Guidance Note
on
Accounting for Share-based Payments

Research Committee
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

The recent time has witnessed a rise in the number of transactions involving share-based payments. Globally, the employers use share-based payments as a part of remuneration package for their employees a practice adopted by many companies in India. Apart from using share-based payments to compensate employees for their services, such payments are also used by employers to incentivise their employees to reward them for their efforts in improving its performance and remain committed to the Company.

Several companies also offer share-based payments to non-employees, including vendors. The concept of share-based payments is broader than employee share options. Indian Accounting Standard 102 covers the share-based payments to non-employees also. Recognising the need for establishing uniform accounting principles and practices for all types of share-based payments for the companies following Accounting Standards under Companies (Accounting Standards) Rules, 2006, as amended under Section 133 of Companies Act, 2013, it is heartening to note that the Research Committee of the Institute has come out with this '**Guidance Note on Accounting for Share-based Payments**'.

I would like to congratulate CA. Anuj Goyal, Chairman, Research Committee, CA. Kemisha Soni, Vice-Chairperson, Research Committee, and other members of the Research Committee for their contribution in development of this Guidance Note.

I am confident that this endeavour of the Research Committee will go a long way in establishing sound principles on Accounting for Share-based Payments and providing guidance to the members as well as others concerned stakeholders.

New Delhi
September 23, 2020

CA. Atul Kumar Gupta
President, ICAI

Preface

Large number of entities in India are involved in share-based payment transactions. At present, to provide guidance in this regard and to address the accounting issues relating to share based payment transactions, a need was being felt for revising the Guidance Note originally issued in 2005 with a view to provide more guidance on the matter.

Keeping this in view, Research Committee has revised this as '**Guidance Note on Accounting for Share-based Payments**' which deals with the share-based payment transactions with employees as well as non-employees. The approach is to align this Guidance Note with Indian Accounting Standard 102 as much as possible. This Guidance Note deals extensively with group-wide share-based payment transactions (e.g., grants by the parent company to employees of a subsidiary company).

I would like to convey my sincere thanks to CA. Atul Kumar Gupta, President, ICAI and CA. Nihar N. Jambusaria, Vice-President, ICAI for providing unflinching guidance on various activities of the Committee. I would like to convey my sincere thanks to CA. Kemisha Soni, Vice-Chairperson, Research Committee for her constant support and co-operation.

I would like to take this opportunity to express my gratitude and thanks to CA. Babu Abraham Kallivayalil, Past Chairman, Research Committee and CA. Satish Kumar Gupta, Past Vice-Chairman, Research Committee for initiating the task of revising this Guidance Note in a timely manner for the benefit of all.

I would also like to acknowledge the invaluable contribution made by CA. M.P. Vijay Kumar, CCM who spared his valuable time for providing significant inputs and for representing the draft Guidance Note before the Council, CA. Sanjay Vasudeva, Co-opted Member, Research Committee for providing invaluable inputs in preparation of draft Guidance Note, CA. Santosh Maller, Resource Person for formulating the draft of this Guidance Note, and other members for their invaluable support in this endeavour of the Research Committee. I am also thankful to the branches of ICAI, members at large and to various representatives of industry for giving their invaluable comments and suggestions on the exposure draft on the said Guidance Note.

I also appreciate the untiring efforts made by Dr. Amit Kumar Agrawal, Secretary, Research Committee, CA. Amit Agarwal, Senior Executive Officer and CA. Sakshi Garg, Project Associate, Research Committee in finalising the Guidance Note.

I believe and trust that this Guidance Note would be immensely useful for the members of the Institute as well as others concerned

New Delhi **CA Anuj Goyal**
September 4, 2020 **Chairman, Research Committee**

Contents

Guidance Note on Accounting for Share-based Payments

(The following is the text of the Guidance Note on Accounting for Share-based Payments, issued by the Institute of Chartered Accountants of India. This Guidance Note is applicable for enterprises that are not required to follow Indian Accounting Standards. Pursuant to the issuance of this, "Guidance Note on Accounting for Employee Share-based Payments" stands withdrawn)

Introduction

1. In a number of countries, shares and share options comprise a significant element of the total remuneration package of senior personnel; a trend encouraged by the current consensus that it is a matter of good corporate governance to promote significant long-term shareholdings by senior management, so as to align their economic interests with those of shareholders. Such plans generally take the forms of Employee Stock Option Plans (ESOPs), Employee Stock Purchase Plans (ESPPs) and Stock Appreciation Rights (SARs). ESOPs are plans under which an enterprise grants options for a specified period to its employees to purchase its shares at a fixed or determinable price. ESPPs are plans under which the enterprise grants rights to its employees to purchase its shares at a stated fair value at the time of public issue or otherwise (such ESPPs are outside the scope of share-based payment plan under this Guidance Note). One advantage of ESOPs and ESPPs as remuneration is that they need not entail any cash cost to the enterprise. SARs is a form of employee share-based payments whereby the employees become entitled to a future cash payment or shares based on the increase in the price of the shares from a specified level over a specified period. Apart from using share-based payments to compensate employees for their services, such payments are also used by an employer as an incentive to the employees to remain in its employment and to reward them for their efforts in improving its performance. Unlisted companies, in particular, start-up companies, often give share-based compensation since they cannot afford to pay high salaries to their employees but are willing to share the future prosperity of the company. Several companies also offer

share-based payments to non-employees, including various vendors. It is hence important that cost relating to these recognised in the financial statements.

2. Recognising the need for establishing uniform accounting principles and practices for all types of share-based payments, the Institute has issued a Guidance note on Accounting for Employee Share-based Payments in 2005. Considering that share based payments to vendors is on the rise, the Guidance note on Accounting for Employee Share-based Payments has been replaced by this Guidance Note. Once the Accounting Standard dealing with Share- based Payments comes into force, this Guidance Note will automatically stand withdrawn.

This Guidance Note is applicable to companies following Accounting Standards under Companies (Accounting Standards) Rules, 2006, as amended under Section 133 of Companies Act, 2013. Companies following Companies (Indian Accounting Standards) Rules, 2015, as amended, shall continue to follow Ind AS 102 – Accounting for Share Based Payments.

Scope

3. This Guidance Note establishes financial accounting and reporting principles for share-based payment plans, including., ESOPs, ESPPs and SARs as well as share-based payment arrangement with non-employees. For the purposes of this Guidance Note, the term ‘employee’ includes a director of the enterprise, whether whole time or not.

4. Although this Guidance Note was primarily a response to concerns over share-based remuneration, its scope is not restricted to transactions with employees. For example, if an external supplier of goods or services, including another group enterprise, is paid in shares or share options, or cash (or other assets) of equivalent value, this Guidance Note shall be applied. Goods include:

- Inventories;
- Consumables;
- Property, plant and equipment;
- Intangible assets; and
- Other non-financial assets.

Similarly, services include all types of services, including consulting services, engineering services, website development and other services.

5. The Guidance Note must be applied to all share-based payment transactions, including:

(a) equity-settled share-based payment transactions;

(b) cash-settled share-based payment transactions; and

(c) transactions where either the enterprise or the supplier of goods or services can choose whether the transaction is to be equity- settled or cash-settled.

6. However, an enterprise shall not apply this Guidance Note to transactions in which the enterprise acquires goods as part of the net assets acquired in a merger or amalgamation as defined by AS 14, Accounting for Amalgamations, enterprises or the contribution of a business on the formation of a joint venture as defined by AS 27, Financial Reporting of Interests in Joint Ventures. Hence, equity instruments issued in an amalgamation or merger in exchange for control of the acquiree are not within the scope of this Guidance Note.

7. However, equity instruments granted to employees or vendors of the acquiree in their capacity as employees or vendors (e.g. in return for continued service) are within the scope of this Guidance Note. Similarly, the cancellation, replacement or other modification of share-based payment arrangements because of an amalgamation or merger or other equity restructuring shall be accounted for in accordance with this Guidance Note.

8. The scope of this Guidance extends to:

- group share-based payment schemes and certain transactions with shareholders;
- transactions with employee benefit/employee stock option trusts and similar vehicles;
- transactions where the identifiable consideration received appears to be less than the consideration given in the form of shares;
- 'all employee' share-based plans; and
- vested share-based payment transactions.

9. Within a group of companies it is common for one member of the group (typically the parent) to have the obligation to settle a share-based

payment transaction in which services are provided to another member of the group (typically a subsidiary). This transaction is within the scope of this Guidance Note for the enterprise receiving the services (even though it is not a direct party to the arrangement between its parent and its employee), the enterprise settling the transaction and the group as a whole. Accordingly, this Guidance Note requires an enterprise to account for a transaction in which it either:

- receives goods or services when another enterprise in the same group (or a shareholder of any group enterprise) has the obligation to settle the share-based payment transaction, or
- has an obligation to settle a share-based payment transaction when another enterprise in the same group receives the goods or services unless the transaction purpose other than payment for goods or services supplied to the enterprise receiving them.

Appendix X illustrates the accounting for group-wide share-based payment transactions.

10. This also applies to transfers of shares or stock options of the parent of the enterprise, or shares or stock options of another enterprise in the same group as the enterprise, to the employees of the enterprise.

11. For the purposes of this Guidance Note, a transaction with an employee (or any other party) in his/her capacity as a holder of shares of the enterprise is not a share-based payment. For example, if an enterprise grants all holders of a particular class of its shares, the right to acquire additional shares or stock options of the enterprise at a price that is less than the fair value of those shares or stock options, and an receives such a right because he/she is a holder of shares or stock options of that particular class, the granting or exercise of that right is not subject to the requirements of this Guidance Note.

12 For the purposes of this Guidance Note, a grant of shares to the employees at the time of public issue is not an share-based payment if the price and other terms at which the shares are offered to employees are the same or similar to those at which the shares have been offered to general investors, for example, in a public issue an enterprise grants shares to its employees as a preferential allotment while the price and other terms remain the same as those to other investors.

A share-based payment transaction as defined involves the receipt of goods or services by the reporting enterprise or by another group enterprise. Nevertheless, this Guidance Note also applies to share-based payment transactions where no specifically identifiable goods or services have been (or will be) received. If the identifiable consideration received (if any) appears to be less than the fair value of consideration given, the implication is that, in addition to the identifiable goods and services acquired, the enterprise must also have received some unidentifiable consideration equal to the difference between the fair value of the share-based payment and the fair value of any identifiable consideration received.

Accordingly, the cost of the unidentified consideration must be accounted for in accordance with this Guidance Note. For example, if an enterprise agrees to pay a supplier of services with a clearly identifiable market value of ₹ 1,000 by issuing shares with a value of ₹ 1,500, this Guidance Note would require the enterprise to recognise an expense of ₹ 1,500. This is notwithstanding the normal requirement of this Guidance Note that an equity-settled share-based payment transaction with a non-employee be recognised at the fair value of the goods or services received.

Appendix IX provides illustrations of share-based payment transaction with counterparties other than employees.

Definitions

13. For the purpose of this Guidance Note, the following terms are used with the meanings specified:

A *share-based payment arrangement* is 'an agreement between the enterprise (or another group enterprise or any shareholder of any group enterprise) and another party (including an employee) that entitles the other party to receive:

(a) Cash or other assets of the enterprise for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the enterprise or another group enterprise, or

(b) Equity instruments (including shares or share options) of the enterprise or another group enterprise, provided the specified vesting conditions, if any, are met.'

A *share-based payment transaction* is 'a transaction in which the enterprise

(a) Receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement, or

(b) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group enterprise receives those goods or services.'

An *equity-settled share-based payment transaction* is 'a share-based payment transaction in which the enterprise

(a) receives goods or services as consideration for its own equity instruments (including shares or share options), or

(b) receives goods or services but has no obligation to settle the transaction with the supplier.'

A *cash-settled share-based payment transaction* is 'a share-based payment transaction in which the enterprise acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the enterprise or another group enterprise'.

A *group enterprise* in the four definitions above means any parent, subsidiary, or subsidiary of any parent, of the enterprise and is based on the definition of 'group' in AS 21 – Consolidated Financial Statements – as 'a parent and its subsidiaries'.

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities.

An *equity instrument* granted is 'the right (conditional or unconditional) to an equity instrument of the enterprise conferred by the enterprise on another party, under a share-based payment arrangement'.

Exercise means making of an application by the counterparty for issue of equity instruments (including shares or share options) against the option vested in pursuance of the share-based payment arrangement.

Exercise Period is the time period after vesting within which the counterparty should exercise his/her/its right to apply for equity instruments (including shares or share options) against the option vested in him in pursuance of the share-based payment arrangement.

Expected Life of an Option is the period of time from grant date to the date on which an option is expected to be exercised.

Exercise Price is the price payable by the counterparty for exercising the option granted to him/her/it in pursuance of the share-based payment arrangement.

Fair Value is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

Grant Date is the date at which the enterprise and another party (including an employee) agree to a share-based payment arrangement, being when the enterprise and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date, the enterprise confers on the counterparty the right to cash, other assets, or equity instruments of the enterprise, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

Measurement date is the date at which the fair value of the equity instruments granted is measured for the purposes of this Guidance Note. For transactions with employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the enterprise obtains the goods or the counterparty renders service.

Intrinsic Value is the difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of ₹ 15, on a share with a fair value of ₹ 20, has an intrinsic value of ₹ 5.

Market Condition is a performance condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price (or value) of the enterprise's equity instruments (or the equity instruments of another enterprise in the same group), such as:

(a) attaining a specified share price or a specified amount of intrinsic value of a share option; or

(b) achieving a specified target that is based on the market price (or value) of the enterprise's equity instruments (or the equity instruments of another enterprise in the same group) relative to an index of market prices of equity instruments of other enterprises.

A market condition requires the counterparty to complete a specified period of service (i.e. a service condition); the service requirement can be explicit or implicit.

Performance condition is a vesting condition that requires:

(a) the counterparty to complete a specified period of service (i.e. a service condition); the service requirement can be explicit or implicit; and

(b) specified performance target(s) to be met while the counterparty is rendering the service required in (a).

The period of achieving the performance target(s):

(a) shall not extend beyond the end of the service period; and

(b) may start before the service period on the condition that the commencement date of the performance target is not substantially before the commencement of the service period.

A *performance target* is defined by reference to:

(a) the enterprise's own operations (or activities) or the operations or activities of another enterprise in the same group (i.e. a non-market condition); or

(b) the price (or value) of the enterprise's equity instruments or the equity instruments of another enterprise in the same group (including shares and share options) (i.e. a market condition).

A performance target might relate either to the performance of the enterprise as a whole or to some part of the enterprise (or part of the group), such as a division or an individual employee.

Reload Feature is a feature that provides for an automatic grant of additional stock options whenever the option holder exercises previously granted options using the shares of the enterprise, rather than cash, to satisfy the exercise price.

Reload Option is a new stock option granted when a share of the enterprise is used to satisfy the exercise price of a previous stock option.

Repricing of an employee stock option means changing the existing exercise price of the option to a different price.

Share option is a contract that gives the holder the right, but not the obligation, to subscribe to the enterprise's shares at a fixed or determinable price for a specified period of time.

Stock Appreciation Rights are the rights that entitle the employees to receive cash or shares for an amount equivalent to any excess of the market value of a stated number of enterprise's shares over a stated price. The form of payment may be specified when the rights are granted or may be determined when they are exercised; in some plans, the employee may choose the form of payment.

Vest means to become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the enterprise vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.

Vesting Period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Vesting Condition is a condition that determines whether the enterprise receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the enterprise, under a share-based payment arrangement. A vesting condition is either a service condition or a performance condition.

Volatility is a measure of the amount by which a price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The volatility of a share price is the standard deviation of the continuously compounded rates of return on the share over a specified period.

Accounting

14. A share-based payment plan within the scope for this Guidance Note can be accounted for by adopting the fair value method or the intrinsic value method. The accounting treatment recommended herein below is based on the fair value method. The application of the intrinsic value method is explained thereafter in paragraph 72.

Recognition

15. An enterprise shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The enterprise shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction. This account resulting from equity increase in an equity-settled share-based payment transaction is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as per this Guidance Note.

16. When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.

17. Typically, an expense arises from the consumption of goods or services. For example, services are typically consumed immediately, in which case an expense is recognised as the counterparty renders service. Goods might be consumed over a period of time or, in the case of inventories, sold at a later date, in which case an expense is recognised when the goods are consumed or sold. However, sometimes it is necessary to recognise an expense before the goods or services are consumed or sold, because they do not qualify for recognition as assets. For example, an enterprise might acquire goods as part of the research phase of a project to develop a new product. Although those goods have not been consumed, they might not qualify for recognition as assets under the applicable Accounting Standard.

Equity-settled share-based payment transactions

18. For equity-settled share-based payment transactions, the enterprise shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the enterprise cannot estimate reliably the fair value of the goods or services received, the enterprise shall measure their value, and the corresponding increase in

equity, indirectly, by reference to[1] the fair value of the equity instruments granted.

19. If the shares or stock options granted vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those instruments. In the absence of evidence to the contrary, the enterprise should presume that services rendered by the employee as consideration for the instruments have been received. In this case, on the grant date, the enterprise should recognise services received in full with a corresponding credit to the equity account.

