

Accounting 402  
Illustration of Accounting for Stock Options

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The Lexmark Company provides a stock option plan to its executives. Under this plan, the company granted options on January 1, 2005, that permit executives to acquire 4 million of the Company's \$5 par value common shares within the next five years, but not before the vesting date of December 31, 2006. The exercise price is the market price of the shares on the date of the grant, which was \$15 per share. The fair value of the 4 million options, estimated by an appropriate asset pricing model, is \$4 per option. No forfeitures are expected. Ignore tax implications.

- A. Determine the total compensation cost pertaining to the options, assuming the company follows the fair value approach for fixed compensation plans.
- B. Prepare the journal entry to record the awarding of the options on January 1, 2005.
- C. Prepare the journal entry to record compensation expense on December 31, 2005.
- D. Prepare the journal entry to record compensation expense on December 31, 2006.
- E. Determine the total compensation cost of the options, assuming the company does not follow the fair value approach for fixed compensation plans.