OOPS! ACCOUNTING FOR ESPPS - SHARE TRUE UPS?

One of the most common mistakes I see in accounting for Section 423-qualified Employee Stock Purchase Plans (ESPPs) is that when the purchase occurs, the expense is trued up to the shares that were actually purchased. Wrong! (At least in many cases.)

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

1. If a participant **voluntarily withdraws** from the plan during the offering period, but is still employed at the time of purchase, you should NOT reduce the amount of expense booked for the reduction in shares actually purchased. This is analogous to the participant choosing NOT to exercise their stock option, even though it vested. The "requisite service period" has been completed, so you "get" to keep the expense. Lucky you. (ASC Topic 718-50-35-2)
2. Likewise, if a participant **reduces their enrollment contribution**, but is still employed at the purchase, you should NOT reduce the amount of expense booked for the reduction in shares actually purchased. This is analogous to the participant choosing to exercise only a portion of their stock option, even though it vested. Again, the "requisite service period" has been completed, so the expense is retained. (ASC Topic 718-50-35-2)
3. If the number of **shares purchased increases because market value drops** during the offering period (and there is no limit in the plan restricting the participant from purchasing more shares). The possibility of the purchase of more shares is already captured in the fair value calculated on the grant date (aka enrollment date). One component of the fair value of these types of plans is a "put option" that reflects the additional value received by the participant from this feature. So again, no true up is required. (ASC Topic 718-50-55-24)

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

1. If the participant terminates and thereby withdraws from the plan this is akin to forfeiting an option and any expense recognized on forfeited shares can be reversed because the requisite service period was not completed (ASC Topic 718-50-35-2) OR
2. If the number of shares purchased increases due to a salary increase, bonus, etc. (and these increases do not trigger modification accounting unlike many others) (ASC Topic 718-50-35-1)

I recently worked with a client that had been truing up expense to the exact number of shares purchased for many years. The issue was raised and the client made a change to their process, only truing up for the cases mentioned above. When the auditor arrived that quarter, he asked why the process had changed. We explained and cited the appropriate literature. He was surprised and concerned that "now what are we going to reconcile to?" Apparently some may be more concerned with having a number to easily tie out to than following the guidance correctly.

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