20. To apply the requirements of paragraph 17 to transactions with employees and others providing similar services[2], the enterprise shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received. The fair value of those equity instruments shall be measured at grant date.

21. Typically, shares, share options or other equity instruments are granted to employees as part of their remuneration package, in addition to a cash salary and other employment benefits. Usually, it is not possible to measure directly the services received for particular components of the employee's remuneration package. It might also not be possible to measure the fair value of the total remuneration package independently, without measuring directly the fair value of the equity instruments granted. Furthermore, shares or share options are sometimes granted as part of a bonus arrangement, rather than as a part of basic remuneration, e.g. as an incentive to the employees to remain in the enterprise's employment or to reward them for their efforts in improving the enterprise's performance. By granting shares or share options, in addition to other remuneration, the enterprise is paying additional remuneration to obtain additional benefits. Estimating the fair value of those additional benefits is likely to be difficult. Because of the difficulty of measuring directly the fair value of the services

[1] This GN uses the phrase 'by reference to' rather than 'at', because the transaction is ultimately measured by multiplying the fair value of the equity instruments granted, measured at the date specified in paragraph 20 or 22 (whichever is applicable), by the number of equity instruments that vest, as explained in paragraph 28.

[2] In the remainder of this GN, all references to employees also include others providing similar services.

received, the enterprise shall measure the fair value of the employee services received by reference to the fair value of the equity instruments granted.

22. To apply the requirements of paragraph 17 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the enterprise obtains the goods or the counterparty renders service. In rare cases, if the enterprise rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the enterprise shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the enterprise obtains the goods or the counterparty renders service.

23. In particular, if the identifiable consideration received (if any) by the enterprise appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (i.e. unidentifiable goods or services) has been (or will be) received by the enterprise. The enterprise shall measure the identifiable goods or services received in accordance with this Guidance Note. The enterprise shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The enterprise shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be premeasured at the end of each reporting period until it is settled in accordance with paragraphs 44-47.

Transactions in which services are received

24. If the equity instruments granted vest immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the enterprise shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the enterprise shall recognise the services received in full, with a corresponding increase in equity.

25. If the equity instruments granted do not vest until the counterparty completes a specified period of service, the enterprise should presume that the services to be rendered by the counterparty as consideration for those instruments will be received in the future, during the vesting period. The enterprise should account for those services as they are rendered by the employee during the vesting period, on a time proportion basis, with a corresponding credit to the equity account. For example:

(a) if an employee is granted share options conditional upon completing three years' service, then the enterprise shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period.

(b) if an employee is granted share options conditional upon the achievement of a performance condition and remaining in the enterprise's employment until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the enterprise shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. The enterprise shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a market condition, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted and shall not be subsequently revised. If the performance condition is not a market condition, the enterprise shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates.

Transactions measured by reference to the fair value of the equity instruments granted

Determining the fair value of equity instruments granted

26. For transactions measured by reference to the fair value of the equity instruments granted, an enterprise shall measure the fair value of equity instruments granted at the measurement date, based on market prices if

available, taking into account the terms and conditions upon which those equity instruments were granted (subject to the requirements of paragraphs 28-33).

27. If market prices are not available, the enterprise shall estimate the fair value of the equity instruments granted using a valuation technique to estimate what the price of those equity instruments would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties. The valuation technique shall be consistent with generally accepted valuation methodologies for pricing financial instruments, and shall incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price (subject to the requirements of paragraphs 28-33).

Treatment of vesting conditions

28. A grant of equity instruments might be conditional upon satisfying specified vesting conditions. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the enterprise's employment for a specified period of time. There might be performance conditions that must be satisfied, such as the enterprise achieving a specified growth in profit or a specified increase in the enterprise's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, e.g. the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 30.

29. To apply the requirements of paragraph 28, the enterprise shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments

expected to vest differs from previous estimates. On vesting date, the enterprise shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 30.

30. Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the enterprise shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions (e.g. services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied.

Treatment of non-vesting conditions

31. Similarly, an enterprise shall take into account all non-vesting conditions when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with non-vesting conditions, the enterprise shall recognise the goods or services received from a counterparty that satisfies all vesting conditions that are not market conditions (e.g. services received from an employee who remains in service for the specified period of service), irrespective of whether those non-vesting conditions are satisfied.

32. Appendix I contains further guidance on the measurement of the fair value of shares and stock options, focusing on the specific terms and conditions that are common features of a grant of shares or stock options to employees.

Reload features

33. For options with a reload feature, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a reload option shall be accounted for as a new option grant, if and when a reload option is subsequently granted.

After vesting date

34. Having recognised the goods or services received in accordance with paragraphs 18–33, and a corresponding increase in equity, the enterprise shall make no subsequent adjustment to total equity after vesting date. For example, the enterprise shall not subsequently reverse the amount recognised for services received from an employee if the vested equity

instruments are later forfeited or, in the case of share options, the options are not exercised. However, this requirement does not preclude the enterprise from recognising a transfer within equity, i.e. a transfer from one component of equity to another.

Appendix II contains various illustrations of the accounting for equity-settled employee share-based payment plans that do not involve modifications to the terms and conditions of the grants.

If the fair value of the equity instruments cannot be estimated reliably

35. The requirements in paragraphs 26–34 apply when the enterprise is required to measure a share-based payment transaction by reference to the fair value of the equity instruments granted. In rare cases, the enterprise may be unable to estimate reliably the fair value of the equity instruments granted at the measurement date, in accordance with the requirements in paragraphs 26-33.

36. In these rare cases only, the enterprise shall instead:

(a) measure the equity instruments at their intrinsic value, initially at the date the enterprise obtains the goods or the counterparty renders service and subsequently at the end of each reporting period and at the date of final settlement, with any change in intrinsic value recognised in profit or loss. For a grant of share options, the share-based payment arrangement is finally settled when the options are exercised, are forfeited (e.g. upon cessation of employment) or lapse (e.g. at the end of the option's life).

(b) recognise the goods or services received based on the number of equity instruments that ultimately vest or (where applicable) are ultimately exercised. To apply this requirement to share options, for example, the enterprise shall recognise the goods or services received during the vesting period, if any, in accordance with paragraphs 24 and 25, except that the requirements in paragraph 25(b) concerning a market condition do not apply. The amount recognised for goods or services received during the vesting period shall be based on the number of share options expected to vest. The enterprise shall revise that estimate, if necessary, if subsequent information indicates that the number of share options expected to vest differs from previous estimates. On vesting date, the enterprise shall revise the estimate to equal the number of equity instruments that ultimately vested. After vesting date, the enterprise shall reverse the amount recognised for goods or services received if the share options are later forfeited or lapse at the end of the share option's life.

37. If an enterprise applies paragraph 36, it is not necessary to apply paragraphs 38– 43, because any modifications to the terms and conditions on which the equity instruments were granted will be taken into account when applying the intrinsic value method set out in paragraph 36. However, if an enterprise settles a grant of equity instruments to which paragraph 36 has been applied:

(a) if the settlement occurs during the vesting period, the enterprise shall account for the settlement as an acceleration of vesting and shall therefore recognise immediately the amount that would otherwise have been recognised for services received over the remainder of the vesting period.

(b) any payment made on settlement shall be accounted for as the repurchase of equity instruments, i.e. as a deduction from equity, except to the extent that the payment exceeds the intrinsic value of the equity instruments, measured at the repurchase date. Any such excess shall be recognised as an expense.

Modifications to the terms and conditions on which equity instruments were granted, including cancellations and settlements

38. An enterprise might modify the terms and conditions on which the shares or stock options were granted. For example, it might reduce the exercise price of options granted to employees (i.e., reprice the options), which increases the fair value of those options.

39. The requirements in paragraphs 40–43 to account for the effects of modifications are expressed in the context of share-based payment transactions with employees. However, the requirements shall also be applied to share-based payment transactions with parties other than employees that are measured by reference to the fair value of the equity instruments granted. In the latter case, any references in paragraphs 40–43 to grant date shall instead refer to the date the enterprise obtains the goods or the counterparty renders service.

40. The enterprise shall recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. This applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments. In addition, the enterprise shall recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

41. If a grant of equity instruments is cancelled or settled during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) the enterprise shall account for the cancellation or settlement as an acceleration of vesting and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

(b) any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest, i.e. as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess shall be recognised as an expense. However, if the share-based payment arrangement included liability components, the enterprise shall premeasure the fair value of the liability at the date of cancellation or settlement. Any payment made to settle the liability component shall be accounted for as an extinguishment of the liability.

(c) if new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the enterprise identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the enterprise shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 40. The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with (b) above. If the enterprise does not identify new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the enterprise shall account for those new equity instruments as a new grant of equity instruments.

42. If an enterprise or counterparty can choose whether to meet a non-vesting condition, the enterprise shall treat the enterprise's or counterparty's failure to meet that non-vesting condition during the vesting period as a cancellation.

43. If an enterprise repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

Recognition and Measurement-Cash-settled share-based payment transactions

44. For cash-settled share-based payment transactions, the enterprise shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the enterprise shall premeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

45. For example, an enterprise might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the enterprise's share price from a specified level over a specified period of time. Or an enterprise might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (e.g. upon cessation of employment) or at the employee's option.

Recognition and measurement

46. The enterprise shall recognise the services received, and a liability to pay for those services, as the employees render service. For example, some share appreciation rights[3] vest immediately, and the employees are therefore not required to complete a specified period of service to become entitled to the cash payment. In the absence of evidence to the contrary, the enterprise shall presume that the services rendered by the employees in exchange for the share appreciation rights have been received. Thus, the enterprise shall recognise immediately the services received and a liability to pay for them. If the share appreciation rights do not vest until the employees have completed a specified period of service, the enterprise shall recognise the services received, and a liability to pay for them, as the employees render service during that period.

47. The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date.

Appendix III contains illustrations on modifications to the terms and conditions on which stock options were granted.

Treatment of vesting and non-vesting conditions

48. A cash-settled share-based payment transaction might be conditional upon satisfying specified vesting conditions. There might be performance conditions that must be satisfied, such as the enterprise achieving a specified growth in profit or a specified increase in the enterprise's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date. Instead, vesting conditions, other than market conditions, shall be taken into account by adjusting the number of awards included in the measurement of the liability arising from the transaction.

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[3] These arrangements are examples of cash-settled share-based payment transactions. Share appreciation rights are used to illustrate some the requirements of paragraph 44. However, these requirements apply to all the cash-settled share-based payment transactions.

49. To apply the requirements in paragraph 48, the enterprise shall recognise an amount for the goods or services received during the vesting period. That amount shall be based on the best available estimate of the number of awards that are expected to vest. The enterprise shall revise that estimate, if necessary, if subsequent information indicates that the number of awards that are expected to vest differs from previous estimates. On the vesting date, the enterprise shall revise the estimate to equal the number of awards that ultimately vested.

50. Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, as well as non-vesting conditions, shall be taken into account when estimating the fair value of the cash-settled share-based payment granted and when remeasuring the fair value at the end of each reporting period and at the date of settlement.

51. As a result of applying paragraphs 44–50, the cumulative amount ultimately recognised for goods or services received as consideration for the cash-settled share-based payment is equal to the cash that is paid.

Share-based payment transactions with a net settlement feature for withholding tax obligations

52. Tax laws or regulations may oblige an enterprise to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee's behalf. To fulfil this obligation, the terms of the share-based payment arrangement may permit or require the enterprise to withhold the number of equity instruments equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment (ie the share-based payment arrangement has a 'net settlement feature').

53. As an exception to the requirements in paragraph 56 , the transaction described in paragraph 52 shall be classified in its entirety as an equity-settled share-based payment transaction if it would have been so classified in the absence of the net settlement feature.

54 The enterprise applies paragraph 43 of this Guidance Note to account for the withholding of shares to fund the payment to the tax authority in respect of the employee's tax obligation associated with the share based

payment. Therefore, the payment made shall be accounted for as a deduction from equity for the shares withheld, except to the extent that the payment exceeds the fair value at the net settlement date of the equity instruments withheld.

55. The exception in paragraph 53 does not apply to:

(a) a share-based payment arrangement with a net settlement feature for which there is no obligation on the enterprise under tax laws or regulations to withhold an amount for an employee's tax obligation associated with that share-based payment; or

(b) any equity instruments that the enterprise withholds in excess of the employee's tax obligation associated with the share-based payment (ie the enterprise withheld an amount of shares that exceeds the monetary value of the employee's tax obligation).

Such excess shares withheld shall be accounted for as a cash-settled share-based payment when this amount is paid in cash (or other assets) to the employee.

Share-based Payment Plans with Cash Alternatives

56. For share-based payment transactions in which the terms of the arrangement provide either the enterprise or the counterparty with the choice of whether the enterprise settles the transaction in cash (or other assets) or by issuing equity instruments, the enterprise shall account for that transaction, or the components of that transaction, as a cash settled share-based payment transaction if, and to the extent that, the enterprise has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

Share-based payment transactions in which the terms of the arrangement provide the counterparty with a choice of Settlement

57. If an enterprise has granted the counterparty the right to choose whether a share based payment transaction is settled in cash[4] or by issuing equity instruments, the plan has two components which includes a debt component (i.e. the counterparty's right to demand payment in cash) and an equity component (i.e. the counterparty's right to demand settlement in equity instruments rather than in cash). For transactions with parties other than employees, in which the fair value of the goods or services received is measured directly, the enterprise shall measure the equity component of the plan as the difference between the fair value of the goods or services received and the fair value of the debt component, at the date when the goods or services are received.

58. For other transactions, including transactions with employees, the enterprise shall measure the fair value of the plan at the measurement date, taking into account the terms and conditions on which the rights to cash or equity instruments were granted.

59. To apply paragraph 58, the enterprise shall first measure the fair value of the debt component, and then measure the fair value of the equity component—taking into account that the counterparty must forfeit the right to receive cash in order to receive the equity instrument. The fair value of the share-based payment arrangement is the sum of the fair values of the two components. However, share-based payment transactions in which the counterparty has the choice of settlement are often structured so that the fair value of one settlement alternative is the same as the other. For example, the counterparty might have the choice of receiving share options or cash settled share appreciation rights. In such cases, the fair value of the equity component is zero, and hence the fair value of the share-based payment arrangement is the same as the fair value of the debt component. Conversely, if the fair values of the settlement alternatives differ, the fair value of the equity component usually will be greater than zero, in which

[4] In paragraphs 57-65 all references to cash also include other assets of the enterprise.

case the fair value of the share-based payment arrangement will be greater than the fair value of the debt component.

60. The enterprise shall account separately for the goods or services received or acquired in respect of each component of the share-based payment arrangement. For the debt component, the enterprise shall recognise the goods or services acquired, and a liability to pay for those goods or services, as the counterparty supplies goods or renders service, in accordance with the requirements applying to cash-settled share-based payment transactions (paragraphs 44–47). For the equity component (if any), the enterprise shall recognise the goods or services received, and an increase in equity, as the counterparty supplies goods or renders service, in accordance with the requirements applying to equity-settled share-based payment transactions (paragraphs 18–43).

61. At the date of settlement, the enterprise shall remeasure the liability to its fair value. If the enterprise issues equity instruments on settlement rather than paying cash, the liability shall be transferred direct to equity, as the consideration for the equity instruments issued.

62. If the enterprise pays in cash on settlement rather than issuing equity instruments, that payment shall be applied to settle the liability in full. Any equity component previously recognised shall remain within equity. By electing to receive cash on settlement, the counterparty forfeited the right to receive equity instruments. However, this requirement does not preclude the enterprise from recognising a transfer within equity, i.e. a transfer from one component of equity to another.

Share-based payment transactions in which the terms of the arrangement provide the enterprise with a choice of settlement

63. For a share-based payment transaction in which the terms of the arrangement provide an enterprise with the choice of whether to settle in cash or by issuing equity instruments, the enterprise shall determine whether it has a present obligation to settle in cash and account for the share-based payment transaction accordingly. The enterprise has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance (e.g. because the enterprise is legally prohibited from issuing shares), or the enterprise has a past practice or a stated policy of

settling in cash, or generally settles in cash whenever the counterparty asks for cash settlement.

For example, an enterprise may have consistently adopted a policy in the past of granting ex gratia cash compensation to all those employees deemed to be 'good' leavers or all 'good' leavers belonging to certain seniority, in respect of partially vested share options. Such a scheme may be treated as cash-settled for the purposes of this Guidance Note to the extent to which there are expected to be such 'good' leavers during the vesting period.

Another example is that an enterprise having a share-based payment scheme for all its employees and employees of all its foreign subsidiaries around the world. The enterprise may have an option for cash settlement which it always exercises in respect of awards to employees in jurisdictions where it is difficult or illegal to hold shares in the parent. Such a scheme should be treated as a cash-settled scheme in respect of those jurisdictions.

64. If the enterprise has a present obligation to settle in cash, it shall account for the transaction in accordance with the requirements applying to cash-settled share-based payment transactions, in paragraphs 44-47.

65. If no such obligation exists, the enterprise shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in paragraphs 18–43. Upon settlement:

(a) If the enterprise elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, i.e. as a deduction from equity, except as noted in (c) below.

