter</u> of:
    - Its remaining expected life; or
    - The expected life of the modified option.

Settlements of Awards

- Occasionally an enterprise may repurchase equity instruments that have vested.
- As long as, the amount of cash or other asset paid / liabilities incurred to repurchase an equity instrument is <u>not greater than</u> the value of the instruments that were repurchased, the amount paid is charged to equity.
- However, if the amount paid <u>was greater than</u> the value of the instruments repurchased, the excess must be recognized as a cost.
- When an enterprise settles a non-vested award for cash, the enterprise has effectively vested the award. The amount of cost measured at the grant date but not yet recognized <u>must be</u> recognized at the date of repurchase.

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