Accounting for ESPPs – Share True Ups

One of the most common mistakes seen in accounting for IRC Section 423-qualified Employee Stock Purchase Plans (ESPPs) is that when the purchase occurs, the ESPP expense is trued up to the shares that were actually purchased. This is not exactly correct under FASB ASC 718.

A few examples demonstrating why this is not always the right thing to do:

1. If a participant voluntarily withdraws from the ESPP Plan during the offering/purchase period, but is still employed on the ESPP Purchase Date, you should NOT reduce the amount of ESPP expense booked for the reduction in shares actually purchased. This is similar to the participant choosing NOT to exercise their vested ESPP stock option. The "requisite service period" has been completed as the participant stayed with the company during the ESPP offering/purchase period, so ESPP expense should NOT be reversed nor reduced. Think of it as the vested ESPP stock option is being cancelled or it has expired pursuant to its original terms. (See FASB ASC 718-50-35-2 and CEPI GPS- ESPP Publication (2015) Section 11.5.4[(1)])

2. Likewise, if a participant reduces their enrollment contribution to $0 or 0%, but is still employed on the ESPP Purchase Date (whether or not they obtain a refund of amounts previously contributed) you should NOT reduce the amount of ESPP expense booked for the reduction in shares actually purchased (either Zero or a smaller number of shares). This is similar to the participant choosing to exercise only a portion of their vested ESPP stock option. Again, the "requisite service period" has been completed, so the grant date fair value ESPP expense should be retained. (See FASB ASC 718-50-35-2 and CEPI GPS- ESPP Publication (2015) Section 11.5.4[(1)])

3. If the number of shares purchased increases because the fair market value (stock price) drops during the offering period (and there is no limit in the plan restricting the participant from purchasing more shares), the possibility of purchasing more shares is already captured in the ESPP fair value calculated on the grant date (aka ESPP enrollment date/offering begin date). One component of the ESPP grant date fair value for these types of plans (called look-back plans) is a "put option" which reflects the additional value received by the participant from this feature. So again, no ESPP Expense true up is required. (See FASB ASC 718-50-55-24 and CEPI GPS- ESPP Publication (2015) Section 11.4.3[(1)])

So when DO you true up ESPP expense to the shares actually purchased? Generally, in two cases:

1. You true up if the participant terminates employment with the company and thereby is terminated from the ESPP plan pursuant to its terms. This is similar to the participant forfeiting an unvested ESPP stock option. As we know, expense previously recognized on unvested/forfeited shares is reversed because the "requisite service period" was not completed. In other words, the participant did not stay with the company during the ESPP offering/purchase period (See FASB ASC 718-50-35-2 and CEPI GPS- ESPP Publication (2015) Section 11.5.4[(1)]) OR

2. You true up if the number of ESPP shares purchased increased due to a salary increase, commission or bonus payment (not the result of the participant increasing his/her contribution %). These types of increases do not trigger ESPP modification accounting unlike some others. (See FASB ASC 718-50-35-1 and CEPI GPS- ESPP Publication (2015) Section 11.5.3[(1)])

[(1)]- Certified Equity Professional Institute's Guidance|Procedures|Systems: ESPP 2015 Edition.

Now it is not easy to perform these share true ups when looking at contributions or shares in the aggregate. So, you may have to look on an individual participant basis and then sum the totals. Should your equity database not be able to provide participant level ESPP Expense, please check out our SOS ESPP Expensing Edge Application. Here is a Datasheet as well as a brief Webcast on this cool application.

Questions or comments? Please email us at xtra@sos-team.com

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