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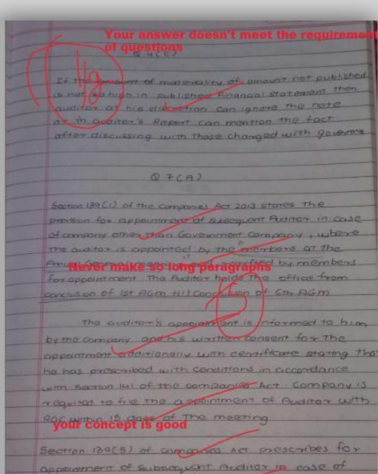

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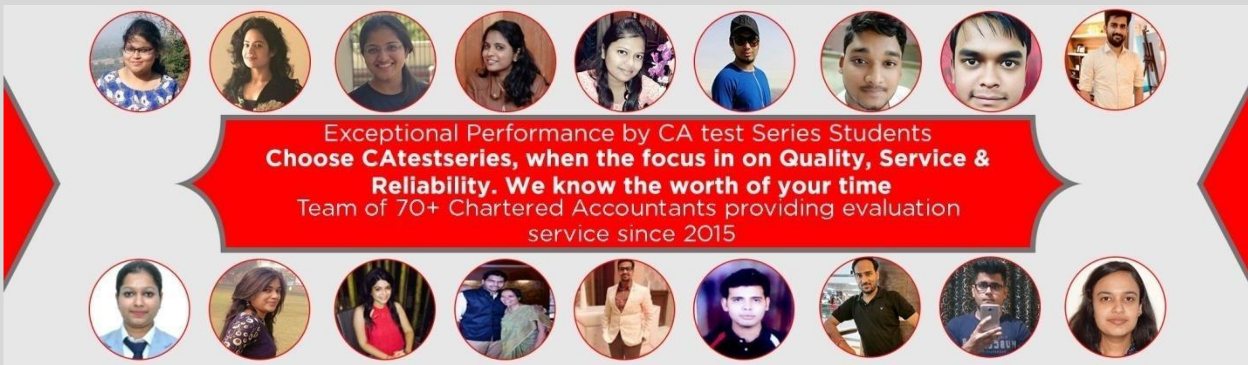

Rahul Singla *"It was hard for me to think of what to do since it was my 3rd attempt of Inter but thanks to catestseries.org and their team who helped me through this test series. Now I am positive for my results"*

Sima Bansal *"I want to give a big thanks to catestseries.org. I had cleared my Ipcc 19 attempted. I have suggested all my friends about your test series and they are happy with their results."*

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Advance Accounting

Chapter - 3 ESOP

ESOP: An employee stock ownership plan (ESOP) is a type of employee benefit plan which is intended to encourage employees to acquire stocks or ownership in the company.

ESOP's Cycle

- Grant (Receive the right)
- Vest (Earns the right)
- Exercise (Exercise the right)
- Sale (Sell the shares)

An option is first granted to an employee and after a specific period (when exercised) vests with the employee. This period is referred to as the vesting period. Vesting Period=Period between vesting and granting.

Accounting Treatment at various stages of cycle

At the time of Grant:

The Company should recognize an amount for the service received during the vesting period based upon the best available estimate of number of shares expected to vest and should revise estimate if necessary.

Example: 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 completed 3 years vesting period.

ESOP from the view of Taxation (For an Employee)

At the time of **receiving ESOP**;

- Benefit arising from ESOP – taxed as **perquisite** in the hands of **Employee**
- **Calculation : Fair Market Value on date of exercise – Exercise Price**
- Employer is required to deduct **TDS** in respect of such perquisite.

At the time of **Sale of Shares**;

- Treated as **Capital Gain**
- Calculation : **Sale Price – FMV @ Exercise date**
- Long Term Capital Gain(LTCG) – taxed @ 20%
- Short Term Capital Gain(STCG) – taxed @ 15%
- LTCG through recognized stock exchange – NOT TAXED but STCG – taxed @ 15%

ESOP from the View of Accounting:

Example;

X Co. Ltd Has its share capital dividend into equity shares of Rs. 10 each. On 1.1.2012 it granted 20,000 employees stock option at Rs. 50 per share, when the market price was Rs. 120 per share. The options were to be exercised between 15thmarch, 2013 and 31st march, 2013. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st march every year. Show Journal entries (with narration).

