Snapshot

NOVEMBER 30, 2021
SNAPSHOT 2021-17

SEC staff issues SAB 120 on 'spring-loaded' awards

The staff of the SEC's Office of the Chief Accountant and Division of Corporation Finance issued Staff Accounting Bulletin (SAB) 120, in part, to provide accounting and disclosure guidance for "spring-loaded awards" made to executives. "Spring-loaded awards" are share-based compensation awards granted to executives shortly before an entity announces market-moving information, such as an earnings release with better-than-expected results or a significant transaction, such as a new material customer contract. The remaining changes in the SAB make conforming amendments to the Staff Accounting Bulletin Series to align with the current authoritative accounting guidance in ASC 718, *Compensation – Stock Compensation*.

Background

Share-based payment awards, such as share options, are initially measured at their grant-date fair value under ASC 718. For equity awards, the grant-date fair value is generally not adjusted subsequently and reflects the ultimate share-based payment expense recognized by the entity in its financial statements.

The most common valuation technique used by entities to estimate the grant-date fair value of share options is the Black-Scholes-Merton model. This option-pricing model requires various inputs, including the fair value of the equity shares underlying the option (called the current price input) and the expected volatility of the price of the underlying share. ASC 718 requires an entity to determine assumptions used in estimating the fair value of share-based payment awards consistently from financial reporting period to period.

Staff guidance

According to the guidance in SAB 120, entities should consider whether observable market prices need to be adjusted in determining the current price input of an underlying share (for example, whether the observable market price does not reflect certain material nonpublic information known to the entity but unavailable to marketplace participants when the market price is observed). Determining whether an adjustment to an observable market price is necessary could require significant judgment. In making this determination, entities should consider the following factors, among other things:

- If the share-based payment award is entered into in contemplation of, or shortly before, the entity plans to release material nonpublic information
- If the planned release of material nonpublic information is expected to result in a material increase in the observable share price
- If the share-based payment award is non-routine in nature (for instance, the entity historically issues awards on January 1 of each calendar year, but is now issuing awards prior to a press release on June 30)

Finally, the SEC staff believes that entities should take into consideration whether a marketplace participant would consider the material nonpublic information when the entity estimates the expected volatility. If so, entities should make corresponding adjustments to the volatility input.

Disclosure

ASC 718 requires entities to disclose a description of the method and significant assumptions used to estimate the fair value of share-based payment awards. The SAB explains that the SEC staff expects an entity to disclose, at a minimum, the following information:

- How it determines the current price of shares underlying share options for purposes of determining the grant-date fair value
- The accounting policy related to how it determines when an adjustment to the closing price is required
- How it determines the amount of the adjustment to the closing share price
- Any significant assumptions used to determine the adjustment

Finally, an entity should disclose the characteristics of the spring-loaded options if these characteristics are different from the entity's other share-based payment awards.

MD&A

The SAB notes that entities should also consider the requirements of Item 303(b)(3) in Regulation S-K on critical accounting estimates in Management's Discussion and Analysis (MD&A) when determining which information to disclose. An entity should determine whether its estimates, including the current price and volatility, involve a significant level of estimation uncertainty and if they have had, or are reasonably likely to have, a material impact on the entity's financial condition or operations.

Example

PubCo plans to issue better-than-expected earnings at 8 p.m. Eastern Standard Time (EST) on June 30. The market closes at 4 p.m. EST and PubCo's closing share price is $10/share. At 6 p.m. EST on June 30, PubCo awards non-routine share options to its executives. PubCo's Board of Directors approves the awards in contemplation of the earnings release and expects the share price to significantly increase to $15/share shortly after the announcement is made. PubCo's accounting policy is to use the closing share price on the day of the grant as the current share price in estimating the grant-date fair value of its share options.

In determining if it should adjust the closing share price to determine the current price of shares underlying the awarded options, PubCo considers whether the awards are consistent with its policies and procedures. PubCo also considers whether the awards were granted in contemplation of, or shortly before, a planned release of material nonpublic information and whether that information was expected to result in a material increase in share price.

PubCo concludes that absent an adjustment to the closing share price to reflect the impact of PubCo's better-than-expected earnings, the closing share price of $10/share would not reflect a price that is unbiased for marketplace participants at the time of the grant, resulting in PubCo understating the grant-date fair value of its share-based payment and the related expense in its financial statements.

Further, PubCo concludes that the impact of the material nonpublic information should be included in estimating the expected volatility input when determining the grant-date fair value of the options.

Grant Thornton insight

Entities often possess material nonpublic information at the time they issue share-based payment awards. However, the SAB focuses on non-routine awards that are intentionally granted prior to announcing market-moving information to the public, with the expectation that the entity's observable stock price will jump. Without adjusting the current price and volatility inputs, an entity would understate the grant-date fair market value of its share-based payment awards and related compensation expense.

We encourage entities to revisit their corporate governance policies and internal control procedures around share-based payment award issuances to ensure the current policies and procedures support accounting and disclosure in accordance with the SEC staff guidance.

Contacts

Susan Mercier
Partner
Accounting Principles Group
T +1 312.602.8084
E Susan.Mercier@us.gt.com

Sandy Heuer
Partner
Accounting Principles Group
T +1 612 677 5122
E Sandy.Heuer@us.gt.com