(b) If the enterprise elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below.

(c) If the enterprise elects the settlement alternative with the higher fair value, as at the date of settlement, the enterprise shall recognise an additional expense for the excess value given, i.e. the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable.

Share-based payment transactions among group enterprises

66. For share-based payment transactions among group enterprises, in its separate or individual financial statements, the enterprise receiving the goods or services shall measure the goods or services received as either an equity-settled or a cash-settled share-based payment transaction by assessing:

(a) the nature of the awards granted, and

(b) its own rights and obligations.

67. The amount recognised by the enterprise receiving the goods or services may differ from the amount recognised by the consolidated group or by another group enterprise settling the share-based payment transaction.

68. The enterprise receiving the goods or services shall measure the goods or services received as an equity-settled share-based payment transaction when:

(a) the awards granted are its own equity instruments, or

(b) the enterprise has no obligation to settle the share-based payment transaction.

69. The enterprise shall subsequently remeasure such an equity-settled share-based payment transaction only for changes in non-market vesting conditions in accordance with paragraphs 41–43. In all other circumstances, the enterprise receiving the goods or services shall measure the goods or services received as a cash-settled share-based payment transaction.

70. The enterprise settling a share-based payment transaction when another enterprise in the group receives the goods or services shall recognise the transaction as an equity-settled share-based payment transaction only if it is settled in the enterprise's own equity instruments. Otherwise, the transaction shall be recognised as a cash-settled share-based payment transaction.

71. Some group transactions involve repayment arrangements that require one group enterprise to pay another group enterprise for the provision of the share-based payments to the suppliers of goods or services. In such cases, the enterprise that receives the goods or services shall account for the

share-based payment transaction in accordance with paragraph 60 regardless of intragroup repayment arrangements.

Intrinsic Value Method

72. Accounting for share-based payment plans dealt with hereto before is based on the fair value method. There is another method known as the 'Intrinsic Value Method' for valuation of share- based payment plans. Intrinsic value, in the case of a listed company, is the amount by which the fair value (in this case the quoted market price) of the underlying share exceeds the exercise price of an option. For example, an option with an exercise price of ₹ 100 on an equity share whose current quoted market price is ₹ 125, has an intrinsic value of ₹ 25 per share on the date of its valuation. If the quoted market price is not available on the grant date, then the share price nearest to that date is taken. In the case of a non- listed company, since the shares are not quoted on a stock exchange, value of its shares is determined on the basis of a valuation report from an independent valuer.

For accounting for share-based payment plans, the intrinsic value may be used, *mutatis mutandis*, in place of the fair value as described in paragraphs 18 to 71.

In rare cases, an enterprise generally using fair value method, may be unable to estimate reliably the fair value of the equity instruments as envisaged in paragraph 35.In those rare cases, the enterprise shall apply the requirements of paragraph 36.

Examples of equity-settled employee share-based payment plan and cash-settled employee share-based payment plan, using intrinsic value method, are given in Illustration 1 of Appendix II and the Illustration in Appendix IV, respectively.

Recommendation

73. It is recommended that accounting for share-based payment plans should be based on the fair value approach as described in paragraphs 18 to 71. However, intrinsic value method as described in paragraph 64 is also permitted.

Graded Vesting

74. In case the options/shares granted under a share-based payment

arrangement do not vest on one date but have graded vesting schedule, total plan should be segregated into different groups, depending upon the vesting dates. Each of such groups would be having different vesting period and expected life and, therefore, each vesting date should be considered as a separate option grant and evaluated and accounted for accordingly. For example, suppose an employee is granted 100 options which will vest @ 25 options per year at the end of the third, fourth, fifth and sixth years. In such a case, each tranche of 25 options would be evaluated and accounted for separately.

An illustration of a share-based payment arrangement having graded vesting is given in Appendix VI.

Employee Share-based Payment Plan Administered through a Trust

75. An enterprise may administer an employee share-based payment plan through a trust constituted for this purpose. The trust may have different kinds of arrangements, for example, the following:

(a) The enterprise allots shares to the trust as and when the employees exercise stock options

(b) The enterprise provides finance to the trust for subscription to the shares issued by the enterprise at the beginning of the plan.

(c) The enterprise provides finance to the trust to purchase shares from the market at the beginning of the plan.

76. Since the trust administers the plan on behalf of the enterprise, it is recommended that irrespective of the arrangement for issuance of the shares under the employee share-based payment plan, the enterprise should recognise in its separate financial statements the expense on account of services received from the employees in accordance with the recommendations contained in this Guidance Note. Thus, though the ESOP trust itself may prepare its own financial statements, for example, to meet regulatory requirements, the standalone financial statements of the enterprise should portray the picture as if the enterprise itself is administering the ESOP Scheme. This has two results viz., (i) the enterprise should recognise any expense arising from the employee share-based payment plans, and (ii) the operations of ESOP trust are included in standalone

financial statements of the enterprise insofar as the ESOP is concerned. In such a situation, in the standalone financial statements of the enterprise, 'Loans to ESOP Trust' will not appear at all. Accordingly, the following adjustments are required:

(i) Loans to ESOP Trust in the books of the enterprise should be eliminated against loan from company as appearing in the books of Trust.

(ii) The amount representing the grant date fair value (or intrinsic value) of the options yet to be exercised by the employees (originally recorded as a debit on issue of shares to ESOP Trust even before the exercise of options by the employees) will be added to 'Investment in shares of the company' and the sum may be described as 'Shares held in trust for employees under ESOP Scheme'. This should be presented as a deduction from Share Capital to the extent of face value of the shares and Securities Premium to the extent of amount exceeding face value of shares. The enterprise should give a suitable note in the Notes to Accounts to explain the nature of this deduction. In absence of adequate balance in securities premium account, the enterprise may deduct the amount exceeding face value of the shares from another appropriate head within 'Reserves and Surplus'.

Various aspects of accounting for employee share-based payment plan administered through a trust under the arrangements mentioned above, are illustrated in Appendix XI, for the purpose of preparation of separate financial statements.

Earnings Per Share Implications

77. For the purpose of calculating Basic Earnings Per Share as per Accounting Standard (AS) 20, 'Earnings Per Share', shares or stock options granted pursuant to an share-based payment plan, including shares or options issued to an ESOP trust, should not be included in the shares outstanding till the counterparty has exercised their right to obtain shares or stock options, after fulfilling the requisite vesting conditions. Till such time, shares or stock options so granted should be considered as dilutive potential equity shares for the purpose of calculating Diluted Earnings Per Share. Diluted Earnings Per Share should be based on the actual number of shares or stock options granted and not yet forfeited, unless doing so would be anti-dilutive.

78. For computations required under paragraph 35 of AS 20 with regard to shares or stock options granted pursuant to an employee share-based payment plan, the assumed proceeds from the issues should include the exercise price and the unamortised compensation cost which is attributable to future services.

An example to illustrate computation of Earnings Per Share in a situation where the enterprise has granted stock options to its employees is given in Appendix VII.

Disclosures

79. An enterprise should describe the method used to account for the share-based payment plans.

80. An enterprise should disclose information that enables users of the financial statements to understand the nature and extent of share- based payment plans that existed during the period.

81. To give effect to the principle in paragraph 80 the enterprise should disclose at least the following:

(a) A description of each type of share-based payment plan that existed at any time during the period, including the general terms and conditions of each plan, such as vesting requirements, the maximum term of options granted, and the method of settlement (e.g., whether in cash or equity). An enterprise with substantially similar types of plans may aggregate this information, unless separate disclosure of each arrangement is necessary to satisfy the principle in paragraph 80.

(b) the number and weighted average exercise prices of stock options for each of the following groups of options:

   (i) outstanding at the beginning of the period;

   (ii) granted during the period;

   (iii) forfeited during the period;

   (iv) exercised during the period;

   (v) expired during the period;

   (vi) outstanding at the end of the period; and

   (vii) exercisable at the end of the period.

(c) for stock options exercised during the period, the weighted average share price at the date of exercise. If options were exercised on a regular basis throughout the period, the enterprise may instead disclose the weighted average share price during the period.

(d) for stock options outstanding at the end of the period, the range of exercise prices and weighted average remaining contractual life (comprising the vesting period and the exercise period). If the range of exercise prices is wide, the outstanding options should be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received upon exercise of those options.

82. An enterprise should disclose the following information to enable users of the financial statements to understand how the fair value of shares or stock options granted, during the period, was determined:

(a) for stock options granted during the period, the weighted average fair value of those options at the measurement date and information on how that fair value was measured, including:

   (i) the option pricing model used and the inputs to that model, including the weighted average share price, exercise price, expected volatility, option life (comprising the vesting period and the exercise period), expected dividends, the risk-free interest rate and any other inputs to the model, including the method used and the assumptions made to incorporate the effects of expected early exercise;

   (ii) how expected volatility was determined, including an explanation of the extent to which expected volatility was based on historical volatility; and

   (iii) whether and how any other features of the option grant were incorporated into the measurement of fair value, such as a market condition.

(b) for other instruments granted during the period (i.e., other than stock options), the number and weighted average fair value of those instruments at the measurement date, and information on how that fair value was measured, including:

   (i) If fair value was not measured on the basis of an observable market price, how it was determined;

(ii) whether and how expected dividends were incorporated into the measurement of fair value; and

(iii) whether and how any other features of the instruments granted were incorporated into the measurement of fair value.

(c) for share-based payment plans that were modified during the period:

(i) an explanation of those modifications;

(ii) the incremental fair value granted (as a result of those modifications); and

(iii) information on how the incremental fair value granted was measured, consistently with the requirements set out in (a) and (b) above, where applicable.

83. An enterprise should disclose the following information to enable users of the financial statement to understand the effect of share-based payment plans on the profit or loss of the enterprise for the period and on its financial position:

(a) the total expense recognised for the period arising from share-based payment plans in which the goods and services received did not qualify for recognition as a part of the cost of an asset and hence were recognised immediately as an expense, including separate disclosure of that portion of the total expense that arises from transactions accounted for as equity-settled share-based payment plans;

(b) for liabilities arising from share-based payment plans:

(i) the total carrying amount at the end of the period; and

(ii) the total intrinsic value at the end of the period of liabilities for which the counterparty's right to cash or other assets had vested by the end of the period (e.g., vested stock appreciation rights).

84. If the enterprise has measured directly the fair value of goods or services received during the period, the enterprise shall disclose how that fair value was determined, eg whether fair value was measured at a market price for those goods or services.

85. If the enterprise has rebutted the presumption in paragraph 22, it shall disclose that fact, and give an explanation of why the presumption was rebutted.

86. If the information required to be disclosed by this GN does not satisfy the principles in paragraphs 80, 82 and 83, the enterprise shall disclose such additional information as is necessary to satisfy them.

Appendix VIII contains illustrative disclosures.

Effective Date

87. This Guidance Note applies to share-based payment plans the grant date in respect of which falls on or after April 1, 2021. An enterprise is not required to apply this Guidance Note to share-based payment to equity instruments that are not fully vested as at April 1, 2021.

Appendix I

Estimating the Fair Value of Shares or Stock Options Granted

1. The appendix discusses measurement of the fair value of shares and share-based payment arrangements granted, focusing on the specific terms and conditions that are common features of a grant of share-based payment arrangements. Therefore, it is not exhaustive. However, many of the valuation issues discussed below will be relevant to measurement of fair value of shares granted parties other than employees.

Shares

2. The fair value of the shares granted should be measured at the market price of the shares of the enterprise (or an estimated value based on the valuation report of an independent valuer, if the shares of the enterprise are not publicly traded), adjusted to take into account the terms and conditions upon which the shares were granted (except for vesting conditions that are excluded from the measurement of fair value in accordance with this Guidance Note).

3. For example, if the employee is not entitled to receive dividends during the vesting period, this factor should be taken into account when estimating the fair value of the shares granted. Similarly, if the shares are subject to restrictions on transfer after vesting date, that factor should be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares. Restrictions on transfer or other restrictions that exist during the vesting period should not be taken into account when estimating the grant date fair value of the shares granted, because those restrictions stem from the existence of vesting conditions, which are accounted for in accordance with paragraphs 26 to 37 of the text of the Guidance Note.

Share options

4. For share options granted to employees, in many cases market prices are not available, because the options granted are subject to terms and conditions that do not apply to traded options. If traded options with similar terms and conditions do not exist, the fair value of the options granted should be estimated by applying an option pricing model.

5. The enterprise should consider factors that knowledgeable, willing market participants would consider in selecting the option pricing model to apply. For example, many employee options have long lives, are usually exercisable during the period between vesting date and the end of the life of the option and are often exercised early. These factors should be considered when estimating the grant date fair value of the options. For many enterprises, this might preclude the use of the Black-Scholes-Merton formula, which does not allow for the possibility of exercise before the end of the option's life (comprising the vesting period and the exercise period) and may not adequately reflect the effects of expected early exercise. It also does not allow for the possibility that expected volatility and other model inputs might vary over the option's life. However, for stock options with relatively short contractual lives (comprising the vesting period and the exercise period), or that must be exercised within a short period of time after vesting date, the factors identified above may not apply. In these instances, the Black-Scholes-Merton formula may produce a value that is substantially the same as a more flexible option pricing model.

6. All option pricing models take into account, as a minimum, the following factors:

(a) the exercise price of the option;

(b) the life of the option;

(c) the current price of the underlying shares;

(d) the expected volatility of the share price;

(e) the dividends expected on the shares (if appropriate); and

(f) the risk-free interest rate for the life of the option.

7. Other factors that knowledgeable, willing market participants would consider in setting the price should also be taken into account (except for vesting conditions and reload features that are excluded from the

measurement of fair value in accordance with paragraphs 26 to 37 of the text of the Guidance Note).

8. For example, a stock option granted to an employee typically cannot be exercised during specified periods (e.g., during the vesting period or during periods specified, if any, by securities regulators). This factor should be taken into account if the option pricing model applied would otherwise assume that the option could be exercised at any time during its life. However, if an enterprise uses an option pricing model that values options that can be exercised only at the end of the options' life, no adjustment is required for the inability to exercise them during the vesting period (or other periods during the options' life), because the model assumes that the options cannot be exercised during those periods.

9. Similarly, another factor common to employee stock options is the possibility of early exercise of the option, for example, because the option is not freely transferable, or because the employee must exercise all vested options upon cessation of employment. The effects of expected early exercise should be taken into account, as discussed in paragraphs 16 to 21 of this Appendix.

10. Factors that a knowledgeable, willing market participant would not consider in setting the price of a stock option should not be taken into account when estimating the fair value of stock options granted. For example, for stock options granted to employees, factors that affect the value of the option from the perspective of the individual employee only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant.

Inputs to option pricing models

11. In estimating the expected volatility of and dividends on the underlying shares, the objective is to approximate the expectations that would be reflected in a current market or negotiated exchange price for the option. Similarly, when estimating the effects of early exercise of employee stock options, the objective is to approximate the expectations that an outside party with access to detailed information about employees' exercise behaviour would develop based on information available at the grant date.

12. Often, there is likely to be a range of reasonable expectations about future volatility, dividends and exercise behaviour. If so, an expected value

should be calculated, by weighting each amount within the range by its associated probability of occurrence.

13. Expectations about the future are generally based on experience, modified if the future is reasonably expected to differ from the past. In some circumstances, identifiable factors may indicate that unadjusted historical experience is a relatively poor predictor of future experience. For example, if an enterprise with two distinctly different lines of business disposes of the one that was significantly less risky than the other, historical volatility may not be the best information on which to base reasonable expectations for the future.

14. In other circumstances, historical information may not be available. For example, a newly listed enterprise will have little, if any, historical data on the volatility of its share price. Unlisted and newly listed enterprises are discussed further below.

15. In summary, an enterprise should not simply base estimates of volatility, exercise behaviour and dividends on historical information without considering the extent to which the past experience is expected to be reasonably predictive of future experience.

Expected early exercise

16. Employees often exercise stock options early, for a variety of reasons. For example, employee stock options are typically non- transferable. This often causes employees to exercise their stock options early, because that is the only way for the employees to liquidate their position. Also, employees who cease employment are usually required to exercise any vested options within a short period of time, otherwise the stock options are forfeited. This factor also causes the early exercise of employee stock options. Other factors causing early exercise are risk aversion and lack of wealth diversification.

17. The means by which the effects of expected early exercise are taken into account depends upon the type of option pricing model applied. For example, expected early exercise could be taken into account by using an estimate of the expected life of the option (which, for an employee stock option, is the period of time from grant date to the date on which the option is expected to be exercised) as an input into an option pricing model (e.g., the Black-Scholes-Merton formula). Alternatively, expected early exercise could

be modelled in a binomial or similar option pricing model that uses contractual life as an input.

18. Factors to consider in estimating early exercise include:

(a) the length of the vesting period, because the stock option typically cannot be exercised until the end of the vesting period. Hence, determining the valuation implications of expected early exercise is based on the assumption that the options will vest. The implications of vesting conditions are discussed in paragraphs 26 to 37 of the text of the Guidance Note.

(b) the average length of time similar options has remained outstanding in the past.