Entries in Records:

31/03/2013

Dr. Employee Compensation A/c 14, 00,000/- [20,000*(120-50)*1]/1

Cr. Employee Stock Option A/c 14, 00,000/-

(Being Employee Stock Option Recorded)

Calculation of above done as: [(No of option still available * (MP – EP) * Expired Period) / Vesting Period] – Expense recognized in previous year

Dr. Profit and Loss A/c 14, 00,000/- 20000*70

Cr. Employee Compensation A/c 14.00, 000/-

(Being Amount Write off)

Dr. Bank A/c 8, 00,000/- 16000*50

Cr. To Employee Stock Option A/c 8, 00,000/-

(Being Amount Received)

Dr. Employee Stock Option A/c 19, 20,000/- 16000*120

Cr. Equity Share Capital A/c 1, 60,000/- 16000*10

Cr. Equity Share Premium A/c 17, 60,000/- 16000*110

(Being Share Allotted)

Dr. Employee Stock Option A/c 2, 80,000/- 4000*70

Cr. General Reserve A/c 2, 80,000/-

(Being ESOP Cancelled)

Questions for practice

Q1 P Ltd. granted option for 8,000 equity shares of nominal value of Rs10 on 1stOctober, 20X0 at Rs80 when the market price was Rs170. The vesting period is 4½ years, 4,000 unvested options lapsed on 1stDecember, 20X2, 3,000 options were exercised on 30th September, 20X5 and 1,000 vested options lapsed at the end of the exercise period. Pass Journal Entries for above transactions.

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In the books of P Ltd.
Journal Entries

Date	Particulars	Rs	Rs
31.3.20X1	Employees compensation expense account Dr. To Employee stock option outstanding account (Being compensation expenses for 6 months recognized in respect of the employee stock options i.e. 8,000 options granted to employees at a discount of Rs 90 (170-80) each, amortized on straight line basis over 41/2 years [(8,000 stock options x Rs 90)/ 4.5 years] x 0.5) (W.N.1)	80,000	 80,000
	Profit and loss account Dr. To Employees compensation expenses account (Being expenses transferred to profit and loss account at the yearend)	80,000	 80,000
31.3.20X2	Employees compensation expense account Dr. To Employee stock option outstanding account (Being compensation expense recognized in respect of the employee stock option i.e. 8,000 options	1,60,000	 1,60,000

	granted to employees at a discount of Rs 90 each, amortized on straight line basis over 4*1/2 years (8,000 stock options x Rs 90)/ 4.5 years) x 1 year)		
	Profit and loss account Dr. To Employees compensation expense account (Being expenses transferred to profit and loss account at year end)	1,60,000	 1,60,000
31.3.20X3	Employees compensation expense account Dr. To Employee stock option outstanding account (Being compensation expense recognized in respect of the employee stock option i.e. 4,000 options granted to employees at a discount of Rs 90 each, amortized on straight line basis over 4*1/2 years (4,000 stock options x Rs 90)/ 4.5 years) x 1 year)	80,000	 80,000
	Employee stock option outstanding account Dr. (W.N.2) To General Reserve account (W.N.2) (Being excess of employees compensation expenses transferred to general reserve account)	1,20,000	 1,20,000
	Profit and loss account Dr. To Employees compensation expense account (Being expenses transferred to profit and loss account at year end)	80,000	 80,000
31.3.20X4	Employees compensation expense account Dr.	80,000	

	To Employee stock option outstanding account (Being compensation expense recognized in respect of the employee stock option i.e. 4,000 options granted to employees at a discount of Rs 90 each, amortized on straight line basis over 4*1/2 years (4,000 stock options x Rs 90)/ 4.5 years) x 1 year)		80,000
	Profit and loss account Dr. To Employees compensation expense account (Being expenses transferred to profit and loss account at year end)	80,000	 80,000
31.3.20X5	Employees compensation expense account Dr. To Employee stock option outstanding account (Being compensation expense recognized in respect of the employee stock option i.e. 4,000 options granted to employees at a discount of Rs 90 each, amortized on straight line basis over 4*1/2 years (4,000 stock options x Rs 90)/ 4.5 years) x 1 year)	80,000	 80,000
	Profit and loss account Dr. To Employees compensation expense account (Being expenses transferred to profit and loss account at year end)	80,000	 80,000
30.9.20X5	Bank A/c (3,000 × Rs 80) Dr. Employee stock option outstanding Dr.	2,40,000 2,70,000	

