

Guidance Note on Accounting for Employee Share-based Payments

(The following is the Executive Summary * of the Guidance Note on Accounting for Employee Share-based Payments. The complete text of the Guidance Note, which is available for sale separately, should be referred to for applying the recommendations of the Guidance Note.)

1. Recognising the need for establishing uniform sound accounting principles and practices for all types of share-based payments, the Accounting Standards Board of the Institute is developing an Accounting Standard covering various types of share-based payments including employee share-based payments. However, as the formulation of the Standard is likely to take some time, the Institute has decided to bring out this Guidance Note. Once the Accounting Standard dealing with Share-based Payments comes into force, this Guidance Note will automatically stand withdrawn.
2. This Guidance Note establishes financial accounting and reporting principles for employee share-based payment plans, viz., employee stock option plans, employee stock purchase plans and stock appreciation rights. For the purposes of this Guidance Note, the term 'employee' includes a director of the enterprise, whether whole time or not.
3. For accounting purposes, employee share-based payment plans are classified into the following categories:
 - a. Equity-settled: Under these plans, the employees receive shares.
 - b. Cash-settled: Under these plans, the employees receive cash based on the price (or value) of the enterprise's shares.
 - c. Employee share-based payment plans with cash alternatives: Under these plans, either the enterprise or the employee has a choice of whether the enterprise settles the payment in cash or by issue of shares.
4. An employee share-based payment plan falling in the above categories 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 15.

EQUITY-SETTLED EMPLOYEE SHARE-BASED PAYMENT PLANS

Recognition

5. An enterprise should recognise as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, 'Stock Options Outstanding Account'. This account 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 recommended in this Guidance Note.
6. 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.
7. If the shares or stock options granted do not vest until the employee completes a specified period of service, the enterprise should presume that the services to be rendered by the employee 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.

Measurement

8. An enterprise should measure the fair value of shares or stock options granted at the grant date, based on market prices if available, taking into account the terms and conditions upon which those shares or stock options were granted (subject to the requirements of paragraphs 9 to 11). If market prices are not available, the enterprise should estimate the fair value of the instruments granted using a valuation technique to estimate what the price of those instruments would have been on the grant date in an arm's length transaction between knowledgeable, willing parties. The valuation technique should be consistent with generally accepted valuation methodologies for pricing financial instruments (e.g., use of an option pricing model for valuing stock options) and should incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price (subject to the requirements of paragraphs 9 to 11).
9. Vesting conditions, other than market conditions, should not be taken into account when estimating options at the grant date. Instead, vesting conditions should be taken into account by adjusting the measurement of the transaction amount so that, ultimately, the amount recognised for the shares or stock options granted is based on the number of shares or stock options that ultimately vest. On a cumulative basis, no amount is recognised for employee services received if the shares or stock options are forfeited, e.g., the employee fails to satisfy a vesting condition (i.e., these are forfeited), e.g., the employee fails to satisfy a performance condition is not satisfied.
10. To apply the requirements of paragraph 9, the enterprise should recognise an amount for the employee services received during the vesting period based on the best available estimate of the number of shares or stock options expected to vest and should 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 should revise the estimate to equal the number of shares or stock options that ultimately vest.
11. Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, should be taken into account when estimating the fair value of the shares or stock options granted.

After vesting date

12. On exercise of the right to obtain shares or stock options, the enterprise issues shares on receipt of the exercise price. The shares so issued should be considered to have been issued at the consideration comprising the exercise price and the corresponding amount standing to the credit of the relevant equity account (e.g., Stock Options Outstanding Account). In a situation where the right to obtain shares or stock option expires unexercised, the balance standing to the credit of the relevant equity account should be transferred to general reserve.

CASH-SETTLED EMPLOYEE SHARE-BASED PAYMENT PLANS

13. For cash-settled employee share-based payment plans, the enterprise should measure the services received and the liability incurred at the fair value of the liability. Until the liability is settled, the enterprise is required to remeasure the fair value of the liability at each reporting date and at the date of settlement, with any changes in value recognised in profit or loss for the period.

EMPLOYEE SHARE-BASED PAYMENT PLANS WITH CASH ALTERNATIVES

14. For employee share-based payment plans in which the terms of the arrangement provide either the enterprise or the employee with a choice of whether the enterprise settles the transaction in cash or by issuing shares, the enterprise is required to account for that transaction, or the components of that transaction, as a cash-settled share-based payment plan 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 plan if, and to the extent that, no such liability has been incurred.

INTRINSIC VALUE METHOD

15. Accounting for employee 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 employee share-based payment plans. Intrinsic value, in the case of a listed company, is the amount by which the quoted market price of the underlying share exceeds the exercise price of an option. 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 employee share-based payment plans, the intrinsic value may be used, mutatis mutandis, in place of the fair value as described in paragraphs 5 to 14.

RECOMMENDATION

16. It is recommended that accounting for employee share-based payment plans should be based on the fair value approach as described in paragraphs 5 to 14. However, intrinsic value method as described in paragraph 15 is also permitted. An enterprise using intrinsic value method is required to make fair value disclosures.

OTHER ASPECTS DEALT WITH IN THE GUIDANCE NOTE

17. Apart from the above, the Guidance Note also deals with various other significant aspects of the employee share-based payment plans including those related to performance conditions, modifications to the terms and conditions of the grant of shares or stock options, reload feature, graded vesting, earnings-per-share implications, accounting for employee share-based payments administered through a trust, etc. The Guidance Note also recommends detailed disclosure requirements. The appendices to the Guidance Note provide detailed guidance on measurement of fair value of shares and stock options, including determination of various inputs to the option-pricing models and examples to illustrate application of various principles recommended in the Guidance Note.