(c) the price of the underlying shares. Experience may indicate that the employees tend to exercise options when the share price reaches a specified level above the exercise price.

(d) the employee's level within the organisation. For example, experience might indicate that higher-level employees tend to exercise options later than lower-level employees (discussed further in paragraph 21 of this Appendix).

(e) expected volatility of the underlying shares. On average, employees might tend to exercise options on highly volatile shares earlier than on shares with low volatility.

19. As noted in paragraph 17 of this Appendix, the effects of early exercise could be taken into account by using an estimate of the option's expected life as an input into an option pricing model. When estimating the expected life of stock options granted to a group of employees, the enterprise could base that estimate on an appropriately weighted average expected life for the entire employee group or on appropriately weighted average lives for subgroups of employees within the group, based on more detailed data about employees' exercise behaviour (discussed further below).

20. Separating an option grant into groups for employees with relatively homogeneous exercise behaviour is likely to be important. Option value is not a linear function of option term; value increases at a decreasing rate as the term lengthens. For example, if all other assumptions are equal, although a two-year option is worth more than a one-year option, it is not worth twice

as much. That means that calculating estimated option value on the basis of a single weighted average life that includes widely differing individual lives would overstate the total fair value of the stock options granted. Separating options granted into several groups, each of which has a relatively narrow range of lives included in its weighted average life, reduces that overstatement.

21. Similar considerations apply when using a binomial or similar model. For example, the experience of an enterprise that grants options broadly to all levels of employees might indicate that top-level executives tend to hold their options longer than middle-management employees hold theirs and that lower-level employees tend to exercise their options earlier than any other group. In addition, employees who are encouraged or required to hold a minimum amount of their employer's shares or stock options, might on average exercise options later than employees not subject to that provision. In those situations, separating options by groups of recipients with relatively homogeneous exercise behaviour will result in a more accurate estimate of the total fair value of the stock options granted.

Expected volatility

22. Expected volatility is a measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. Volatility is typically expressed in annualised terms that are comparable regardless of the time period used in the calculation, for example, daily, weekly or monthly price observations.

23. The rate of return (which may be positive or negative) on a share for a period measures how much a shareholder has benefited from dividends and appreciation (or depreciation) of the share price.

24. The expected annualised volatility of a share is the range within which the continuously compounded annual rate of return is expected to fall approximately two-thirds of the time. For example, to say that a share with an expected continuously compounded rate of return of 12 per cent has a volatility of 30 per cent means that the probability that the rate of return on the share for one year will be between –18 per cent (12% – 30%) and 42 per cent (12% + 30%) is approximately two-thirds. If the share price is ₹ 100 at the beginning of the year and no dividends are paid, the year-end share price

would be expected to be between ₹ 83.53 (₹ 100 × $e^{-0.18}$) and ₹ 152.20 (₹ 100 × $e^{0.42}$) approximately two-thirds of the time.

25. Factors to be considered in estimating expected volatility include:

(a) Implied volatility from traded stock options on the shares of the enterprise, or other traded instruments of the enterprise that include option features (such as convertible debt), if any.

(b) The historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option (taking into account the remaining contractual life of the option and the effects of expected early exercise).

(c) The length of time shares of an enterprise has been publicly traded. A newly listed enterprise might have a high historical volatility, compared with similar enterprises that have been listed longer. Further guidance for newly listed enterprises is given in paragraph 26 of this Appendix.

(d) The tendency of volatility to revert to its mean, i.e., its long- term average level, and other factors indicating that expected future volatility might differ from past volatility. For example, if share price of an enterprise was extraordinarily volatile for some identifiable period of time because of a failed takeover bid or a major restructuring, that period could be disregarded in computing historical average annual volatility.

(e) Appropriate and regular intervals for price observations. The price observations should be consistent from period to period. For example, an enterprise might use the closing price for each week or the highest price for the week, but it should not use the closing price for some weeks and the highest price for other weeks.

Newly listed enterprises

26. As noted in paragraph 25 of this Appendix, an enterprise should consider historical volatility of the share price over the most recent period that is generally commensurate with the expected option term. If a newly listed enterprise does not have sufficient information on historical volatility, it should nevertheless compute historical volatility for the longest period for which trading activity is available. It could also consider the historical volatility of similar enterprises following a comparable period in their lives.

For example, an enterprise that has been listed for only one year and grants options with an average expected life of five years might consider the pattern and level of historical volatility of enterprises in the same industry for the first six years in which the shares of those enterprises were publicly traded.

Unlisted enterprises

27. An unlisted enterprise will not have historical information upon which to base an estimate of expected volatility. It will therefore have to estimate expected volatility by some other means. The enterprise could consider the historical volatility of similar listed enterprises, for which share price or option price information is available, to use as the basis for an estimate of expected volatility.

Expected dividends

28. Whether expected dividends should be taken into account when measuring the fair value of shares or stock options granted depends on whether the employees are entitled to dividends or dividend equivalents. For example, if employees were granted options and are entitled to dividends on the underlying shares or dividend equivalents (which might be paid in cash or applied to reduce the exercise price) between grant date and exercise date, the options granted should be valued as if no dividends will be paid on the underlying shares, i.e., the input for expected dividends should be zero. Similarly, when the grant date fair value of shares granted to employees is estimated, no adjustment is required for expected dividends if the employees are entitled to receive dividends paid during the vesting period.

29. Conversely, if the employees are not entitled to dividends or dividend equivalents during the vesting period (or before exercise, in the case of an option), the grant date valuation of the rights to shares or options should take expected dividends into account. That is to say, when the fair value of an option grant is estimated, expected dividends should be included in the application of an option pricing model. When the fair value of a share grant is estimated, that valuation should be reduced by the present value of dividends expected to be paid during the vesting period.

30. Option pricing models generally call for expected dividend yield. However, the models may be modified to use an expected dividend amount rather than a yield. An enterprise may use either its expected yield or its expected payments. If the enterprise uses the latter, it should consider its

historical pattern of increases in dividends. For example, if policy of an enterprise has generally been to increase dividends by approximately 3 per cent per year, its estimated option value should not assume a fixed dividend amount throughout the option's life unless there is evidence that supports that assumption.

31. Generally, the assumption about expected dividends should be based on publicly available information. An enterprise that does not pay dividends and has no plans to do so should assume an expected dividend yield of zero. However, an emerging enterprise with no history of paying dividends might expect to begin paying dividends during the expected lives of its employee stock options. Those enterprises could use an average of their past dividend yield (zero) and the mean dividend yield of an appropriately comparable peer group.

Risk-free interest rate

32. Typically, the risk-free interest rate is the implied yield currently available on zero-coupon government issues, with a remaining term equal to the expected term of the option being valued (based on the option's remaining contractual life and taking into account the effects of expected early exercise). It may be necessary to use an appropriate substitute, if no such government issues exist or circumstances indicate that the implied yield on zero-coupon government issues is not representative of the risk- free interest rate. Also, an appropriate substitute should be used if market participants would typically determine the risk-free interest rate by using that substitute, rather than the implied yield of zero-coupon government issues, when estimating the fair value of an option with a life equal to the expected term of the option being valued.

Capital structure effects

33. Typically, third parties, not the enterprise, write traded stock options. When these stock options are exercised, the writer delivers shares to the option holder. Those shares are acquired from existing shareholders. Hence the exercise of traded stock options has no dilutive effect.

34. In contrast, if stock options are written by the enterprise, new shares are issued when those stock options are exercised. Given that the shares will be issued at the exercise price rather than the current market price at the date of exercise, this actual or potential dilution might reduce the share price,

so that the option holder does not make as large a gain on exercise as on exercising an otherwise similar traded option that does not dilute the share price.

35. Whether this has a significant effect on the value of the stock options granted depends on various factors, such as the number of new shares that will be issued on exercise of the options compared with the number of shares already issued. Also, if the market already expects that the option grant will take place, the market may have already factored the potential dilution into the share price at the date of grant.

36. However, the enterprise should consider whether the possible dilutive effect of the future exercise of the stock options granted might have an impact on their estimated fair value at grant date. Option pricing models can be adapted to take into account this potential dilutive effect.

Appendix II

Equity-settled Employee Share-based Payment Plans

Illustration 1: Stock Options with Service Condition only

(A) Accounting during the vesting period

At the beginning of year 1, an enterprise grants 300 options to each of its 1,000 employees. The contractual life (comprising the vesting period and the exercise period) of options granted is 6 years. The other relevant terms of the grant are as below:

Vesting Period	3 years
Exercise Period	3 years
Expected Life	5 years
Exercise Price	₹ 50
Market Price	₹ 50
Expected forfeitures per year	3%

The fair value of options, calculated using an option pricing model, is ₹ 15 per option. Actual forfeitures, during the year 1, are 5 per cent and at the end of year 1, the enterprise still expects that actual forfeitures would average 3 per cent per year over the 3-year vesting period. During the year 2, however, the management decides that the rate of forfeitures is likely to continue to increase, and the expected forfeiture rate for the entire award is changed to 6 per cent per year. It is also assumed that 840 employees have actually completed 3 years vesting period.

Suggested Accounting Treatment

Year 1

1. At the grant date, the enterprise estimates the fair value of the options expected to vest at the end of the vesting period as below:

No. of options expected to vest

= 300 x 1,000 x 0.97 x 0.97 x 0.97 = 2,73,802 options

Fair value of options expected to vest

= 2,73,802 options x ₹ 15 = ₹ 41,07,030

2. At the balance sheet date, since the enterprise still expects actual forfeitures to average 3 per cent per year over the 3-year vesting period, no change is required in the estimates made at the grant date. The enterprise, therefore, recognises one-third of the amount estimated at (1) above (i.e., ₹ 41,07,030/3) towards the employee services received by passing the following entry:

Employee compensation expense A/c	Dr. ₹ 13,69,010	
To Stock Options Outstanding A/c		₹ 13,69,010

(Being compensation expense recognised in respect of the ESOP)

3. Credit balance in the 'Stock Options Outstanding A/c' may be disclosed in the balance sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus'.

Year 2

1. At the end of the financial year, management has changed its estimate of expected forfeiture rate from 3 per cent to 6 per cent per year. The revised number of options expected to vest is 2,49,175 (3,00,000 x .94 x .94 x .94). Accordingly, the fair value of revised options expected to vest is ₹ 37,37,625 (2,49,175 x ₹ 15). Consequent to the change in the expected forfeitures, the expense to be recognised during the year are determined as below:

Revised total fair value	= ₹ 37, 37,625
Revised cumulative expense at the end of year 2=	
(₹ 37,37,625 x 2/3)	= ₹ 24,91,750
Expense already recognised in year 1	= ₹ 13, 69,010
Expense to be recognised in year 2	= ₹ 11, 22,740

2. The enterprise recognises the amount determined at (1) above (i.e., ₹ 11, 22,740) towards the employee services received by passing the following entry:

Employee compensation expense A/c Dr. ₹ 11,22,740

To Stock Options Outstanding A/c ₹ 11, 22,740

(Being compensation expense recognised in respect of the ESOP)

3. Credit balance in the 'Stock Options Outstanding A/c' may be disclosed in the balance sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus'.

Year 3

1. At the end of the financial year, the enterprise would examine its actual forfeitures and make necessary adjustments, if any, to reflect expense for the number of options that actually vested. Considering that

840 employees have completed three years vesting period, the expense to be recognised during the year is determined as below:

No. of options actually vested = 840 x 300 = 2,52,000

Fair value of options actually vested

(₹ 2,52,000 x ₹ 15) =	₹ 37,80,000
Expense already recognised	₹ 24,91,750
Expense to be recognised in year 3	₹ 12,88,250

2. The enterprise recognises the amount determined at (1) above towards the employee services received by passing the following entry:

Employee compensation expense A/c	Dr. ₹ 12,88,250	
To Stock Options Outstanding A/c		₹ 12,88,250

(Being compensation expense recognised in respect of ESOP)

3. Credit balance in the 'Stock Options Outstanding A/c' may be disclosed in the balance sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus'.

(B) Accounting at the time of exercise/expiry of the vested options

Continuing Illustration 1(A) above, the following further facts are provided:

(a) 200 employees exercise their right to obtain shares vested in them in pursuance of the ESOP at the end of year 5 and 600 employees exercise their right at the end of year 6.

(b) Rights of 40 employees expire unexercised at the end of the contractual life of the option, i.e., at the end of year 6.

(c) Face value of one share of the enterprise is ₹ 10.

Suggested Accounting Treatment

1. On exercise of the right to obtain shares, the enterprise issues share to the respective employees on receipt of the exercise price. The shares so issued are considered to have been issued on a consideration comprising the exercise price and the corresponding amount standing to the credit of the Stock Options Outstanding Account. In the present case, the exercise price is ₹ 50 per share and the amount of compensation expense Recognised in the 'Stock Options Outstanding A/c' is ₹ 15 per option. The enterprise, therefore, considers the shares to be issued at a price of ₹ 65 per share.

2. The amount to be recorded in the 'Share Capital A/c' and the 'Securities Premium A/c', upon issuance of the shares, is calculated as below:

Particulars	**Exercise Date**	
	Year-end 5	**Year-end 6**
No. of employees exercising option	200	600
No. of shares issued on exercise @ 300 per employee	60,000	1,80,000
Exercise Price received @ ₹ 50 per share	30,00,000	90,00,000
Corresponding amount recognised in the 'Stock Options Outstanding A/c' @ ₹ 15 per option	9,00,000	27,00,000
Total Consideration	39,00,000	1,17,00,000
Amount to be recorded in 'Share Capital A/c' @ ₹ 10 per share	6,00,000	18,00,000
Amount to be recorded in 'Securities Premium A/c' @ ₹ 55 per share	33,00,000	99,00,000
Total	39,00,000	1,17,00,000

3. The enterprise passes the following entries at end of year 5 and year 6, respectively, to record the shares issued to the employees upon exercise of options vested in them in pursuance of the Employee Stock Option Plan:

Year 5

Bank A/c	Dr. ₹	30,00,000	
Stock Options Outstanding A/c	Dr. ₹	9,00,000	
To Share Capital A/c			₹ 6,00,000
To Securities Premium A/c			₹ 33,00,000

(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)

Year 6

Bank A/c	Dr. ₹	90,00,000	
Stock Options Outstanding A/c	Dr. ₹	27,00,000	
To Share Capital A/c			₹ 18,00,000
To Securities Premium A/c			₹ 99,00,000

(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)

4. At the end of year 6, the balance of ₹ 1,80,000 (i.e., 40 employees x 300 options x ₹ 15 per option) standing to the credit of the Stock Options Outstanding Account, in respect of vested options expiring unexercised, is transferred to general reserve by passing the following entry:

Stock Options Outstanding A/c	Dr. ₹ 1,80,000	
To General Reserve		₹ 1,80,000

(Being the balance standing to the credit of the Stock Options Outstanding Account, in respect of vested options expired unexercised, transferred to the general reserve)

(C) Intrinsic value method

The accounting treatment suggested in Illustrations 1(A) and 1(B) above is based on the fair value method. In case the enterprise follows the intrinsic value method instead of the fair value method, it would not recognise any compensation expense since the market price of the underlying share at the grant date is the same as the exercise price and the intrinsic value of the options is nil. However, in case the market price of the underlying share at the grant date is more than the exercise price, say, ₹ 52 per share, then the difference of ₹ 2 between the market value and the exercise price would be the intrinsic value of the option. In such a case, the enterprise would treat the said intrinsic value as compensation expense over the vesting period on the lines of Illustrations 1(A) and 1(B) above.

Illustration 2: Grant with a Performance Condition, in which the Length of the Vesting Period varies

At the beginning of year 1, the enterprise grants 100 stock options to each of its 500 employees, conditional upon the employees remaining in the employment of the enterprise during the vesting period. The options will vest at the end of year 1 if the earnings of the enterprise increase by more than 18 per cent; at the end of year 2 if the earnings of the enterprise increase by more than an average of 13 per cent per year over the two- year period; and at the end of year 3 if the earnings of the enterprise increase by more than an average of 10 per cent per year over the three- year period. The fair value of the options, calculated at the grant date using an option pricing model, is ₹ 30 per option. No dividends are expected to be paid over the three-year period.

By the end of year 1, the earnings of the enterprise have increased by 14 per cent, and 30 employees have left. The enterprise expects that earnings will continue to increase at a similar rate in year 2, and, therefore, expects that the options will vest at the end of year 2. The enterprise expects, on the basis of a weighted average probability, that a further 30 employees will leave during year 2, and, therefore, expects that options will vest in 440 employees at the end of year 2.

By the end of year 2, the earnings of the enterprise have increased by only 10 per cent and, therefore, the options do not vest at the end of year 2. 28 employees have left during the year. The enterprise expects that a further 25 employees will leave during year 3, and that the earnings of the enterprise will increase by at least 6 per cent, thereby achieving the average of 10 per cent per year.

By the end of year 3, 23 employees have left and the earnings of the enterprise have increased by 8 per cent, resulting in an average increase of 10.67 per cent per year. Therefore, 419 employees received 100 shares each at the end of year 3.

