FASB Interpretation No. 28

FIN 28 Status Page
FIN 28 Summary

Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans

an interpretation of APB Opinions No. 15 and 25

December 1978

Financial Accounting Standards Board
of the Financial Accounting Foundation
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CONTENTS

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FIN 28 Summary

This Interpretation clarifies aspects of accounting for compensation related to stock appreciation rights and other variable stock option or award plans. The Interpretation specifies that compensation should be measured at the end of each period as the amount by which the quoted market value of the shares of the enterprise's stock covered by a grant exceeds the option price or value specified under the plan and should be accrued as a charge to expense over the periods the employee performs the related services. Changes in the quoted market value should be reflected as an adjustment of accrued compensation and compensation expense in the periods in which the changes occur until the date the number of shares and purchase price, if any, are both known.

INTRODUCTION

1. The FASB has been asked to clarify whether the provisions of *APB Opinion No. 25*, "Accounting for Stock Issued to Employees," apply to stock appreciation rights and, if so, how the Opinion should be applied. Similar questions have been raised about awards under other stock compensation plans with variable terms, that is, plans for which the number of shares of stock the employee may receive, the price per share the employee must pay, or both the number of shares and the price are unknown at the date of grant or award. Appendix A provides additional background information about these matters. Appendix B illustrates applications of this Interpretation.

INTERPRETATION

2. *APB Opinion No. 25* applies to plans for which the employer's stock is issued as compensation or the amount of cash paid as compensation is determined by reference to the market price of the stock or to changes in its market price. Plans involving stock appreciation rights and other variable plan awards [1] are included in those plans dealt with by Opinion No. 25. When stock appreciation rights or other variable plan awards are granted, an enterprise shall measure compensation as the amount by which the quoted market value of the shares of the enterprise'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. Changes, either increases or decreases, in the quoted market value of those shares between the date of grant and the measurement date [2] result in a change in the measure of compensation for the right or award.

3. Compensation determined in accordance with paragraph 2 shall be accrued as a charge to expense over the period or periods the employee performs the related services (hereinafter referred to as the "service period"). If the stock appreciation rights or other variable plan awards are granted for past services, compensation shall be accrued as a charge to expense of the period in which the rights or awards are granted. If the service period is not defined in the plan or some other agreement, such as an employment agreement, as a shorter or previous period, the service period shall be presumed to be the vesting period.[3]

4. Compensation accrued during the service period in accordance with paragraph 3 shall be adjusted in subsequent periods up to the measurement date [4] for changes, either increases or decreases, in the quoted market value of the shares of the enterprise's stock covered by the grant but shall not be adjusted below zero. The offsetting adjustment shall be made to compensation expense of the period in which changes in the market value occur. Except as provided in paragraph 5, the accrued compensation for a right that is forfeited or cancelled shall be adjusted by decreasing compensation expense in the period of forfeiture, in accordance with paragraph 15 of *APB Opinion No. 25*.

5. For purposes of applying paragraph 11(h) [5] of *APB Opinion No. 25*, compensation expense for a combination plan [6] involving stock appreciation rights or other variable plan awards (including those that are granted after the date of grant of related stock options) shall be measured according to the terms the employee is most likely to elect based on the facts available each period. An enterprise shall presume that the employee will elect to exercise the stock appreciation rights or other variable plan awards, but the presumption may be overcome if past experience or the terms of a combination plan that limit the market appreciation available to the employee in the stock appreciation rights or other variable plan awards provide evidence that the employee will elect to exercise the related stock option. If an enterprise has been accruing

compensation for a stock appreciation right or other variable plan award and a change in circumstances provides evidence that the employee will likely elect to exercise the related stock option, accrued compensation recorded for the right or award shall *not* be adjusted.[7] If the employee elects to exercise the stock option, the accrued compensation recorded for the right or award shall be recognized as a consideration for the stock issued. If all parts of the grant or award (e.g., both the option and the right or award) are forfeited or cancelled, accrued compensation shall be adjusted by decreasing compensation expense in that period.