	To Equity share capital account (3,000 x Rs 10) To Securities premium (Rs 170 – Rs 10) x 3,000 (Being 3,000 employee stock option exercised at an exercise price of Rs80 each)		30,000 4,80,000
	Employee stock option outstanding account Dr. (W.N.3) To General reserve account (W.N.3) (Being ESOS outstanding A/c transferred to General Reserve A/c on lapse of 1000 vested options at the end of the exercise period)	90,000	90,000

Working Notes:

1. Fair value = Rs 170 – Rs 80 = Rs 90

2. At 1.12.X2, 4,000 unvested option lapsed on which till date expenses recognized to be transferred to general reserve = Rs(80,000 + 1,60,000) x 4,000/ 8,000 = Rs 1,20,000

3. Expenses charged on lapsed vested options transferred to general reserve = 1,000 x Rs 90 = Rs 90,000

Q2 JKS Ltd. has its share capital divided into equity shares of Rs10 each. On 1.1.2018 it granted 5,000 employee stock options at Rs30 per share, when the market price was Rs50 per share. The options were to be exercised between 15th March, 2018 and 31St March, 2018. The employees exercised their options for 3,600 shares only and the remaining options lapsed. The company closes its books on 31st March every year.

You are required to prepare journal entries (with narration) as would appear in the books of the company up to 31st March, 2018.

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Journal Entries in the books of JKS Ltd

		Rs	Rs
15.03.2018 to 31.3.18	Bank A/c(3,600 x Rs30) Dr. Employee compensation expense A/c(3,600 x Rs20) Dr. To Equity share capital A/c(3600 x Rs10) To Securities premium A/c(3600 x Rs40) (Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)	1,08,000 72,000	 36,000 1,44,000
31.3.18	Profit and Loss A/c Dr. To Employee compensation expenses A/c (Being transfer of employee compensation expenses transfer to Profit and Loss Account)	72,000	 72,000

Working Notes:

1. No entry is passed when stock options are granted to employees. Hence, no entry will be passed on 1st January 2018;

2. Market Price = Rs50 per share and stock option price = Rs30, Hence, the difference Rs50 Rs30= Rs20 per share is equivalent to employee cost or employee compensation expense and will be charged to P&L Account as such for the number of options exercised i.e. 3,600 shares.

Q3 Ajanta grants 120 share options to each of its 460 employees. Each grant is conditional on the employee working for Ajanta over the next three years. Ajanta has estimated that the fair value of each share option is Rs12. Ajanta estimates that 25% of employees will leave during the three-year period and so forfeit their rights to the share options. Everything turns out exactly as expected.

Required:

Calculate the amounts to be recognized as expense during the vesting period.

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Year	Calculation	Expense for Period	Cumulative expense
1.	55,200 options x 75% x Rs12 x 1/3 years	1,65,600	1,65,600
2.	(55,200 options x 75% x Rs12 x 2/3 years) - Rs165,600	1,65,600	3,31,200
3.	(55,200 options x 75% x Rs12 x 3/3 years)- Rs331,200	1,65,600	4,96,800

An enterprise should review all estimates taken in consideration for valuation of option. The value of options recognised as expense in an accounting period is the excess of cumulative expense as per latest estimates upto the current accounting period over total expense recognised upto the previous accounting period.

Q4 PQ Ltd. grants 100 stock options to each of its 1,000 employees on 1-4-2015, conditional upon the employee remaining in the company for 2 years. The fair value of the option is Rs 18 on the grant date and the exercise price is Rs 55 per share. The other information is given as under:

(i) Number of employees expected to satisfy service condition are 930 in the 1st year and 850 in the 2nd year.

(ii) 40 employees left the company in the 1st year of service and 880 employees have actually completed 2 year vesting period.

You are required to calculate ESOP cost to be amortized by PQ Ltd. in the years 2015-2016 and 2016-2017

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Calculation of ESOP cost to be amortized

	2015- 2016	**2016-2017**
Fair value of options per share	Rs 18	Rs 18
No. of options expected to vest under the scheme	93,000 (930 x 100)	88,000 (880 x 100)
Fair value of options	Rs16,74,000	Rs15,84,000
Value of options recognized	(Rs16,74,000 / 2)	(Rs15,84,000 –Rs8,37,000)
as expenses	8,37,000	7,47,000