Suggested Accounting Treatment

1. In the given case, the length of the vesting period varies, depending on when the performance condition is satisfied. In such a situation, as per paragraph 24 of the text of the Guidance Note, the enterprise estimates the length of the expected vesting period, based on the most likely outcome of the performance condition, and revises that estimate, if necessary, if subsequent information indicates that the length of the vesting period is likely to differ from previous estimates.

2. The enterprise determines the compensation expense to be recognised each year as below:

Particulars	Year 1	Year 2	Year 3
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
No. of employees expected to meet vesting conditions	440 employees	417 employees	419 employees
No. of options expected to vest	44,000	41,700	41,900
Fair value of options expected to vest @ ₹ 30 per option (₹)	13,20,000	12,51,000	12,57,000
Compensation expense accrued till the end of year (Rs)	6,60,000 [13,20,000/2]	8,34,000 (12,51,000 *2/3)	12,57,000
Compensation expense recognised till the end of previous year (₹)	Nil	6,60,000	8,34,000
Compensation expense to be recognised for the year (₹)	**6,60,000**	**1,74,000**	**4,23,000**

Illustration 3: Grant with a Performance Condition, in which the number of Stock Options varies

At the beginning of year 1, an enterprise grants stock options to each of its 100 employees working in the sales department. The stock options will vest at the end of year 3, provided that the employees remain in the employment of the enterprise, and provided that the volume of sales of a particular product increases by at least an average of 5 per cent per year. If the volume of sales of the product increases by an average of between 5 per cent and 10 per cent per year, each employee will receive 100 stock options. If the volume of sales increases by an average of between 10 per cent and 15 per cent each year, each employee will receive 200 stock options. If the volume of sales increases by an average of 15 per cent or more, each employee will receive 300 stock options.

On the grant date, the enterprise estimates that the stock options have a fair value of ₹ 20 per option. The enterprise also estimates that the volume of sales of the product will increase by an average of between 10 per cent and 15 per cent per year, and therefore expects that, for each employee who remains in service until the end of year 3, 200 stock options will vest. The enterprise also estimates, on the basis of a weighted average probability, 20 per cent of employees will leave before the end of year 3.

By the end of year 1, seven employees have left, and the enterprise still expects that a total of 20 employees will leave by the end of year 3. Hence, the enterprise expects that 80 employees will remain in service for the three-year period. Product sales have increased by 12 per cent and the enterprise expects this rate of increase to continue over the next 2 years.

By the end of year 2, a further five employees have left, bringing the total to 12 to date. The enterprise now expects that only three more employees will leave during year 3, and therefore expects that a total of 15 employees will have left during the three-year period, and hence 85 employees are expected to remain. Product sales have increased by 18 per cent, resulting in an average of 15 per cent over the two years to date. The enterprise now expects that sales increase will average 15 per cent or more over the three-year period, and hence expects each sales employee to receive 300 stock options at the end of year 3.

By the end of year 3, a further two employees have left. Hence, 14 employees have left during the three-year period, and 86 employees remain. The sales of the enterprise have increased by an average of 16 per cent over the three years. Therefore, each of the 86 employees receives 300 stock options.

Suggested Accounting Treatment

Since the number of options varies depending on the outcome of a performance condition that is not a market condition, the effect of that condition (i.e., the possibility that the number of stock options might be 100, 200 or 300) is not taken into account when estimating the fair value of the stock options at grant date. Instead, the enterprise revises the transaction amount to reflect the outcome of that performance condition, as illustrated below.

Year	Calculation	Compensation expense for period (₹)	Cumulative compensation expense (₹)
1	80 employees × 200 options× ₹ 20 × 1/3	1,06,667	1,06,667
2	(85 employees × 300 options × ₹ 20 × 2/3) – ₹ 1,06,667	2,33,333	3,40,000
3	(86 employees × 300 options × ₹ 20 × 3/3) – ₹ 3,40,000	1,76,000	5,16,000

Illustration 4: Grant with a Performance Condition, in which the Exercise Price varies

At the beginning of year 1, an enterprise grants 10,000 stock options to a senior executive, conditional upon the executive remaining in the employment of the enterprise until the end of year 3. The exercise price is ₹ 40. However, the exercise price drops to ₹ 30 if the earnings of the enterprise increase by at least an average of 10 per cent per year over the three-year period.

On the grant date, the enterprise estimates that the fair value of the stock options, with an exercise price of ₹ 30, is ₹ 16 per option. If the exercise price is ₹ 40, the enterprise estimates that the stock options have a fair value of ₹ 12 per option. During year 1, the earnings of the enterprise increased by 12 per cent, and the enterprise expects that earnings will continue to increase at this rate over the next two years. The enterprise, therefore, expects that the earnings target will be achieved, and hence the stock options will have an exercise price of ₹ 30. During year 2, the earnings of the enterprise increased by 13 per cent, and the enterprise continues to expect that the earnings target will be achieved.

During year 3, the earnings of the enterprise increased by only 3 per cent, and therefore the earnings target was not achieved. The executive completes three years' service, and therefore satisfies the service condition. Because the earnings target was not achieved, the 10,000 vested stock options have an exercise price of ₹ 40.

Suggested Accounting Treatment

Because the exercise price varies depending on the outcome of a performance condition that is not a market condition, the effect of that performance condition (i.e. the possibility that the exercise price might be ₹ 40 and the possibility that the exercise price might be ₹ 30) is not taken into account when estimating the fair value of the stock options at the grant date. Instead, the enterprise estimates the fair value of the stock options at the grant date under each scenario (i.e. exercise price of ₹ 40 and exercise price of ₹ 30) and ultimately revises the transaction amount to reflect the outcome of that performance condition, as illustrated below:

Year	Calculation	Compensation expense for period (₹)	Cumulative compensation expense (₹)
1	10,000 options × ₹ 16 × 1/3	53,333	53,333
2	(10,000 options × ₹ 16 × 2/3) – ₹ 53,333	53,334	1,06,667
3	(10,000 options × ₹ 12 × 3/3) – ₹ 1,06,667	13,333	1,20,000

Illustration 5: Grant with a Market Condition

At the beginning of year 1, an enterprise grants 10,000 stock options to a senior executive, conditional upon the executive remaining in the employment of the enterprise until the end of year 3. However, the stock options cannot be exercised unless the share price has increased from ₹ 50 at the beginning of year 1 to above ₹ 65 at the end of year 3. If the share price is above ₹ 65 at the end of year 3, the stock options can be exercised at any time during the next seven years, i.e. by the end of year 10.

The enterprise applies a binomial option pricing model, which takes into account the possibility that the share price will exceed ₹ 65 at the end of year 3 (and hence the stock options become exercisable) and the possibility that the share price will not exceed ₹ 65 at the end of year 3 (and hence the options will not become exercisable). It estimates the fair value of the stock options with this market condition to be ₹ 24 per option.

Suggested Accounting Treatment

Because this Guidance Note requires the enterprise to recognise the services received from an employee who satisfies all other vesting conditions (e.g., services received from an employee who remains in service for the specified service period), irrespective of whether that market condition is satisfied, it makes no difference whether the share price target is achieved. The possibility that the share price target might not be achieved has already been taken into account when estimating the fair value of the stock options at the grant date. Therefore, if the enterprise expects the executive to complete the three-year service period, and the executive does so, the enterprise recognises the following amounts in years 1, 2 and 3:

Year	Calculation	Compensation expense for period (₹)	Cumulative compensation expense (₹)
1	10,000 options × ₹ 24 × 1/3	80,000	80,000
2	(10,000 options × ₹ 24 × 2/3) – ₹ 80,000	80,000	1,60,000
3	(10,000 options × ₹ 24) – ₹ 1,60,000	80,000	2,40,000

As noted above, these amounts are recognised irrespective of the outcome of the market condition. However, if the executive left during year 2 (or year 3), the amount recognised during year 1 (and year 2) would be reversed in year 2 (or year 3). This is because the service condition, in contrast to the market condition, was not taken into account when estimating the fair value of the stock options at grant date. Instead, the service condition is taken into account by adjusting the transaction amount to be based on the number of shares or stock options that ultimately vest, in accordance with this Guidance Note.

Illustration 6: Grant with a Market Condition, in which the Length of the Vesting Period varies

At the beginning of year 1, an enterprise grants 10,000 stock options with a ten-year life to each of ten senior executives. The stock options will vest and become exercisable immediately if and when the share price of the enterprise increases from 50 to 70, provided that the executive remains in service until the share price target is achieved.

The enterprise applies a binomial option pricing model, which takes into account the possibility that the share price target will be achieved during the ten-year life of the options, and the possibility that the target will not be achieved. The enterprise estimates that the fair value of the stock options at grant date is 25 per option. From the option pricing model, the enterprise determines that the mode of the distribution of possible vesting dates is five years. In other words, of all the possible outcomes, the most Likely outcome of the market condition is that the share price target will be achieved at the end of year 5. Therefore, the enterprise estimates that the expected vesting period is five years. The enterprise also estimates that two executives will have left by the end of year 5, and therefore expects that 80,000 stock options (10,000 stock options x 8 executives) will vest at the end of year 5.

Throughout years 1-4, the enterprise continues to estimate that a total of two executives will leave by the end of year 5. However, in total three executives leave, one in each of years 3, 4 and 5. The share price target is achieved at the end of year 6. Another executive leaves during year 6, before the share price target is achieved.

Suggested Accounting Treatment

The Guidance Note requires the enterprise to recognise the services received over the expected vesting period, as estimated at grant date, and also requires the enterprise not to revise that estimate. Therefore, the enterprise recognises the services received from the executives over years 1 to 5. Hence, the transaction amount is ultimately based on 70,000 stock options (10,000 stock options × 7 executives who remain in service at the end of year 5). Although another executive left during year 6, no adjustment is made, because the executive had already completed the expected vesting period of 5 years. Therefore, the enterprise recognises the following amounts in years 1-5:

Year	Calculation	Compensation expense for period (₹)	Cumulative compensation expense (₹)
1	80,000 options × ₹ 25 × 1/5	4,00,000	4,00,000

2	(80,000 options × ₹ 25 × 2/5) – ₹ 4,00,000	4,00,000	8,00,000
3	(80,000 options × ₹ 25 × 3/5) – ₹ 8,00,000	4,00,000	12,00,000
4	(80,000 options × ₹ 25 × 4/5) – ₹ 12,00,000	4,00,000	16,00,000
5	(70,000 options × ₹ 25) – ₹ 16,00,000	1,50,000	17,50,000

Illustration 7: Employee Share Purchase Plan

An enterprise offers all its 1,000 employees the opportunity to participate in an employee stock purchase plan. The employees have two weeks to decide whether to accept the offer. Under the terms of the plan, the employees are entitled to purchase a maximum of 100 shares each. The purchase price will be 20 per cent less than the market price of the shares of the enterprise at the date the offer is accepted, and the purchase price must be paid immediately upon acceptance of the offer. All shares purchased must be held in trust for the employees and cannot be sold for five years. The employee is not permitted to withdraw from the plan during that period. For example, if the employee ceases employment during the five-year period, the shares must nevertheless remain in the plan until the end of the five-year period. Any dividends paid during the five-year period will be held in trust for the employees until the end of the five-year period.

In total, 800 employees accept the offer and each employee purchases, on average, 80 shares, i.e., the employees purchase a total of 64,000 shares. The weighted-average market price of the shares at the purchase date is ₹ 30 per share, and the weighted-average purchase price is ₹ 24 per share.

Suggested Accounting Treatment

This Guidance Note provides that the enterprise should measure the fair value of the employee services received by reference to the fair value of the shares or stock options granted. To apply this requirement, it is necessary first to determine the type of instrument granted to the employees. Although the plan is described as an employee stock purchase plan (ESPP), some ESPPs include option features and are therefore, in effect, stock option plans. For example, an ESPP might include a 'lookback feature', whereby the employee is able to purchase shares at a discount, and choose whether the discount is applied to the share price of the enterprise at the date of grant or its share price at the date of purchase. Or an ESPP might specify the purchase price, and then allow the employees a significant period of time to decide whether to participate in the plan. Another example of an option feature is an ESPP that permits the participating employees to cancel their participation before or at the end of a specified period and obtain a refund of amounts previously paid into the plan.

However, in this example, the plan includes no option features. The discount is applied to the share price at the purchase date, and the employees are not permitted to withdraw from the plan.

Another factor to consider is the effect of post-vesting transfer restrictions, if any. Paragraph 3 of the Appendix I to the Guidance Note states that, if shares are subject to restrictions on transfer after vesting date, that factor should be taken into account when estimating the fair value of those shares, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.

In this example, the shares are vested when purchased, but cannot be sold for five years after the date of purchase. Therefore, the enterprise should consider the valuation effect of the five-year post-vesting transfer restriction. This entails using a valuation technique to estimate what the price of the restricted share would have been on the purchase date in an arm's length transaction between knowledgeable, willing parties. Suppose that, in this example, the enterprise estimates that the fair value of each restricted share is 28. In this case, the fair value of the instruments granted is 4 per share (being the fair value of the restricted share of ₹ 28 less the purchase price of ₹ 24). Because 64,000 shares were purchased, the total fair value of the instruments granted is ₹ 2, 56,000.

In this example, there is no vesting period. Therefore, in accordance with the Guidance Note, the enterprise should recognise an expense of ₹ 2, 56,000 immediately.

Appendix III

Modifications to the Term and Conditions of Equity-settled Employee Share-based Payment Plans

Illustration 1: Grant of Stock Options that are Subsequently Repriced

At the beginning of year 1, an enterprise grants 100 stock options to each of its 500 employees. The grant is conditional upon the employee remaining in service over the next three years. The enterprise estimates that the fair value of each option is ₹ 15. On the basis of a weighted average probability, the enterprise estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the stock options.

Suppose that 40 employees leave during year 1. Also suppose that by the end of year 1, the share price of the enterprise has dropped, and the enterprise reprices its stock options, and that the repriced stock options vest at the end of year 3. The enterprise estimates that a further 70 employees will leave during years 2 and 3, and hence the total expected employee departures over the three-year vesting period is 110 employees. During year 2, a further 35 employees leave, and the enterprise estimates that a further 30 employees will leave during year 3, to bring the total expected employee departures over the three-year vesting period to 105 employees. During year 3, a total of 28 employees leave, and hence a total of 103 employees ceased employment during the vesting period. For the remaining 397 employees, the stock options vested at the end of year 3.

The enterprise estimates that, at the date of repricing, the fair value of each of the original stock options granted (i.e., before taking into account the repricing) is ₹ 15 and that the fair value of each repriced stock option is ₹ 18.

Suggested Accounting Treatment

The Guidance Note requires the enterprise to recognise the effects of modifications that increase the total fair value of the employee share-based payment plans or are otherwise beneficial to the employee. If the modification increases the fair value of the shares or stock options granted (e.g., by reducing the exercise price), measured immediately before and after the modification, this Guidance Note requires the enterprise to include the incremental fair value granted (i.e., the difference between the fair value of the modified instrument and that of the original instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the instruments granted. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified instruments vest, in addition to the amount based on the grant date fair value of the original instruments, which is recognised over the remainder of the original vesting period.

The incremental value is ₹ 3 per stock option (₹ 18 – ₹ 15). This amount is recognised over the remaining two years of the vesting period, along with remuneration expense based on the original option value of ₹ 15.

The amounts recognised towards employees services received in years 1-3 are as follows:

Year	Calculation	Compensation expense for period (₹)	Cumulative compensation expense (₹)
1	(500 – 110) employees × 100 options × ₹ 15 × 1/3	1,95,000	1,95,000
2	(500 – 105) employees × 100 options × (₹ 15 × 2/3 + ₹ 3 × 1/2) – ₹ 1,95,000	2,59,250	4,54,250
3	(500 – 103) employees × 100 options × (₹ 15 + ₹ 3) – ₹ 4,54,250	2,60,350	7,14,600

Illustration 2: Grant of Stock Options with a Vesting Condition that is Subsequently Modified

At the beginning of year 1, the enterprise grants 1,000 stock options to each member of its sales team, conditional upon the employees remaining in the employment of the enterprise for three years, and the team selling more than 50,000 units of a particular product over the three-year period. The fair value of the stock options is ₹ 15 per option at the date of grant.

During year 2, the enterprise increases the sales target to 1, 00,000 units. By the end of year 3, the enterprise has sold 55,000 units, and the stock options do not vest. Twelve members of the sales team have remained in service for the three-year period.

Suggested Accounting Treatment

The Guidance Note requires, for a performance condition that is not a market condition, the enterprise to recognise the services received during the vesting period based on the best available estimate of the number of shares or stock options expected to vest and to revise that estimate, if necessary, if subsequent information indicates that the number of shares or stock options expected to vest differs from previous estimates. On vesting date, the enterprise revises the estimate to equal the number of instruments that ultimately vested. However, the Guidance Note requires, irrespective of any modifications to the terms and conditions on which the instruments were granted, or a cancellation or settlement of that grant of instruments, the enterprise to recognise, as a minimum, the services received, measured at the grant date fair value of the instruments granted, unless those instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. Furthermore, paragraph 26(c) of the text of this Guidance Note specifies that, if the enterprise modifies the vesting conditions in a manner that is not beneficial to the employee, the enterprise does not take the modified vesting conditions into account when applying the requirements of paragraphs 18 to 20 of the text of the Guidance Note.