6. Stock appreciation rights and other variable plan awards are common stock equivalents to the extent payable in stock for purposes of applying the provisions of *APB Opinion No. 15*, "Earnings per Share." Accrued compensation for those rights or awards shall be considered additional "proceeds" for purposes of applying the treasury stock method described in paragraph 36 of Opinion No. 15 for determining the dilutive effect of options in earnings per share computations. Stock appreciation rights and other variable plan awards payable only in cash are not common stock equivalents for the computation of earnings per share under that Opinion.

EFFECTIVE DATE AND TRANSITION

7. The provisions of this Interpretation shall be applied prospectively for stock appreciation rights and other variable plan awards granted in fiscal years beginning after December 15, 1978. Early application is encouraged for stock appreciation rights and other variable plan awards granted in fiscal years beginning before December 16, 1978 for which financial statements have not been previously issued. In addition, this Interpretation may be, but is not required to be, adopted for stock appreciation rights and other variable plan awards granted in fiscal years beginning before December 16, 1978 for which financial statements have been previously issued; if so adopted, an accrual of compensation expense or an adjustment of accrued compensation resulting from the application of this Interpretation for stock appreciation rights and other variable plan awards granted in fiscal years beginning before December 16, 1978 shall be accounted for as a change in estimate in the period of change (see paragraphs 31-33 of *APB Opinion No. 20*). This Interpretation shall not be applied retroactively for previously issued annual financial statements.

8. If early application is adopted in financial reports for interim periods of a fiscal year beginning before December 16, 1978, previously issued financial information for any interim periods of that fiscal year that precede the period of adoption shall be restated to give effect to the provisions of this Interpretation. Any subsequent presentation of that information shall be on the restated basis.

This Interpretation was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board following submission to the Financial Accounting Standards Advisory Council and the Screening Committee on Emerging Problems.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Oscar S. Gellein
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: BACKGROUND INFORMATION

9. Stock appreciation rights are awards entitling employees to receive cash, stock, or a combination of cash and stock in an amount equivalent to any excess of the market value of a stated number of shares of the employer company's stock over a stated price. The form of payment may be specified when the rights are granted or may be determined when they are exercised; in some plans the employee may choose the form of payment.

10. Stock appreciation rights are usually granted in combination with compensatory stock options but also may be granted separately. Combination plans usually provide that the rights are exercisable for the same period as the companion stock options and that the exercise of either cancels the other. In some combination plans, the enterprise may grant stock appreciation rights either when the options are granted or at a later date. In some cases the holder of stock options may apply to receive share appreciation in cash or stock with the approval of the enterprise, in lieu of exercising the options.

11. Paragraph 10 of *APB Opinion No. 25* specifies that "compensation for services that a corporation receives as consideration for stock issued through employee stock option, purchase, and award plans should be measured by the quoted market price of the stock at the measurement date less the amount, if any, that the employee is required to pay." Paragraphs 12-15 of Opinion No. 25 refer to accrual of compensation in periods for which service is rendered before issuance of stock. Paragraph 13 states that "the employer corporation should accrue compensation expense in each period in which the services are performed" and "if the measurement date is later than the date of grant or award, an employer corporation should record the compensation expense each period from date of grant or award to date of measurement based on the quoted market price of the stock at the end of each period." Paragraph 15 of Opinion No. 25 states that the effect of the change in estimated compensation expense should be accounted for in the period

of change in accordance with paragraphs 31-33 of *APB Opinion No. 20*, "Accounting Changes."

12. Paragraph 11(c) of *APB Opinion No. 25* states that "the measurement date of an award of stock for current service may be the end of the fiscal period, which is normally the effective date of the award, instead of the date that the award to an employee is determined if (1) the award is provided for by the terms of an established formal plan, (2) the plan designates the factors that determine the total dollar amount of awards to employees for the period (for example, a percent of income), although the total amount or the individual awards may not be known at the end of the period, and (3) the award pertains to current service of the employee for the period."

13. Paragraph 11(h) of *APB Opinion No. 25* states that "compensation cost for a combination plan permitting an employee to elect one part should be measured according to the terms that an employee is most likely to elect based on the facts available each period." Although Opinion No. 25 principally addresses the measurement of compensation when stock is issued to an employee, the Opinion also addresses situations in which cash or stock is paid to an employee for appreciation in the market price of an enterprise's stock. Paragraph 32 of the Opinion states that "the terms of some plans, often called *phantom stock* or *shadow stock* plans, base the obligations for compensation on increases in market price of or dividends distributed on a specified or variable number of shares of stock of the employer corporation but provide for settlement of the obligation to the employee in cash, in stock of the employer corporation, or a combination of cash and stock."

