Liability Accounting Primer

No one ever said that the process of preparing data to be reported under liability accounting methods was an enjoyable experience. Well, maybe one or two SOS'ers think so… Going through the motions of preparing your current period liability expense can be done without too much headache, as long as you keep yourself organized and focused. First, the grants that are subject to liability accounting need to be identified. Can they simply be "tagged" with a user-defined field unique to liability grants? Should a separate database be created to house those grants alone? Keep in mind the need to report other aspects of those grants in disclosures and the possible administrative maintenance of a second production database. Whatever you do, think mostly about the precedent you could be creating for each reporting period going forward.

Once those grants are identified, detail the steps needed to mark their values to market, and document them for later use. Can you use another user-defined field to further identify their status in the mark-to-market process (i.e. "Released", "Terminated", "Unvested")? Using a second-level identifier may make it easier to change their market value based on their status during the reporting period. A grant that is cancelled while unvested during the period will simply be reversing whatever expense has been amortized up through that date, so the value they are assigned no longer matters and will not need to be updated. Grants that have not yet vested by the end of the reporting period must be assigned the market value as of the last day of the period. And grants that have vested during the period are assigned the value as of their date of vest. Note: In our experience, some companies lump all the vestings during a period and assign a single valuation at the end of the month or quarter. This should be OK as long as the valuations are not materially different from the actual vesting date. It also cuts down on the number of valuations performed as non-employee grants are usually immaterial to the overall grant population, but each vesting tranche is valued separately. However, if the auditors want to see every valuation, be prepared to show them.

Before you are done updating your data, ask yourself whether you will ever need to go back to a previous period and reverse the mark-to-market (What?! He wasn't termed until the following quarter?!). Be realistic, not necessarily optimistic. If so, the second-level identifiers could use period-specific terms such as "Rlsd FY09Q4" or "Term FY09Q4". Using more specific tagging can help if they ever need to be retroactively changed. Just remember to keep it relatively intuitive.

When your data is updated, you are ready to run the report. Remember to run only the population of grants that are subject to liability accounting. If your software does not support liability accounting, you will need to manually calculate the current period liability for each grant. You can match up grant numbers from the previous report and take the to-date expense after adjustments from the current report, and subtract the previous period's to-date expense to get the current month's expense. Add up all the resulting dollars for each non-employee grant and you have your current period liability.

Note: The steps outlined above were developed for a client's cash-settled RSUs, which are measured on their release date. Other cash-settled instruments such as SARs and options are measured on their exercise date therefore the process will differ slightly. In March 2017, the FASB released some proposed accounting guidance that will simplify the accounting for non-employee grants and also eliminate this mark to market valuation. See our Accounting Update-March 2017 and FASB Comment Letter for more details.

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This article was originally published March 2010 and updated in August 2017.