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DON'T FORGET ACCOUNTING RULES WHEN ACCELERATING VESTING OF STOCK-BASED AWARDS

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WHAT HAPPENED

Last month, the SEC settled charges against Celsius Holdings, Inc. for allegedly improper accounting when it modified equity compensation awards for six departing employees and retiring directors. The errors caused allegedly inaccurate financial statements due to the understatement of G&A expenses.

Without admitting or denying the SEC's findings, the company agreed to cease and desist from violating SEC rules and pay a $3.0 million civil penalty.

In addition, before the settlement, the company's CEO reimbursed the company for $1.5 million in profits from stock sales after the issuance of the erroneous financial statements. In addition, the CEO returned 18,000 RSUs or shares that were granted shortly before announcement of the erroneous financial statements. Although not mentioned by the SEC, Section 304 of the Sarbanes-Oxley Act provides that CEOs and CFOs shall reimburse companies for certain compensation or stock-sale profits where earnings are restated as a result of misconduct.

TAKEAWAYS

The case highlights the importance of coordinating review by HR, accounting and legal functions whenever companies take actions relating to equity compensation awards, such as accelerating vesting or otherwise modifying such awards.

The company's remedial steps cited by the SEC (described at the end of this post) underscore the importance of maintaining:

- Disclosure and internal controls addressing modifications to stock-based compensation awards.
- Legal review of reporting and disclosure issues.
- An appropriate internal audit function.

- An effective disclosure committee.

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Background

The key facts are taken from the SEC Order. In the past, employees or directors of Celsius forfeited any stock awards when they left. However, in mid-2021, the company accelerated the vesting of awards, or allowed continued vesting, for six departing employees and retiring directors.

ASC 718 requires companies to re-value stock awards as of the date of any modification and record any additional value of the modified award over the fair value of the original award as incremental compensation costs over the remaining service period.

Re-valuing the awards would have increased their value and corresponding stock-based compensation expense. Here, the company failed to recognize such incremental expense and therefore materially understated G&A expenses in earnings releases furnished on Form 8-Ks and Form 10-Qs for Q2 and Q3 of 2021.

On March 1, 2022, Celsius filed a Form 8-K disclosing that its stock-based compensation expenses in Q2 and Q3 of 2021 had been materially understated. As a result, Celsius overstated net income by approximately 400% for Q2 2021, and understated net loss by approximately 130% for Q3 2021.

On March 16, 2022, the company filed restated financial information in its 2021 Form 10-K. The corrections caused previously reported net income to become a net loss for the three- and nine-month periods ended September 30, 2021.

Return of equity awards; reimbursement of stock sale profits

After Celsius filed quarterly reports for Q2 and Q3 of 2021 with misstated financial statements, the company's CEO sold 20,000 Celsius shares on December 27, 2021, for a profit of $1,493,200. The CEO subsequently reimbursed that amount to Celsius.

On January 1, 2022, the company granted the CEO 18,000 restricted stock units. Of the 18,000 total RSUs, 12,000 had vested by January 2024. The CEO returned the 12,000 shares to Celsius. Celsius also cancelled the remaining 6,000 RSUs granted to the CEO before they would have vested in 2025.

Although not mentioned in the SEC Order, Section 304 of Sarbanes-Oxley provides that the CEO and CFO shall reimburse a company for any bonus or other incentive- or equity-based compensation, and any profits from stock sales, during the twelve months following the release of financial statements that require restatement as a result of misconduct.

Alleged violations; terms of settlement

The SEC alleged violations of the Securities Exchange Act of 1934, including:

- Section 13(a) as a result of issuing materially inaccurate and misleading financial statements in Form 10-Qs and earnings releases furnished on Form 8-K relating to Q2 and Q3 of 2021.
- Section 13(b)(2)(A) as a result of understating expenses in the company's books and records associated with modified vesting terms in 2021 for stock awards for former employees and directors.
- Section 13(b)(2)(B) as a result of failing to maintain internal accounting controls that provided reasonable assurance that its stock-based compensation expense was recorded in accordance with GAAP.
- Rule 13a-15(a) as a result of not maintaining disclosure controls and procedures to ensure non-financial information was disclosed, as required

In reaching the settlement, the SEC considered remedial actions taken by the company after it learned of the investigation, including:

- Retaining external legal counsel to advise on reporting and disclosure issues.
- Developing enhanced controls to address the evaluation and application of modifications to stock-based compensation awards.
- Creating an internal audit function.
- Establishing a disclosure committee.
- Hiring a new CFO.
- Hiring a Chief Legal Officer.

Hiring a communications executive to review the company's filings.

RELATED PRACTICE AREAS

- Securities Litigation and Enforcement
- Securities & Corporate Governance

MEET THE TEAM

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