14. A draft of a proposed Interpretation, "Accounting for Stock Appreciation Rights and Other Compensation Plans with Variable Terms Related to the Price of a Company's Stock," was released for comment August 17, 1978. The Board received 62 letters of comment in response to the proposed Interpretation. Certain of the comments received and the Board's consideration of them are discussed in paragraphs 15-18 below.

15. The proposed Interpretation required that compensation expense for stock appreciation rights and other variable plan awards be accrued to the extent that the quoted market value of the shares of the enterprise's stock covered by the grant exceeds the value specified. A majority of the respondents disagreed with that provision as a required allocation method and recommended that other methods be permitted for allocating compensation cost as an expense in the periods in which the related services are performed. In adopting that recommendation, the Board concluded that the recommendation is consistent with the recognition principles underlying *APB Opinion No. 25*.

16. The proposed Interpretation specified that compensation expense for stock appreciation rights and other variable plan awards should be measured by the extent that the quoted market value of the shares of the enterprise's stock covered by the grant exceeds the value specified, by reference to a market price or otherwise. Several respondents recommended that the compensation expense be measured by using the average market price of the stock, the value of the right or award at the date of grant, or some other value. The Board considered those

recommendations and concluded that the method of measuring compensation for stock appreciation rights and other variable plan awards should not be changed without a comprehensive reexamination of the measurement principles underlying *APB Opinion No. 25*. The Board plans such a reexamination in the future but has concluded that issuance of this Interpretation should not be delayed in the meantime.

17. Some respondents requested guidance on whether stock appreciation rights and other variable plan awards are common stock equivalents for purposes of computing earnings per share. Guidance in this regard is provided in paragraph 6 of this Interpretation.

18. The transition called for by the proposed Interpretation required that an accrual of compensation expense or an adjustment of accrued compensation resulting from initial application of the Interpretation should be accounted for as a change in estimate in the period of change. The proposed effective date was for annual periods *ending* after December 15, 1978. Several respondents recommended either prospective or retroactive application because, in their view, the application of the Interpretation would result in a change in accounting method for some enterprises. The Board concluded that the effective date and transition should be changed to prospective application for stock appreciation rights and other variable plan awards granted in fiscal years *beginning* after December 15, 1978. The Interpretation also provides an election that it may be applied to grants made in fiscal years beginning before December 16, 1978 as a change in estimate in the period of the change.

Appendix B: ILLUSTRATION OF THE ACCOUNTING FOR STOCK APPRECIATION RIGHTS AND OTHER VARIABLE STOCK OPTION OR AWARD PLANS

19. This Appendix illustrates applications of this Interpretation in accounting for stock appreciation rights and other variable stock option or award plans when the service period is presumed to be the vesting period. The examples do not comprehend all possible combinations of circumstances nor do the examples illustrate the computation of deferred income taxes.

20. Provisions of the agreements:

Stock appreciation rights are granted in tandem with stock options for market value appreciation in excess of the option price. Exercise of the rights cancels the option for an equal number of shares and vice versa. Share appreciation is payable in stock, cash, or a combination of stock and cash at the enterprise's election.

Date of grant	January 1, 1979
Expiration date	December 31, 1988
Vesting	100% at the end of 1982
Number of shares under option	1,000
Option price	$10 per share
Quoted market price at date of grant	$10 per share

21. Market price assumptions:

Quoted market price per share at December 31 of subsequent years:

1979—$11
1980— 12
1981— 15
1982— 14
1983— 15
1984— 18

EXAMPLE 1

22. The following example illustrates the annual computation of compensation expense for the above described stock appreciation right plan.