Therefore, because the modification to the performance condition made it less likely that the stock options will vest, which was not beneficial to the employee, the enterprise takes no account of the modified performance condition when recognising the services received. Instead, it continues to recognise the services received over the three-year period based on the original vesting conditions. Hence, the enterprise ultimately recognises cumulative remuneration expense of ₹ 1,80,000 over the three-year period (12 employees × 1,000 options × ₹ 15).

The same result would have occurred if, instead of modifying the performance target, the enterprise had increased the number of years of service required for the stock options to vest from three years to ten years. Because such a modification would make it less likely that the options will vest, which would not be beneficial to the employees, the enterprise would take no account of the modified service condition when recognising the services received. Instead, it would recognise the services received from the twelve employees who remained in service over the original three-year vesting period.

Appendix IV

Cash-settled Employee Share-based Payment Plans

Continuing, Illustration 1(A) of Appendix II, suppose the enterprise has granted stock appreciation rights (SARs) to its employees, instead of the options whereby the enterprise pays cash to the employees equal to the intrinsic value of the SARs as on the exercise date. The SARs are granted on the condition that the employees remain in its employment for the next three years. The contractual life [comprising the vesting period (3 years) and the exercise period (2 years)] of SARs is 5 years.

The other facts of the Illustration are the same as those in Illustration 1(A) of Appendix II. However, it is also assumed that at the end of year 3, 400 employees exercise their SARs, another 300 employees exercise their SARs at the end of year 4 and the remaining 140 employees exercise their SARs at the end of year 5.

The enterprise estimates the fair value of the SARs at the end of each year in which a liability exists and the intrinsic value of the SARs at the end of years 3, 4 and 5. The values estimated by the enterprise are as below:

Year	**Fair Value**	**Intrinsic Value**
1	₹ 15.30	
2	₹ 16.50	
3	₹ 19.20	₹ 16.00
4	₹ 21.30	₹ 21.00
5		₹ 26.00

Suggested Accounting Treatment

1. The expense to be recognised each year in respect of SARs are determined as below:

Year 1	
No. of SARs expected to vest (as per the original estimate)	
1,000 x 300 x 0.97 x 0.97 x 0.97 =	2,73,802 SARs
Provision required at the year-end	
2,73,802 SARs x ₹ 15.30 x 1/3 =	₹ 13,96,390
Less: provision at the beginning of the year	Nil
Expense for the year	₹ 13,96,390
Year 2	
No. of SARs expected to vest (as per the revised estimate)	
1,000 x 300 x 0.94 x 0.94 x 0.94 =	2,49,175 SARs
Provision required at the year-end	
2,49,175 SARs x ₹ 16.50 x 2/3 =	₹ 27,40,925
Less: provision at the beginning of the year	₹ (13,96,390)
Expense for the year	₹ 13,44,535
Year 3	
No. of SARs actually vested	
840 employees x 300 SARs	2,52,000 SARs
No. of SARs exercised at the year-end	
400 employees x 300 SARs	1,20,000 SARs
No. of SARs outstanding at the year-end	1,32,000 SARs
Provision required in respect of SARs outstanding at the year-end	
1,32,000 SARs x ₹ 19.20 =	₹ 25,34,400
Plus: Cash paid on exercise of SARs by employees	
1,20,000 SARs x ₹ 16.00 =	₹ 19,20,000
Total	₹ 44,54,400
Less: provision at the beginning of the year	₹ (27,40,925)
Expense for the year	₹ 17,13,475

<u>*Year 4*</u>

No. of SARs outstanding at the beginning of the year	1,32,000 SARs
No. of SARs exercised at the year-end	
300 employees x 300 SARs	<u>90,000 SARs</u>
No. of SARs outstanding at the year-end	<u>42,000 SARs</u>
Provision required in respect of SARs outstanding at the year-end	
42,000 SARs x ₹ 21.30 =	₹ 8,94,600
Plus: Cash paid on exercise of SARs	
90,000 SARs x ₹ 21.00 =	<u>₹ 18,90,000</u>
Total ₹ 27,84,600	
Less: provision at the beginning of the year	<u>₹ (25,34,400)</u>
Expense for the year	<u>₹ 2,50,200</u>

<u>*Year 5*</u>

No. of SARs outstanding at the beginning of the year	42,000 SARs
No. of SARs exercised at the year-end	
140 employees x 300 SARs	<u>42,000 SARs</u>
No. of SARs outstanding at the year-end	<u>Nil</u>
Provision required in respect of SARs outstanding at the year-end	Nil
Plus: Cash paid on exercise of SARs	
42,000 SARs x ₹ 26.00 =	<u>₹ 10,92,000</u>
Total	₹ 10,92,000
Less: provision at the beginning of the year	<u>₹ (8,94,600)</u>
Expense for the year	<u>₹ 1,97,400</u>

2. The enterprise passes the following entry, in each of the years, to recognise the compensation expense determined as above:

Employee compensation expense A/c Dr. ___________

To Provision for payment of SARs A/c ___________

(Being compensation expense recognised in respect of SARs)

3. The enterprise passes the following entry, in the years 3, 4 and 5, to record the cash paid on exercise of SARs:

Provision for payment of SARs A/c Dr. _________

To Bank A/c _________

(Being cash paid on exercise of SARs)

4. Balance in the 'Provision for payment of SARs Account', outstanding at year-end, is disclosed in the balance sheet, as a provision under the heading 'Current Liabilities and Provisions'.

Intrinsic Value Method

The accounting treatment suggested above is based on the fair value method. In case the enterprise has followed the intrinsic value method instead of the fair value method, it would make all the computations suggested above on the basis of intrinsic value of SARs on the respective dates instead of the fair value. To illustrate, suppose the intrinsic value of SARs at the grant date is ₹ 6 per right. The intrinsic values of the SARs on the subsequent dates are as below:

Year	Intrinsic Value
1	₹ 9.00
2	₹ 12.00
3	₹ 16.00
4	₹ 21.00
5	₹ 26.00

In the above case, the enterprise would determine the expense to be recognised each year in respect of SARs as below:

Year 1

No. of SARs expected to vest (as per the original estimate)

1,000 x 300 x 0.97 x 0.97 x 0.97 = 2,73,802 SARs

Provision required at the year-end	
2,73,802 SARs x ₹ 9.00 x 1/3 =	₹ 8,21,406
Less: provision at the beginning of the year	Nil
Expense for the year	₹ 8,21,406
Year 2	
No. of SARs expected to vest (as per the revised estimate)	
1,000 x 300 x 0.94 x 0.94 x 0.94 =	2,49,175 SARs
Provision required at the year-end	
2,49,175 SARs x ₹ 12.00 x 2/3 =	₹ 19,93,400
Less: provision at the beginning of the year	₹ (8,21,406)
Expense for the year	₹ 11,71,994
Year 3	
No. of SARs actually vested	
840 employees x 300 SARs	2,52,000 SARs
No. of SARs exercised at the year-end	
400 employees x 300 SARs	1,20,000 SARs
No. of SARs outstanding at the year-end	1,32,000 SARs
Provision required in respect of SARs outstanding at the year-end	
1,32,000 SARs x ₹ 16.00 =	₹ 21,12,000
Plus: Cash paid on exercise of SARs by employees	
1,20,000 SARs x ₹ 16.00 =	₹ 19,20,000
Total	₹ 40,32,000
Less: provision at the beginning of the year	₹ (19,93,400)
Expense for the year	₹ 20,38,600
Year 4	
No. of SARs outstanding at the beginning of the year	1,32,000 SARs

No. of SARs exercised at the year-end 300 employees x 300 SARs	90,000 SARs
No. of SARs outstanding at the year-end	42,000 SARs
Provision required in respect of SARs outstanding at the year-end	
42,000 SARs x ₹ 21.00 =	₹ 8,82,000
Plus: Cash paid on exercise of SARs	
90,000 SARs x ₹ 21.00 =	₹ 18,90,000
Total	₹ 27,72,000
Less: provision at the beginning of the year	₹ (21,12,000)
Expense for the year	₹ 6,60,000
Year 5	
No. of SARs outstanding at the beginning of the year	42,000 SARs
No. of SARs exercised at the year-end	
140 employees x 300 SARs	42,000 SARs
No. of SARs outstanding at the year-end	Nil
Provision required in respect of SARs outstanding at the year-end	Nil
Plus: Cash paid on exercise of SARs	
42,000 SARs x ₹ 26.00 =	₹ 10,92,000
Total	₹ 10,92,000
Less: provision at the beginning of the year	₹ (8,82,000)
Expense for the year	₹ 2,10,000

Appendix V

Employee Share-based Payment Plan with Cash Alternatives

Illustration: An enterprise grants to an employee the right to choose either a cash payment equal to the value of 1,000 shares, or 1,200 shares. The grant is conditional upon the completion of three years' service. If the employee chooses the equity alternative, the shares must be held for three years after vesting date. The face value of shares is ₹ 10 per share.

At grant date, the fair value of the shares of the enterprise (without considering post-vesting restrictions) is ₹ 50 per share. At the end of years 1, 2 and 3, the said fair value is ₹ 52, ₹ 55 and ₹ 60 per share respectively. The enterprise does not expect to pay dividends in the next three years. After taking into account the effects of the post-vesting transfer restrictions, the enterprise estimates that the grant date fair value of the equity alternative is ₹ 48 per share. At the end of year 3, the employee chooses:

Scenario 1: The cash alternative

Scenario 2: The equity alternative

Suggested Accounting Treatment

1. The employee share-based payment plan granted by the enterprise has two components, viz., (i) a liability component, i.e., the employees' right to demand settlement in cash, and (ii) an equity component, i.e., the employees' right to demand settlement in shares rather than in cash. The enterprise measures, on the grant date, the fair value of two components as below:

Fair value under equity settlement	
1,200 shares x ₹ 48 =	₹ 57,600
Fair value under cash settlement 1,000 shares x ₹ 50 =	₹ 50,000
Fair value of the equity component (₹ 57,600 – ₹ 50,000) =	₹ 7,600
Fair value of the liability component	₹ 50,000

2. The enterprise calculates the expense to be recognised in respect of the liability component at the end of each year as below:

Year 1

Provision required at the year-end	
1,000 x ₹ 52.00 x 1/3 =	₹ 17,333
Less: provision at the beginning of the year	Nil
Expense for the year	₹ 17,333

Year 2

Provision required at the year-end	
1,000 x ₹ 55.00 x 2/3 =	₹ 36,667
Less: provision at the beginning of the year	₹ 17,333
Expense for the year	₹ 19,334

Year 3

Provision required at the year-end	
1,000 x ₹ 60.00 =	₹ 60,000
Less: provision at the beginning of the year	₹ 36,667
Expense for the year	₹ 23,333

3. The expense to be recognised in respect of the equity component at the end of each year is one third of the fair value (₹ 7,600) determined at (1) above.

4. The enterprise passes the following entry at the end of each of the years to recognise compensation expense towards liability component determined at (2) above:

Employee compensation expense A/c Dr.________

To Provision for liability component of employee share-based payment plan ________

(Being compensation expense recognised in respect of liability component of employee share-based payment plan with cash alternative)

5. The enterprise passes the following entry at the end of each of the year to recognise compensation expense towards equity component determined at (3) above:

Employee compensation expense A/c Dr. _________

To Stock Options Outstanding A/c _________

(Being compensation expense recognised in respect of equity component of employee share-based payment plan with cash alternative)

6. Provision for liability component of employee share-based payment plan, outstanding at year-end, is disclosed in the balance sheet, as a provision under the heading 'Current Liabilities and Provisions'. Credit balance in the 'Stock Options Outstanding A/c' is disclosed under a separate heading, between 'Share Capital' and 'Reserves and Surplus'.

7. The enterprise passes the following entry on the settlement of the employee share-based payment plan with cash alternative:

Scenario 1: *The cash alternative*

Provision for liability component of employee share-based payment plan Dr. ₹ 60,000

To Bank A/c ₹ 60,000

(Being cash paid on exercise of cash alternative under the employee share-based payment plan)

Stock Options Outstanding A/c Dr. ₹ 7,600

To General Reserve ₹ 7,600

(Being the balance standing to the credit of the Stock Options Outstanding Account transferred to the general reserve upon exercise of cash alternative)

Scenario 2: *The equity alternative*

Stock Options Outstanding A/c Dr. ₹ 7,600

Provision for liability component of employee share-based Payment plan Dr. ₹ 60,000

To Share Capital A/c (1,200 shares x ₹ 10) ₹ 12,000

To Securities Premium A/c ₹ 45,600

To General Reserve ₹ 10,000

(Being shares issued on exercise of equity alternative under the employee share-based payment plan)

Appendix VI

Graded Vesting

Continuing Illustration 1(A) of Appendix II suppose that the options granted vest according to a graded schedule of 25 per cent at the end of the year 1, 25 per cent at the end of the year 2, and the remaining 50 per cent at the end of the year 3. The expected lives of the options that vest at the end of the year 1, 2 and 3 are 2.5 years, 4 years and 5 years respectively. The fair values of these options, computed based on their respective expected lives, are ₹ 10, ₹ 13 and ₹ 15 per option, respectively. It is also assumed that expected forfeiture rate is 3% per year and does not change during the vesting period.

Suggested Accounting Treatment

A. If accounting treatment specified in paragraph *74 is followed.*

1. Since the options granted have a graded vesting schedule, the enterprise segregates the total plan into different groups, depending upon the vesting dates and treats each of these groups as a separate plan.

2. The enterprise determines the number of options expected to vest under each group as below:

Vesting Date (Year-end)	Options expected to vest
1 300 options x 1,000 employees x 25% x 0.97	= 72,750 options
2 300 options x 1,000 employees x 25% x 0.97 x 0.97	= 70,568 options
3 300 options x 1,000 employees x 50% x 0.97	
x 0.97 x 0.97	=1,36,901 options
Total options expected to vest	2,80,219 options

3. Total compensation expense for the options expected to vest is determined as follows:

Vesting Date (Year-end)	Expected Vesting (No. of Options)	Value per Option (₹)	Compensation Expense (₹)
1	72,750	10	7,27,500
2	70,568	13	9,17,384
3	1,36,901	15	20,53,515
Total			36,98,399

4. Compensation expense, determined as above, is recognised over the respective vesting periods. Thus, the compensation expense of ₹ 7, 27,500 attributable to 72,750 options that vest at the end year 1, is allocated to the year 1. The expense of ₹ 9, 17,384 attributable to the 70,568 options that vest at the end of year 2 is allocated over their 2-year vesting period (year 1 and year 2). The expense of ₹ 20,53,515 attributable to the 1,36,901 Options that vest at the end of year 3 is allocated over their 3-year vesting period (year 1, year 2 and year 3). Total compensation expense of ₹ 36,98,399, determined at the grant date, is attributed to the years 1, 2 and 3 as below:

Vesting Date (End of year)	Cost to be recognised		
	Year 1	Year 2	Year 3
1	7,27,500	4,58,692	
2	4,58,692	6,84,505	
3	6,84,505		6,84,505
Cost for the year	18,70,697	11,43,197	6,84,505
Cumulative cost	18,70,697	30,13,894	36,98,399

Intrinsic Value Method

The accounting treatment suggested above is based on the fair value method. In case the enterprise has followed the intrinsic value method instead of the fair value method, it would make computations suggested above on the basis of intrinsic value of options at the grant date (which would be the same for all groups) instead of the fair value. To illustrate, suppose the intrinsic value of the option at the grant date is ₹ 6 per option.

In such a case, total compensation expense for the options expected to vest would be determined as follows:

Vesting Date (End of year)	Expected Vesting (No. of Options)	Value per Option (₹)	Compensation Expense (₹)
1	72,750	6	4,36,500
2	70,568	6	4,23,408
3	1,36,901	6	8,21,406
Total			16,81,314

Total compensation expense of ₹ 16, 81,314, determined at the grant date, would be attributed to the years 1, 2 and 3 as below:

Vesting Date (End of year)	Cost to be recognised		
	Year 1	Year 2	Year 3
1	4,36,500	2,11,704	2,73,802
2	2,11,704	2,73,802	
3	2,73,802		
Cost for the year	9,22,006	4,85,506	2,73,802
Cumulative cost	9,22,006	14,07,512	16,81,314

Appendix VII

Computation of Earnings per Share

Illustration: At the beginning of year 1, an enterprise grants 300 stock options to each of its 1,000 employees, conditional upon the employees remaining in the employment of the enterprise for two years. The fair value of the stock options, at the date of grant, is ₹ 10 per option and the exercise price is ₹ 50 per share. The other relevant terms of the grant and assumptions are as below:

(a) The number of employees expected to complete two years vesting period, at the beginning of the plan, is 900. 50 employees are expected to leave during the each of the year1 and year 2 and, consequently, the options granted to them are expected to be forfeited.

(b) Actual forfeitures, during the vesting period, are equal to the expected forfeitures and 900 employees have actually completed two-years vesting period.

(c) The profit of the enterprise for the year 1 and year 2, before amortisation of compensation cost on account of ESOPs, is ₹ 25,00,000 and ₹ 28,00,000 respectively.

