Case 13-5
Occupy Mall Street

Occupy Mall Street ("OMS" or "the Company") is a leading real estate management firm that owns and manages over 100 shopping malls across the United States. The Company went public in 2009 and experienced a continued increase in stock price through 2011. With the sustained growth of the business and rising stock price, OMS developed a practice of granting annual stock option awards to its executives at the beginning of each year.

On January 1, 2012, OMS granted 1,000 employee share options that cliff vest after a four-year service period, with an exercise price of $30 per share. Using the Black-Scholes pricing model, the Company determined that the grant-date fair-value-based measure of the awards was $15. On the grant date, the Company's stock was trading at $30 per share.

On January 1, 2014, to provide additional retention incentive to its employees for the third and fourth years of service of the 2012 annual grant, OMS will change the terms of the award by modifying the exercise price to $20 per share. Using the Black-Scholes pricing model, management determined that the fair-value-based measure of the awards was $12 after modification and $9 before the terms of the award were modified. The modification did not affect any of the other terms or conditions of the awards.

Note that no forfeitures are assumed for the purposes of this case.

Required:

1. How much compensation cost should OMS recognize in each year of the award's service period?
2. How would the accounting for these awards change if the modification to the terms (i.e., exercise price) of the award was made on January 1, 2017, after the awards have become fully vested?

Additional Case Facts:

Assume the same facts as described above. However, the terms of the award also include a performance condition in which the awards will vest if cumulative net income over the four-year vesting period is greater than $10 million. On December 31, 2013, because of the loss of several tenants, projected cumulative net income over the four-year period had been revised down to $9 million. As a result, management determined that the performance condition had become improbable to achieve.

On December 31, 2014, management's conclusion that the award's performance condition was improbable of achievement had not changed. In response to this, management reduced the performance condition of the original award to $8 million of cumulative net income over the four-year period. Using the Black-Scholes pricing model, management determined that the fair-value-based measure of the awards was $12 upon modification. The modification did not affect any of the other terms or conditions of the awards; thus, the modification did not affect the option's per-share fair-value-based measure.

Note that OMS had actually achieved $9.2 million of cumulative net income over the four-year period.

Required:

3. How would the Year 2 accounting change if management determined that the performance condition was improbable of achievement on December 31, 2013? What would be the cumulative amount of compensation cost recognized?
4. How much compensation cost would management recognize in Year 3 and Year 4 if the December 31, 2014, modification resulted in the awards becoming probable of achievement?

4a. How would the accounting for this modification differ under IFRSs?

Additional Case Facts:

Assume the same facts as described above. However, contemporaneously with the December 31, 2014, modification, OMS will lose a major tenant to bankruptcy; this loss will have a detrimental effect on the Company's financial results for the year ended December 31, 2014. Even though OMS modified the options to reduce the performance target, loss of the significant tenant prompts OMS to maintain that the achievement of the performance target is improbable (i.e., the options are not expected to vest under the original or modified terms).

Required:

5. If the awards continued to be improbable of achievement after modification, how much cumulative compensation cost would be recognized through December 31, 2015? December 31, 2016?