		Compensation				Accrual of Expense by Year (3)					
Date	Market Price	Per Share	Aggregate (1)	Percentage Accrued (2)	Compensation Accrued to Date	1979	1980	1981	1982	1983	1984
12/31/79	$11	$1	$1,000	25%	$ 250	$250					
					750		$750				
12/31/80	12	2	2,000	50	1,000						
					2,750			$2,750			
12/31/81	15	5	5,000	75	3,750						
					250				$250		
12/31/82	14	4	4,000	100	4,000						
					1,000					$1,000	
12/31/83	15	5	5,000	100	5,000						
					3,000						$3,000
12/31/84	18	8	8,000	100	$8,000						

Notes:

(1) Aggregate compensation for unexercised shares to be allocated to periods service performed.
(2) The percentage accrued is based upon the four-year vesting period.
(3) A similar computation would be made for interim reporting periods.

EXAMPLE 2

23. If the stock appreciation rights vested 25 percent per year commencing in 1979, the computation of compensation expense in the preceding example would change as illustrated in the following examples.

24. Because 25 percent of the rights vest each year commencing in 1979, the service period over which compensation is accrued as a charge to expense is determined separately for each 25 percent portion. For example, the services for the 25 percent portion of the rights vesting in 1980 are performed in both 1979 and 1980 and the related compensation is accrued proportionately as a charge to expense in each year. Similarly, compensation for rights vesting in 1981 is proportionately accrued as a charge to expense in 1979, 1980, and 1981. In this way, compensation related to the portion of the rights vesting in 1979 is recognized in 1979, compensation related to the portion of the rights vesting in 1980 is recognized in 1979 and 1980,

and so forth. The following schedule indicates the service period for each 25 percent portion of the rights and the computation of the *aggregate* percentage of compensation accrued by the end of each year of service (the vesting period). A similar computation would be made for interim reporting periods.

		Aggregate Percentage of Compensation Aggregate Accrued by the End of Each Year of Service			
For Rights Vesting in	**Service Period**	**1979**	**1980**	**1981**	**1982**
1979	1 year	25%	25%	25%	25%
1980	2 years	12.5	25	25	25
1981	3 years	8.33	16.67	25	25
1982	4 years	6.25	12.5	18.75	25
Aggregate percentage accrued at the end of each year		52.08%	79.17%	93.75%	100%
Rounded for purposes of Examples 2 and 3		52%	79%	94%	100%

For periods ending after 1982, 100 percent of the aggregate compensation should be accrued.

25. Additional Assumptions:

On December 31, 1981, the employee exercises the right to receive share appreciation on 300 shares.

On March 15, 1982, the employee exercises the right to receive share appreciation on 100 shares; quoted market price $15 per share.

On June 15, 1983, the employee exercises the right to receive share appreciation on 100 shares; quoted market price $16 per share.

On December 31, 1983, the employee exercises the right to receive share appreciation on 300 shares.

On December 31, 1984, the employee exercises the right to receive share appreciation on 200 shares.

Date	Transaction	Number of Shares	Market Price	Compensation Per Share	Compensation Aggregate (1)	Compensation Percentage Accrued (2)	Compensation Accrued to Date	Accrual of Expense by Year (3) 1979	1980	1981	1982	1983	1984
12/31/79	A		$11	$1	$ 1,000	52%	$ 520	$520					
	A						1,060		$1,060				
12/31/80			12	2	2,000	79	1,580						
	A						3,120			$3,120			
12/31/81			15	5	5,000	94	4,700						
12/31/81	E	300	15	5	(1,500)	—	(1,500)						
							3,200						
3/15/82	E	100	15	5	(500)	—	(500)						
							2,700						
	A						(300)				$(300)		
12/31/82			14	4	2,400	100	2,400						
5/15/83	E	100	16	6	(600)	—	(400)					$200	
							2,000						
	A						500					500	
12/31/83			15	5	2,500	100	2,500						
12/31/83	E	300	15	5	(1,500)	—	(1,500)						
							1,000						
	A						600						$600
12/31/84			18	8	1,600	100	1,600						
12/31/84	E	200	18	8	(1,600)	—	(1,600)						
							$ —						

Transaction Codes

A - Adjustment for changes in the market price of the stock.
E - Exercise of a stock appreciation right.

Notes

(1) Aggregate compensation for unexercised shares to be allocated to periods service performed.
(2) See the schedule in paragraph 24 of this Interpretation.
(3) A similar computation would be made for interim reporting periods.

