Woman C.P.A.

Volume 34 | Issue 5 Article 5

9-1972

Theory and Practice: Current Studies and Concepts

Margaret L. Bailey

Follow this and additional works at: https://egrove.olemiss.edu/wcpa

Part of the Accounting Commons, and the Women's Studies Commons

Recommended Citation

Bailey, Margaret L. (1972) "Theory and Practice: Current Studies and Concepts," *Woman C.P.A.*: Vol. 34 : Iss. 5 , Article 5.
Available at: https://egrove.olemiss.edu/wcpa/vol34/iss5/5

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Woman C.P.A. by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

THEORY AND PRACTICE

Current Studies and Concepts

MARGARET L. BAILEY, CPA, Special Editor
Wheat Ridge, Colorado

In the last issue a summary was given of the proposed reorganization of the Accounting Principles Board (APB) into a completely different organizational structure. The plan was adopted by the Council of the American Institute of Certified Public Accountants, and at press time it was expected that the new Financial Accounting Standards Board (FASB) would be selected and in operation by the start of 1973. It is hoped that the new Board (with its members serving on a full-time basis) will be able to react much more quickly to the needs of the profession than has been possible in the past with a volunteer group serving without pay.

This editor would also express the hope that the new FASB will employ someone who is able to translate the pronouncements of the new Board into language which the average accountant can understand. For in recent years the Opinions issued by the Accounting Principles Board have become increasingly incomprehensible to many accountants, and too often one is forced to rely on an interpretation of those Opinions in order to apply them to situations met in everyday practice.

Because the Accounting Principles Board will shortly go out of existence, the proposed Opinion regarding Stock Issued to Employees may be one of the final Opinions to come from this body. A review of the exposure draft of that Opinion is the subject of this article.

ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES

Background

It has become common practice for a corporation to offer its stock to employees for one reason or another. For a period of time it became traditional to offer the employee an option to buy shares of stock at a specific price for a certain length of time, usually at a discount from the market price of the stock at the time the offer was made. Accounting for these traditional options became a relatively routine matter.

However, with changes in the tax laws and with the ability of the corporate executives to develop increasingly complex and diverse plans, the matter of accounting for such plans has come to be one of the more common headaches encountered by the company's accountant. The new Opinion is an attempt to respond to the need of accountants to apply a set of standards to such plans.

Opinion

In a nutshell, the draft of this Opinion says that, when stock is issued to employees as a form of compensation, the cost to be recorded is equal to the market price of the stock less the amount, if any, to be paid by the employee. This sounds simple enough, but applying the principle to a given situation can be less than simple.

The draft Opinion is a modification of the standard set forth in ARB No. 43, Chapter 13B which remains in effect—that the fair value of a given stock was not necessarily equal to the market quotations of that stock on that date. The Board has come to the conclusion that one cannot objectively measure the value attributable to restrictions on transferability of the stock nor on restrictions on the right to receive stock. For this reason, the Board has concluded that the "unadjusted quoted market price of a share of stock" which is freely traded should be used as the measure of compensation.

This Opinion apparently applies only to those stock plans which are intended to be part of the compensation paid to the employee. It leaves untouched the means of accounting for the traditional noncompensatory stock purchase plan. To qualify as noncompensatory, the Board has stipulated the following four characteristics as essential:

1. Most employees may participate,
2. The stock is offered on a generally equal basis to all employees,
3. The stock is offered for a limited time only (the IRS rules state five years), and
4. The stock is offered at a discount price no greater than would be reasonable if offered to stockholders and others.

An example of such a noncompensatory plan is one which qualifies under Section 423 of the Internal Revenue Code.

Any plan which fails to meet the test of the four above-named characteristics will usually

be considered compensatory—and some charge against income will be necessary.

Compensatory Plans

In the compensatory plans, the price received for the stock is recorded as the cash (or other assets) received plus the services performed by the employee. The catch being, of course, how to determine what the value of the "services received" may be. The Board concludes that such compensation 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." This is a modification of the principles set forth in ARB 43, Chapter 13B, insofar as the meaning of "fair value" of the stock and also the "measurement date" are concerned.

The "measurement date" is set forth as that date on which both the number of shares and the purchase price are known—usually the date the award is granted, but it may be a later date in plans with variable terms which depend on events after the date of award. (At this point, the draft describes the principle in some detail for special situations.)

The draft then proceeds to explain that the compensation costs should be considered an expense of the period in which the employee performs services. Again, complications result because those services will probably extend beyond one accounting period, or because the stock may be issued before the services are performed. In such an event, the accountant must accrue the expense—and such accrual may often have to be an estimate, with adjustments to those estimates to come in later periods.

Obviously, the corporation recognizes no compensation cost if the employee pays an amount at least equal to the quoted market price at the measurement date.

Income Tax Benefits

Because the deduction allowed for income tax purposes may be in different amounts and in a different period than that which the corporation recognizes for financial statement purposes, timing differences may exist and the resultant tax allocation of income taxes may be necessary. A corporation may be entitled to a tax deduction even if there is no compensation expense recorded in computing net income (or the tax deduction may be in excess of the book deduction). In such instances, any "excess" tax reduction should not be included in income but is to be added to capital or, conversely, where tax benefits are less, the difference should be deducted from additional capital (but only to the extent of previous additions to such account through the workings of the same or a similar compensatory stock plan).

Conclusion

This Opinion is to be effective for all awards made after June 30, 1972. It may have been apparent to the Board that this Opinion would be extremely difficult to interpret, and so several illustrative examples are provided in an appendix to demonstrate what the Board considered the most vital distinction of this Opinion—compensatory plans in which the cost of compensation is measured at the date of grant or award—and those in which the cost of compensation depends on events after the date of the grant or award. Even combination plans are described briefly in a final section.

TAX FORUM

(Continued from page 14)

(d) — Record of pre-examination conferences including the participants, their titles and the date or dates of the conferences.

(e) — A list of books, records, schedules, exhibits and analysis to be available at the start of the examination.

(f) — Space and other facilities to be provided for Service personnel and any other pertinent agreements.

The final page of the audit plan also includes a statement that the plan is a guide for examination and "is subject to revision as progress indicates the need for more, less, or different work than originally planned."

It would seem that the planned audit program should provide the IRS with a definitive and more comprehensive examination of large, multi-operational taxpayers, and may well result in greater tax revenue from closer scrutiny of the so-called "gray" areas of the tax laws that are frequently subject to varying interpretations and much litigation. It may also prove to be beneficial to taxpayers whose records, though complex and detailed because of the magnitude of their operations, are factually correct and within the provisions of pertinent Code sections and regulations. A planned program should eliminate wasted time that might otherwise occur as a result of inexperienced Service personnel examining tax areas in which they might have no expertise.