(d) The fair value of shares for these years was ₹ 57 and ₹ 60 respectively.

(e) The enterprise has 5,00,000 shares of ₹ 10 each outstanding at the end of year 1 and year 2.

Compute the Basic and Diluted EPS, ignoring tax impacts, for the year 1 and year 2.

Suggested Computations

(a) The stock options granted to employees are not included in the shares outstanding till the employees have exercised their right to obtain shares or stock options, after fulfilling the requisite vesting conditions. Till such time, the stock options so granted are considered as dilutive potential equity shares for the purpose of calculating Diluted EPS. At the end of each year, computations of diluted EPS are based on the actual number of options granted and not yet forfeited.

(b) For calculating diluted EPS, no adjustment is made to the net profit attributable to equity shareholders as there are no expense or income that would result from conversion of ESOPs to the equity shares.

(c) For calculating diluted EPS, the enterprise assumes the exercise of dilutive options. The assumed proceeds from these issues are considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value are treated as an issue of equity shares for no consideration.

(d) As per paragraph 70 of this Guidance Note, the assumed proceeds to be included for computation, mentioned at (c) above, include (i) the exercise price; and (ii) the unamortised compensation cost related to these ESOPs, attributable to future services.

(e) The enterprise calculates the basic and diluted EPS as below:

Particulars	**Year 1**	**Year 2**
Net profit before amortisation of ESOP cost	₹ 25,00,000	₹ 28,00,000
Less: Amortisation of ESOP cost	(₹ 13,50,000)	(₹ 13,50,000)
[(900 employees × 300 options × ₹ 10)/2]	₹ 11,50,000	₹ 14,50,000
Net profit attributable to equity shareholders	5,00,000 ₹ **2.30**	5,00,000 ₹ **2.90**
Number of shares outstanding		
Basic EPS		
Number of options outstanding (Options granted less actual forfeitures)	2,85,000 [1,000 employees × 300 options – (50 employees × 300 options)]	2,70,000 [2,85,000 options – (50 employees × 300 options)]
Unamortised compensation cost per option	₹ 5 [₹ 10 – ₹ 10/2]	₹ 0
Number of dilutive potential equity shares	10,000 [2,85,000 ({2,85,000	45,000 [2,70,000 –

	* 50) + (2,85,000 * 5)}/57)]	(2,70,000* 50)/60)]
No. of equity shares used to compute diluted earnings per share	5,10,000	5,45,000
Diluted EPS	**₹ 2.255**	**₹ 2.66**

Appendix VIII

Illustrative Disclosures

The following example illustrates the disclosure requirements in paragraphs 79 to 83 of the text of the Guidance Note.[3]

Extract from the Notes to the Financial Statements of Company Z (for the year ended 31 December, 2021)

Employee Share-based Payment Plans

1. During the period ended 31 December, 2021, the Company had four share-based payment arrangements, which are described below:

Type of arrangement	*Senior management stock option plan*	*General employee stock option plan*	*Executive stock plan*	*Senior manage ment stock appreciation cash plan*
Date of grant	January 1, 2020	January 1, 2020	January 1, 2020	July 1, 2020
Number granted	50,000	75,000	50,000	25,000
Contractual life	10 years	10 years	N/A	10 years
Vesting Conditions	1.5 years service and achievement of a share price target, which was achieved.	Three years service.	Three years service and achievement of a target growth in earnings per share.	Three years service and achievement of a target increase in market share.

[3]**Note:** The illustrative example is not intended to be a template or model and is therefore not exhaustive. For example, it does not illustrate the disclosure requirements in paragraph 79 of the text of the Guidance Note.

2. The estimated fair value of each stock option granted in the general employee stock option plan is ₹ 23.60. This was calculated by applying binomial option pricing model. The model inputs were the share price at grant date of ₹ 50, exercise price of ₹ 50, expected volatility of 30 per cent, no expected dividends, contractual life of ten years, and a risk- free interest rate of 5 per cent. To allow for the effects of early exercise, it was assumed that the employees would exercise the options after vesting date when the share price was twice the exercise price. Historical volatility was 40 per cent, which includes the early years of the Company's life; the Company expects the volatility of its share price to reduce as it matures.

3. The estimated fair value of each share granted in the executive stock plan is ₹ 50.00, which is equal to the share price at the date of grant.

4. Further details of the two stock option plans are as follows:

	2020		*2021*	
	Number of options	*Weighted average exercise price*	*Number of options*	*Weighted average exercise price*
Outstanding at start of year	*0*	*—*	*45,000*	*₹ 40*
Granted	*50,000*	*Rs 40*	*7,5000*	*Rs 50*
Forfeited	*(5,000)*	*Rs 40*	*(8,000)*	*Rs 46*
Exercised	*0*	*—*	*(4,000)*	*Rs 40*
Outstanding at end of year	*0*	*Rs 40*	*38,000*	*Rs 40*
Exercisable at end of year	*0*	*Rs 40*	*38,000*	*Rs 40*

5. The weighted average share price at the date of exercise for stock options exercised during the period was ₹ 52. The options outstanding at December 31, 2021 had an exercise price of ₹ 40 or ₹ 50, and a weighted average remaining contractual life of 8.64 years.

6. Other information regarding employee share-based payment plans is as below:

Particulars	2020 (₹)	2021 (₹)
Expense arising from employee share-based payment plans	4,95,000	11,05,867
Expense arising from share and stock option plans	4,95,000	10,07,000
Closing balance of liability for cash stock appreciation plan	—	98,867
Expense arising from increase in fair value of liability for cash stock appreciation plan	—	9,200

Appendix IX

Share-based payment transaction with non-employee

Illustration 1: On 1 April 2020, Company A Ltd., a chocolate producer, enters into a contract with vendor B Ltd. according to which B has to deliver to A one tonne of cocoa beans on 1 April 2021 to be used in A's production of chocolate. The forward price of one tonne of cocoa beans on 1 April 2020 is ₹ 100,000. A agrees to pay B 20,000 shares, to be delivered on delivery of the cocoa beans i.e. 1 April 2021. A's share price on 1 April 2020 is ₹ 5 each.

On delivery, i.e. 1 April 2021, the actual value of cocoa beans per tonne is ₹ 125,000. The actual market price of a share has increased to ₹ 5.50 i.e. total value of ₹ 110,000.

The goods acquired qualify for asset recognition as inventories under AS 2 on 1 April 2021.

A Ltd. accounts for the transaction as follows:

Particulars	Dr. .(₹)	Cr.(₹)
Inventories	-	
Equity		-
Since goods are not obtained in FY 2020-21, there is no entry		
Inventories	125,000	
Equity		125,000
To recognise goods received, measured at their fair value at date of receipt		

Since the fair value of the cocoa beans are reliably measurable, they are recognised at their fair value on the date of recognition i.e. date of delivery. Had the fair value of the goods received not been reliably measurable, they would have been recognised (with a corresponding credit to equity) at ₹ 110,000 i.e. the fair value of the shares at the 'service date'.

Illustration 2: On 1 April 2020, Company A Ltd., a software company, enters into a contract with vendor B Ltd. to render 200 hours of software support each year over next three year period. In consideration, B receives 8,000 shares of A at the end of each year.

The fair value for the type of support service provided by B is readily available. According to B's list of billing rate is ₹ 400 per hour in Year 1 and Year 2. In Year 3, B increases the rate to ₹ 450 per hour.

A Ltd. accounts for the transaction as follows:

Particulars	Dr. .(₹)	Cr.(₹)
FY 2020-21		
Expenses	80,000	
Equity		80,000
To recognise fair value of services received (200 hours X ₹ 400)		
FY 2021-22		
Expenses	80,000	
Equity		80,000
To recognise fair value of services received (200 hours X ₹ 400)		
FY 2022-23		
Expenses	90,000	
Equity		90,000
To recognise fair value of services received (200 hours X ₹ 450)		

The share-based payment expense in this example varies with the value of the services received. Since the fair value of the services are reliably measurable, they are recognised at their fair value on the date of recognition i.e. service date. Had the fair value of the services received not been reliably measurable, they would have been recognised (with a corresponding credit to equity) at the fair value of the shares at the 'service date'.

Illustration 3: On 1 April 2020, Company A Ltd., a software company, enters into a contract with vendor B Ltd. to render consultancy services on a specific project. In consideration, B receives 100,000 shares of A if the project is completed by 31 March 2022. B provides services to A consistently throughout the two-year period.

A considers that the fair value of B's consultancy services are not reliably measurable and therefore measures the services received by reference to the fair value of the shares issued.

Historically, the market price of A's shares have been relatively stable. At each reporting date, A analyses the share price movements and concludes that they have not changed significantly. A therefore applies the approximation technique to determine the average share price at regular intervals over the life of the project. A six-month interval is used in this case.

1st half year of Year 1	₹ 11
2nd half year of Year 1	₹ 13
1st half year of Year 2	₹ 11
2nd half year of Year 2	₹ 10

A expects the performance condition to be met, which it ultimately is.

A accounts for the share-based payment transaction as follows:

Particulars	Dr. .(₹)	Cr.(₹)
FY 2020-21 (1st half)		
Expenses	275,000	
Equity		275,000
To recognise services received, measured with reference to average share price of equity instruments granted when services are rendered (100,000 hours X 11X 1/4)		
FY 2020-21 (2nd half)		
Expenses	325,000	
Equity		325,000
To recognise services received, measured with reference to average share price of equity instruments granted when services are rendered (100,000 hours X 13X 1/4)		
FY 2021-22 (1st half)		
Expenses	275,000	
Equity		275,000
To recognise services received, measured with reference to average share price of equity instruments granted when services are rendered (100,000 hours X 11X 1/4)		

<u>FY 2021-22 (2nd half)</u>		
Expenses	250,000	
Equity		250,000
To recognise services received, measured with reference to average share price of equity instruments granted when services are rendered (100,000 hours X 10X 1/4)		

Appendix X

Group Share-based payment transaction

Illustration 1: Parent grants equity shares to employees of subsidiary

Parent awards equity shares in Parent to employees of Subsidiary in exchange for services to Subsidiary. Parent settles the award with the employees of Subsidiary.

Suggested Accounting Treatment:

<u>Consolidated financial statements of Parent</u>

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent group] receives goods or services in a share-based payment arrangement '. A share-based payment arrangement includes 'an agreement between the enterprise and another party (including an employee) that entitles the other party to receive equity instruments of the enterprise '.

The transaction is classified as an equity-settled transaction because it is settled in an equity instrument of the group.

<u>Separate financial statements of Parent</u>

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent as a single enterprise] incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group enterprise receives those goods or services'.

The transaction is classified as an equity-settled transaction because it is settled in an equity instrument of Parent.

<u>Subsidiary financial statements</u>

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. Subsidiary] receives goods or services in a share-based payment arrangement'. A 'share-based payment arrangement' includes 'an agreement between another group enterprise [i.e. Parent] and another party (including an employee) that entitles the other party to receive equity instruments of another group enterprise'.

The transaction is classified as an equity-settled transaction because Subsidiary 'has no obligation to settle the transaction with the supplier'.

Although the Subsidiary is not a party to the agreement with its employees, it still records a cost for this transaction. In effect, the accounting treatment is representing that Subsidiary has received a capital contribution from Parent, which Subsidiary has then 'spent' on employee remuneration.

Illustration 2: Subsidiary grants its own equity shares to its employees

Subsidiary awards equity shares in Subsidiary to employees of Subsidiary in exchange for services to Subsidiary. Subsidiary settles the award with the employees of Subsidiary.

Consolidated financial statements of Parent

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent group] receives goods or services in a share-based payment arrangement'. A share-based payment arrangement includes 'an agreement between the enterprise and another party (including an employee) that entitles the other party to receive equity instruments of the enterprise'

The transaction is classified as an equity-settled transaction, because it is settled in an equity instrument of the group. In the consolidated financial statements of Parent, shares of Subsidiary not held by Parent are a minority interest.

Separate financial statements of Parent

This arrangement is not within the scope of the GN for the separate financial statements of Parent, because Parent (as a separate enterprise) receives no goods or services, nor does it settle the transaction.

Subsidiary financial statements

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. Subsidiary] receives goods or services in a share-based payment arrangement'. The transaction is classified as an equity-settled transaction, because it is settled in an equity instrument of Subsidiary.

Illustration 3: Parent grants equity shares of Subsidiary to subsidiary's employees

Parent awards equity shares in Subsidiary to employees of Subsidiary in exchange for services to Subsidiary. Parent settles the award with the employees of Subsidiary.

Consolidated financial statements of Parent

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent group] receives goods or services in a share-based payment arrangement'. A share-based payment arrangement includes 'an agreement between the enterprise and another party (including an employee) that entitles the other party to receive equity instruments of the enterprise'

The transaction is classified as an equity-settled transaction, because it is settled in an equity instrument of the group. In the consolidated financial statements of Parent, shares of Subsidiary not held by Parent are a minority interest.

Separate financial statements of Parent

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent as a single enterprise] incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group enterprise [i.e. Subsidiary] receives those goods or services'. The transaction is a share-based payment arrangement for Subsidiary and the consolidated financial statements of Parent.

For Parent, the transaction is classified as a cash-settled transaction, because it is settled not in an equity instrument issued by Parent, but in an equity instrument issued by a subsidiary and held by Parent – i.e. an asset (investment) in Parent's separate financial statements.

Subsidiary financial statements

Under the definition of 'share-based payment transaction', 'the enterprise [i.e.Subsidiary] receives goods or services in a share-based payment arrangement'.

A 'share-based payment arrangement' includes 'an agreement between another group enterprise [i.e. Parent] and another party (including an employee) that entitles the other party to receive equity instruments of the enterprise'.

The transaction is classified as an equity-settled transaction, because Subsidiary ' has no obligation to settle the transaction with the supplier'

Illustration 4: Parent grants cash based on value of shares of Parent to subsidiary's employees

Parent awards cash based on the value of shares in Parent to employees of Subsidiary in exchange for services to Subsidiary. Parent settles the award with the employees of Subsidiary.

Consolidated financial statements of Parent

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent group] receives goods or services in a share-based payment arrangement'. A 'share-based payment arrangement' includes 'an agreement between the enterprise and another party (including an employee) that entitles the other party to receive cash of the enterprise based on the price (or value) of equity instruments of the enterprise'.

The transaction is classified as a cash-settled transaction, because it is settled in cash of the group.

Separate financial statements of Parent

Under the definition of 'share-based payment transaction', 'the enterprise [i.e. the Parent as a single enterprise] incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group enterprise [i.e. Subsidiary] receives those goods or services'.

The transaction is classified as a cash-settled transaction, because it is settled in cash of Parent.

Subsidiary separate financial statements

The transactions settled in cash by another group enterprise (the Parent). The transaction is classified as an equity-settled transaction by Subsidiary, because Subsidiary 'has no obligation to settle the transaction with the supplier'.

Appendix XI

Accounting for Employee Share-based Payment Plans Administered Through a Trust

Illustration 1: Enterprise Allots Shares to the ESOP Trust as and when the Employees Exercise Stock Options

At the beginning of year 1, an enterprise grants 300 stock options to each of its 1,000 employees, conditional upon the employees remaining in the employment of the enterprise for one year. The fair value of the stock options, at the date of grant, is ₹ 15 per option and the exercise price is ₹ 50 per share. The options can be exercised in one year after the date of vesting. The other relevant terms of the grant and assumptions are as below:

(a) The grant is administered by an ESOP trust appointed by the enterprise. According to the terms of appointment, the enterprise agrees to allot shares to the ESOP trust as and when the stock options are exercised by the employees.

(b) The number of employees expected to complete one year vesting period, at the beginning of the plan, is 900, i.e., 100 employees are expected to leave during the vesting period and, consequently, the options granted to them are expected to be forfeited.

(c) Actual forfeitures, during the vesting period, are equal to the expected forfeitures and 900 employees have actually completed one year vesting period.

(d) All 900 employees exercised their right to obtain shares vested in them in pursuance of the ESOP at the end of year 2.

(e) Apart from the shares allotted to the trust, the enterprise has 10,00,000 shares of ₹ 10 each outstanding at the end of year 1. The said shares were issued at a premium of ₹ 15 per share. The full amount of premium received on issue of shares is still standing to the credit of the Securities Premium Account. The enterprise has not made any change in the share capital upto the end of year 2, except that arising from transactions with the employees pursuant to the Employee Stock Option Plan.