EXAMPLE 3

26. If the plan limits the amount of share appreciation that the employee can receive to $5, the computation of compensation expense in Example 2 would change as illustrated in the following example.

27. When the quoted market price exceeds the appreciation limitation, the employee is more likely to exercise the related stock option rather than the stock appreciation right. Therefore, accrued compensation is *not* adjusted for changes in the quoted market price of the stock. The assumptions stated in paragraph 25 of this Interpretation are changed to the extent that on June 15, 1983 and December 31, 1984 the employee exercises the related stock option instead of the stock appreciation right. Accordingly, accrued compensation for the equivalent number of rights is recognized as part or all of the consideration for the stock issued in accordance with paragraph 5 of this Interpretation.

Date	Transaction	Number of Shares	Market Price	Compensation Per Share	Compensation Aggregate (1)	Compensation Percentage Accrued (2)	Compensation Accrued to Date	Accrual of Expense by Year (3) 1979	1980	1981	1982	1983	1984
12/31/79	A		$11	$1	$ 1,000	52%	$ 520	$520					
	A						1,060		$1,060				
12/31/80			12	2	2,000	79	1,580						
	A						3,120			$3,120			
12/31/81			15	5	5,000	94	4,700						
12/31/81	E	300	15	5	(1,500)	—	(1,500)						
							3,200						
3/15/82	E	100	15	5	(500)	—	(500)						
							2,700						
	A						(300)				$(300)		
12/31/82			14	4	2,400	100	2,400						
6/15/83	O	100	16	5	(500)	—	(400)					$100	
							2,000						
	A						500					500	
12/31/83			15	5	2,500	100	2,500						
12/31/83	E	300	15	5	(1,500)	—	(1,500)						
							1,000						
	NA						—						$ —
12/31/84			18	5	1,000	100	1,000						
12/31/84	O	200	18	5	(1,000)	—	(1,000)						
							$ —						

Transaction Codes

A - Adjustment for changes in the market price of the stock.
NA - No adjustment required because the market price exceeds the appreciation limitation.
E - Exercise of a stock appreciation right.
O - Exercise of the related stock option.

Notes

(1) Aggregate compensation for unexercised shares to be allocated to periods service performed.
(2) See the schedule in paragraph 24 of this Interpretation.
(3) A similar computation would be made for interim reporting periods.

Footnotes

FIN28, Footnote 1--Plans for which the number of shares of stock that may be acquired by or awarded to an employee or the price or both are not specified or determinable until after the date of grant or award are referred to in this Interpretation as "variable plan awards." However, plans described in paragraph 11(c) of Opinion No. 25 (see paragraph 12 in Appendix A of this Interpretation) and book value stock option, purchase, or award plans are not covered by this Interpretation. Plans under which an employee may receive cash in lieu of stock or additional cash upon the exercise of a stock option are variable plans for purposes of this Interpretation if the amount is contingent on the occurrence of future events.

FIN28, Footnote 2--Paragraph 10 of Opinion No. 25 defines the measurement date as "the first date on which are known both (1) the number of shares that an individual employee is entitled to receive and (2) the option or purchase price, if any." Generally, the number of shares of stock that may be acquired or awarded under stock appreciation rights and many other variable plan awards are not known until the date that they are exercised.

FIN28, Footnote 3--For purposes of this Interpretation, stock appreciation rights and other variable plan awards become vested when the employee's right to receive or retain shares or cash under the rights or awards is not contingent upon the performance of additional services. Frequently, the vesting period is the period from the date of grant to the date the rights or awards become exercisable.

FIN28, Footnote 4--See footnote 2.

FIN28, Footnote 5--See paragraph 13 in Appendix A of this Interpretation.

FIN28, Footnote 6--See paragraph 10 in Appendix A of this Interpretation.

FIN28, Footnote 7--A change in the circumstances may be indicated by market appreciation in excess of any appreciation limitations under the plan or the cancellation or forfeiture of the stock appreciation right or other variable plan award without a concurrent cancellation or forfeiture of the related stock option. A subsequent decrease in market value that reduces the appreciation to a level below the limitations under the plan would require adjustment of accrued compensation in accordance with paragraph 4 of this Interpretation if evidence then indicates that the employee will elect to exercise the stock appreciation right or other variable plan award.