Case 08-2

Sooner or Later

On January 1, 2006, Sooner or Later Inc. granted 1,000 “at-the-money” employee stock options (i.e., the exercise price was equal to the stock price on the grant date). To align the compensation of the employees with the financial performance of the company, the award will vest only if cumulative revenue over the following three-year reporting period is greater than $10 million and the employees are still employed by Sooner or Later. As of the date of the grant, management believes it probable that the company will achieve cumulative revenue in excess of $10 million over the following three-year period.

Each award has a grant-date fair value of $9. Sooner or Later’s valuation professionals have indicated that if the revenue target was factored into the fair value assessment, the grant-date fair value would be $6.


Revenue in each of the next three years was as follows:

2006: $2 million
2007: $5 million
2008: $4 million

**Required:**

- Should Sooner or Later use the $6 grant-date fair value or the $9 grant-date fair value to measure its compensation cost?

- Over how many years should Sooner or Later recognize compensation cost associated with the stock options, and how much, if any, should be recognized in each of those years? The effects of forfeitures and income taxes should be ignored.