Cahill

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SEC Updates Accounting Guidance for 'Spring-Loaded' Equity Awards

The Securities and Exchange Commission (the "SEC") recently updated its guidance on how public companies should account for equity compensation, including new interpretive guidance for estimating the "fair value" of equity awards when companies are in possession of material non-public information. In particular, the new guidance addresses the valuation assumptions required when accounting for stock options or other share-based compensation granted shortly before the announcement of positive, market-moving information ("spring-loaded awards").

Under FASB Accounting Standards Codification Topic 718, companies generally must recognize compensation cost from equity awards based on their fair value as of the grant date, which may be determined using assumptions including the current market price and expected volatility of the company's shares. In the case of spring-loaded awards, the new SEC guidance provides that companies in possession of positive material non-public information at the time of an award should consider making adjustments to the market price and/or to the expected volatility of the price of the underlying shares when determining the fair value of the award.

Although it does not prescribe specific facts and circumstances where an adjustment to valuation assumptions is required, the SEC believes companies should give special scrutiny to "non-routine" spring-loaded awards. Specifically, in an example discussed in the new guidance, the SEC takes the view that a reasonable estimate of the fair value of an award of stock options, where the award is non-routine and granted in contemplation of the release of material non-public information, would require an adjustment to the current market price on the date of grant.

The SEC's updated guidance also addresses companies' disclosure requirements relating to spring-loaded awards. Per the guidance, the SEC expects that a company would, at a minimum, disclose in a footnote to its financial statements how it determined the current share price and expected volatility assumptions in determining fair value and should consider whether its assumptions require disclosure as critical accounting estimates in the company's MD&A. Companies also should consider whether additional discussion should be included in their compensation disclosures where adjustments to the current share price are reflected in the grant date fair value of awards.

In light of this guidance, companies should give careful consideration to whether they have material non-public information that may be released shortly after the grant of equity awards and that should be reflected in their expected volatility and price assumptions when determining the fair value of the awards at the time of grant. Companies also should evaluate their controls and procedures related to their equity award practices, in order to avoid inadvertent creation of spring-loaded awards, and should consider whether to adopt or revise policies relating to the timing of awards.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Glenn J. Waldrip, Jr. (partner) at 212.701.3110 or gwaldrip@cahill.com; Mark Gelman (counsel) at 212.701.3061 or mgelman@cahill.com; or Sarah Klein-Cloud (attorney) at 212.701.3231 or sklein-cloud@cahill.com; or email publications@cahill.com.