Suggested Accounting Treatment

The accounting treatment, in this case, would be the same as explained in the case where the enterprise itself is administering the Employee Stock Option Plan (ESOP) although the enterprise issues shares to the ESOP Trust instead of issuing shares to the employees directly. The accounting treatment in this case is explained herein below:-

Year 1

1. At the grant date, the enterprise estimates the fair value of the options expected to vest at the end of the vesting period as below:

No. of options expected to vest

(1,000 – 100) employees x 300 options = 2,70,000 options

Fair value of options expected to vest

2,70,000 options x ` 15 = ` 40,50,000

2. At the end of the financial year, the enterprise examines its actual forfeitures and makes necessary adjustments, if any, to reflect expense for the number of options that actually vested. Considering that actual forfeitures, during the vesting period, are equal to the expected forfeitures and 900 employees have actually completed one year vesting period, the enterprise recognises the fair value of options expected to vest (estimated at 1 above) towards the employee services received by passing the following entry:

Employee compensation expense A/c Dr. ₹ 40,50,000

To Stock Options Outstanding A/c ₹ 40,50,000

(Being compensation expense recognised in respect of the ESOP)

3. Credit balance in the 'Stock Options Outstanding Account' is disclosed in the balance sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus', as below:

Extracts from the Balance Sheet

Liabilities Amount (`)

Share Capital

Paid-up Capital:

10,00,000 equity shares of ₹ 10 each	1,00,00,000
Stock Options Outstanding Account	40,50,000
Reserves and Surplus	
Securities Premium A/c (10,00,000 shares x ₹ 15)	1,50,00,000

Year 2

1. On exercise of the right to obtain shares by the employees, the enterprise allots shares to the ESOP Trust for issuance to the employees. The shares so issued are considered to have been issued on a consideration comprising the exercise price and the fair value of the options. In the present case, the exercise price is ` 50 per share and the fair value of the options is ` 15 per option. The enterprise, therefore, considers the shares to be issued at a price of ` 65 per share.

2. The amount to be recorded in the 'Share Capital Account' and the 'Securities Premium Account', upon issuance of the shares, is calculated as below:

No. of employees exercising option	900
No. of shares issued on exercise @ 300 per employee	2,70,000
Exercise Price @ ₹ 50 per share	1,35,00,000
Fair value of options @ ₹ 15 per option	40,50,000
Total Consideration	**1,75,50,000**
Amount to be recorded in 'Share Capital A/c'@ ₹ 10 per share	27,00,000
Amount to be recorded in 'Securities Premium A/c'@ ₹ 55 per share	1,48,50,000
Total	**1,75,50,000**

3. The ESOP Trust receives exercise price from the employees exercising the options vested in them in pursuance of the Employee Stock Option Plan. The Trust passes on the exercise price so received to the enterprise for issuance of shares to the employees. The enterprise allots shares to the ESOP Trust for issuance to the employees exercising the options vested in them in pursuance of the Employee Stock Option Plan. To recognise the transaction, the following entry is passed:

Bank A/c Dr. 1,35,00,000

Stock Options Outstanding A/c Dr. ` 40,50,000

To Share Capital A/c ` 27,00,000

To Securities Premium A/c ` 1,48,50,000

(Being shares allotted to the ESOP Trust for issuance to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)

4. The Share Capital Account and the Securities Premium Account are disclosed in the balance sheet as below:

Extracts from the Balance Sheet

Liabilities Amount (`)

Share Capital

Paid-up Capital:

12,70,000 equity shares of ` 10 each fully paid 1,27,00,000

(Of the above, 2,70,000 shares of ` 10 each have been issued to the employees pursuant to an Employee Share-based Payment Plan. The issue price of the share was ` 65 per share out of which` 15 per share were received in the form

Of employee services over a period of one year).

Reserves and Surplus

Securities Premium A/c 2,98,50,000

Computation of Earnings Per Share

For the purpose of calculating Basic EPS, stock options granted pursuant to the employee share-based payment plan would not be included in the shares outstanding till the employees have exercised their right to obtain shares, after fulfilling the requisite vesting conditions. Till such time, stock options so granted would be considered as dilutive potential equity shares for the purpose of calculating Diluted EPS.

Illustration 2: Enterprise Provides Finance to the ESOP Trust for Subscription to Shares Issued by the Enterprise at the Beginning of the Plan

Continuing Illustration 1 above, suppose the enterprise provides finance, at the grant date, to the ESOP trust for subscription to the shares of the enterprise equivalent to the number of shares expected to vest. With the help of finance provided by the enterprise, the trust subscribes to the shares offered by the enterprise at a cash price of ₹ 50 per share, at the beginning of the plan. The Trust would issue shares to the employees as and when they exercise the right vested in them in pursuance of the Employee Stock Option Plan (ESOP). The other facts of the case are the same as in Illustration 1.

Suggested Accounting Treatment

The computations of employee compensation expense, amount to be recognised in the Share Capital Account and the Securities Premium Account, etc., would be the same as that in Illustration 1 above.

Year 1

1. The enterprise passes the following entry to record provision of finance [₹ 1,35,00,000 (i.e., 2,70,000 shares x ` 50)] to the ESOP trust:

Amount recoverable from ESOP Trust A/c	Dr. ₹ 1,35,00,000	
To Bank A/c		₹ 1,35,00,000

(Being finance provided to the ESOP trust for subscription of shares)

2. The enterprise passes the following entry to record the allotment of 2,70,000 shares to the ESOP Trust at ` 65 per share [comprising the exercise price (` 50) and the fair value of options (` 15)]:

Bank A/c	Dr. ₹ 1,35,00,000	
Amount recoverable from ESOP Trust A/c	Dr. ₹ 40,50,000	
To Share Capital A/c		₹ 27,00,000
To Securities Premium A/c		₹ 1,48,50,000

(Being shares allotted to the ESOP Trust in respect of the Employee Stock Option Plan)

3. The enterprise passes the following entry to recognise the employee services received during the year:

Employee compensation expense A/c	Dr. ₹ 40,50,000	
To Stock Options Outstanding A/c		₹ 40,50,000

(Being compensation expense recognised in respect of the ESOP)

4. The Share Capital Account, the Securities Premium Account, credit balance in the 'Stock Options Outstanding Account' and debit balance in the 'Amount recoverable from ESOP Trust Account' are disclosed in the balance sheet as below:

Extracts from the Balance Sheet

Liabilities		Amount (`)
Share Capital		
Paid-up Capital:		
12,70,000 equity shares of ` 10 each		1,27,00,000
Less: Amount recoverable from ESOP	27,00,000	1,00,00,000
Trust (face value of 2,70,000 share		
allotted to the Trust)		
Stock Options Outstanding Account		40,50,000
Reserves and Surplus		
Securities Premium Account		2,98,50,000
Less: Amount recoverable from ESOP		1,48,50,000
Trust		1,50,00,000
(Premium on 2,70,000 share allotted to the Trust)		

5. Apart from other required disclosures, the enterprise gives a suitable note in the Notes to Accounts to explain the transaction and the nature of deduction of the 'Amount recoverable from ESOP Trust' made from the 'Share Capital' and the 'Securities Premium Account'.

Year 2

1. On exercise of the right to obtain shares, the ESOP trust issues shares to the respective employees after receiving the exercise price of ₹ 50 per share. The ESOP Trust passes on the exercise price received on issue of shares to the enterprise. The enterprise passes the following entry to record the receipt of the exercise price:

Bank A/c	Dr. Rs 1,35,00,000	
To Amount recoverable from ESOP Trust A/c		₹ 1,35,00,000

(Being amount received from the ESOP Trust against finance provided to it at the beginning of the Employee Stock Option Plan)

2. The enterprise transfers the balance standing to the credit of the 'Stock Options Outstanding Account' to the 'Amount recoverable from ESOP Trust Account' by passing the following entry:

Stock Options Outstanding A/c	Dr. ₹ 40,50,000	
To Amount recoverable from ESOP Trust A/c		₹ 40,50,000

(Being consideration for shares issued to the employees received in the form of employee services adjusted against the relevant account)

3. The Share Capital Account and the Securities Premium Account are disclosed in the balance sheet as below:

Extracts from the Balance Sheet

Liabilities Amount (`)

Share Capital

Paid-up Capital:

12,70,000 equity shares of ` 10 each fully paid 1,27,00,000

(Of the above, 2,70,000 shares of ` 10 each have been issued to the employees through ESOP Trust) pursuant to an Employee Share-based Payment Plan.

The issue price of the share was `65 per share out of which ` 15 per share were received in the form of employee services over a period of one year).

Reserves and Surplus

Securities Premium Account 2,98,50,000

Computation of Earnings Per Share

For the purpose of calculating Basic EPS, shares allotted to the ESOP Trust pursuant to the employee share-based payment plan would not be included in the shares outstanding till the employees have exercised their right to obtain shares, after fulfilling the requisite vesting conditions. Till such time, the shares so allotted would be considered as dilutive potential equity shares for the purpose of calculating Diluted EPS.

Illustration 3: Enterprise Provides Finance to the ESOP Trust to Purchase Shares from the Market at the Beginning of the Plan

Continuing Illustration 2 above, suppose the enterprise does not issue fresh shares to the ESOP Trust. Instead, it provides finance, at the grant date, to the trust to purchase shares of the enterprise from the market, equivalent to the number of shares expected to vest. With the help of finance provided by the enterprise, the ESOP Trust purchases 2,70,000 shares from the market @ Rs 52 per share at the beginning of the plan. The other facts remain the same as in Illustration 2 above.

Suggested Accounting Treatment

Year 1

1. The enterprise passes the following entry to record provision of finance [₹ 1,40,40,000 (i.e., 2,70,000 shares x ₹ 52)] to the ESOP trust:

Amount recoverable from ESOP Trust A/c	Dr. ₹ 1,40,40,000	
To Bank A/c		₹ 1,40,40,000

(Being finance provided to the ESOP trust for purchase of shares in respect of the ESOP)

2. The enterprise passes the following entry at the end of the year to recognise the employee services received during the year:

Employee compensation expense A/c	Dr. ₹ 40,50,000	
To Stock Options Outstanding A/c		₹ 40,50,000

(Being compensation expense recognised in respect of the ESOP)

3. Credit balance in the 'Stock Options Outstanding Account' is disclosed on the liability side of the balance sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus'. Debit balance in the 'Amount recoverable from ESOP Trust Account' is disclosed on the asset side under a separate heading, between the 'Investments' and the 'Current Assets, Loans and Advances'. On this basis, the relevant extracts of the balance sheet appear as below:

Extracts from the Balance Sheet

Liabilities Amount (`)	
Share Capital	
Paid-up Capital:	
10,00,000 equity shares of ` 10 each	1,00,00,000
Stock Options Outstanding Account	40,50,000
Reserves and Surplus	
Securities Premium Account	1,50,00,000
Assets Amount (`)	
Investments —	
Amount recoverable from ESOP Trust	1,40,40,000
Current Assets, Loans and Advances —	

4. Apart from the other required disclosures, the enterprise gives a suitable note in the 'Notes to Accounts' to explain the transaction and the nature of the 'Amount recoverable from ESOP Trust'.

Year 2

1. On exercise of the right to obtain shares by the employees, the ESOP trust issues shares to the respective employees after receiving the exercise price. The exercise price so received is passed on to the enterprise. The amount received, in this manner, is ₹ 1,35,00,000 (i.e., 900 employees x300 options x ₹ 50). The enterprise passes the following entry to record the receipt of the exercise price:

Bank A/c Dr. ₹ 1,35,00,000

To Amount recoverable from ESOP Trust A/c ₹ 1,35,00,000

(Being amount received from the ESOP trust against the finance provided to it in respect of the Employee Stock Option Plan)

2. The enterprise transfers an amount equivalent to the difference between the cost of shares to the ESOP Trust and the exercise price from the 'Stock Options Outstanding Account' to the 'Amount recoverable from ESOP Trust Account'. In the present case, there is a difference of ₹ 2 per share (i.e.,

₹ 52 – ₹ 50) between the cost of shares and the exercise price. The number of shares issued to the employees is 2,70,000. The enterprise, accordingly, transfers an amount of ₹ 5,40,000 from the 'Stock Options Outstanding Account' to the 'Amount recoverable from ESOP Trust Account' by passing the following entry:

Stock Options Outstanding A/c Dr. ₹ 5,40,000

To Amount recoverable from ESOP Trust A/c ₹ 5,40,000

(Being the difference between the cost of shares to the ESOP Trust and the exercise price adjusted)

3. The balance of ₹ 35,10,000 (i.e., ₹ 40,50,000 – ₹ 5,40,000) standing to the credit of the 'Stock Options Outstanding Account' is transferred to the 'General Reserve' by passing the following entry:

Stock Options Outstanding A/c Dr. ₹ 35,10,000

To General Reserve ` ₹ 35,10,000

(Being balance in the 'Stock Options Outstanding Account' transferred to the 'General Reserve', at the end of the Employee Stock Option Plan)

4. The Share Capital Account, the Securities Premium Account and the General Reserve are disclosed in the balance sheet as below:

Extracts from the Balance Sheet

Liabilities Amount (`)		
Share Capital		
Paid-up Capital:		
10,00,000 equity shares of ` 10 each fully paid	1,00,00,000	
Reserves and SurplusSecurities Premium Account		1,50,00,000
General Reserve	xx,xx,xxx	
Add: Amount transferred from the Stock		
Options Outstanding Account	35,10,000	yy,yy,yyy

5. The enterprise gives a suitable note in the 'Notes to Accounts' to explain the nature of the addition of ₹ 35,10,000 made in the 'General Reserve'.

Computation of Earnings Per Share

In this case, the enterprise does not issue any new shares either at the beginning of the Employee Stock Option Plan or on exercise of stock options by the employees. Instead, the ESOP Trust purchases the shares from the market at the beginning of the plan and the employees exercising options vested in them are granted shares out of the shares so purchased. The shares purchased by the Trust represent the shares that have already been issued by the enterprise and the same should continue to be included in the shares outstanding for the purpose of calculating Basic EPS as would have been done prior to the purchase of the shares by the Trust. Since the exercise of stock options granted under the plan does not result into any fresh issue of shares, the stock options granted would not be considered as dilutive potential equity shares for the purpose of calculating Diluted EPS.

Appendix A

Key Differences between GN (A) (Issued 2020) Guidance Note on Accounting for Share-based Payment and Ind AS 102- Share-based Payment

1. **Measurement of cost**

Under the Guidance Note, share based payment transactions can be accounted for either by the fair value method or the intrinsic value method as a matter of an accounting policy choice. A company which uses the intrinsic value method is required to make fair value disclosures. Under intrinsic value method, if the exercise price for the instrument (for example, an employee stock option) is not less than the market price of the underlying shares on the date of the grant, no compensation cost is recorded. Under Ind AS 102, subject to some very limited exemptions, costs of share-based payments are recorded based on the fair value of the instrument. Under this approach, the instrument would have a value even if the exercise price is equal to the market price of the underlying shares on the date of grant. This value is generally measured using option pricing models.

Appendix B

Key Differences between GN (A) (Issued 2020) Guidance Note on Accounting for Share-based Payment (GN 2020) and the previously existing GN(A) 18 (Issued 2005) Guidance Note on Accounting for Employee Share-based Payments (GN 2005)

1. Scope

The principles of GN 2005 apply only to share based payments made to employees. There is no specific guidance for share based payments made to non-employees. GN 2020 deals with all types of share-based payments including share-based payments made to non-employees (for example, customers or vendors).

2. Group-wide share-based payment arrangements

GN 2005 did not provide much guidance for accounting for group-wide share-based payment transactions. Therefore, the practice varied for accounting for the cost of any share-based payments granted by a parent to employees of a subsidiary or vice versa.GN 2020 deals extensively with group-wide share-based payment transactions. For grants by the parent to employees of a subsidiary, GN 2020 requires the subsidiary to recognise the cost of the share-based payment with a corresponding credit to equity, as a contribution from the parent, unless there is a recharge arrangement. Similarly, for grants made by the subsidiary to employees of the parent, the parent (in its standalone financial statements) recognises a cost with a corresponding credit for deemed dividend received from the subsidiary.

3. Estimating Historical volatility of measurement of share-based payment transactions involving unlisted enterprises

While estimating the historical volatility for the purpose of determining fair value of equity instrument in case of share-based payment transaction involving unlisted enterprise, GN 2005 provided an option of considering the historical volatility of zero. GN 2020 has removed this option.

4. Recognition of cost

Under the GN 2005, employee stock options with a graded vesting schedule (for example, 25 percent vesting each year over a four year period) are accounted for either as separate grants or a single grant. Under the separate grant approach, the cost is recognised separately over the vesting period of each grant; while under the single grant approach, the cost is generally recognised on a straight-line basis over the full vesting period. In the initial years, the cost under the separate grant approach is significantly higher than the cost under the single grant approach. For example, consider an employee stock option plan where 100 options are granted with a total vesting period of four years, with 25 options vesting at the end of each year. Under the separate grant approach, the cost in the first year would include 100 percent of the costs relating to the 25 options vesting in year 1; 50 percent of the costs relating to the 25 options vesting in year 2; 33 percent of the costs relating to the 25 options vesting in year 3; and 25 percent of the costs relating to the 25 options vesting in year 4. Thus, approximately 52 percent of the total cost of the 100 options will be expensed in year 1. Under the single grant approach, only 25 percent of the total cost will be expensed in year 1. The total cost recognised over the four year period remains the same under both the approaches.

Under GN 2020, all awards with a graded vesting are treated, in essence, like multiple grants and the fair value of each grant is amortised over the respective vesting period (the separate grant approach). As discussed above, this would result in an acceleration of the proportionate cost recognised in the initial years.

5. Disclosure Requirements

Under GN 2005, where an enterprise uses the intrinsic value method, it should also disclose the impact on the net results and EPS – both basic and diluted – for the accounting period, had the fair value method been used.

However, under GN 2020, no such disclosure is required.