Overview

of

Employees' Stock Option Plan

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WHEN
WHO
?
WHAT
HOW
WHY
WHERE

What is ESOP?

Indian Perspective

E – Employee

S – Stock

O – Option

P – Plan

US Perspective

E – Employee

S – Stock

O – Ownership

P – Plan

What is Stock Option?

- Stock Option is a right given to an employee to buy certain number of shares of the company at a fixed pre-determined price over a period of time.

- It has 3 main characteristics:
  - The number of shares that can be bought is pre-determined.
  - The price at which shares can be bought is pre-determined.
  - The right is available over a period of time.

ESOP Lifecycle

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- Conceptualizing & Designing
- Legal Compliance
- Employee Presentation
- Implementation
- Administration

ESOP Terminologies

- Grant Price / Exercise Price – The price at which shares are offered to the employees.
- Vesting Period – The period after which the options can be converted into shares.
- Exercise – The action of paying the price and converting the options into shares.
- Exercise Period - The period after vesting within which the employee has to take the decision of exercising Options.

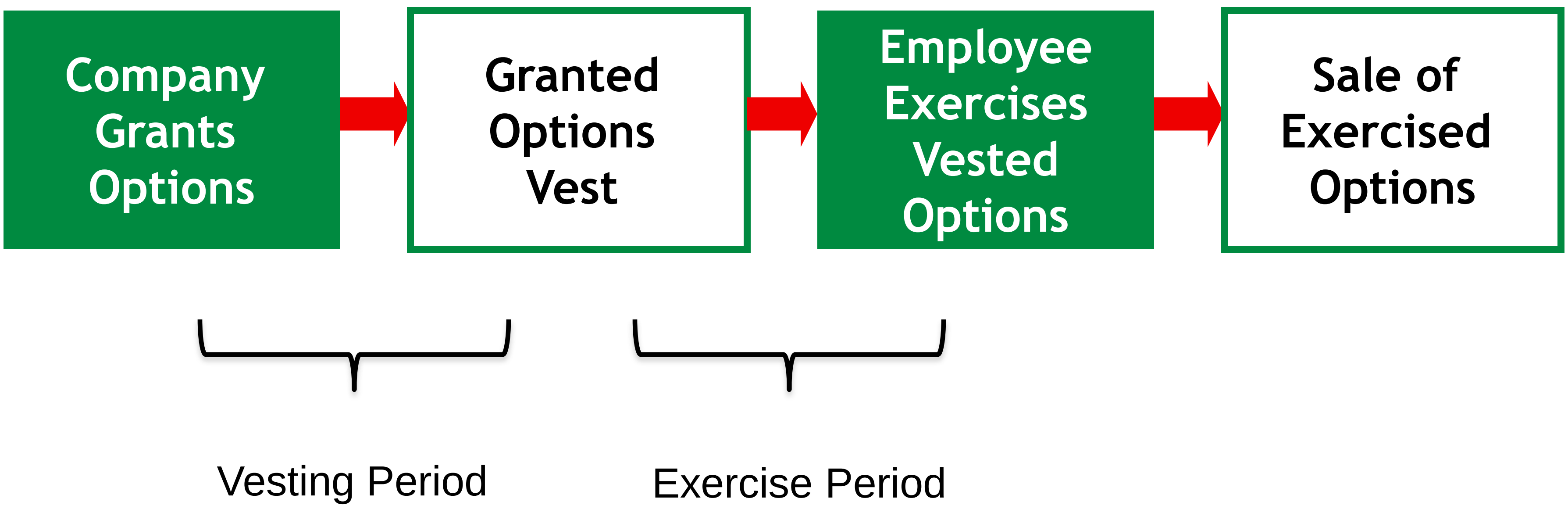
What is Vesting of Options?

- Example of a vesting schedule:

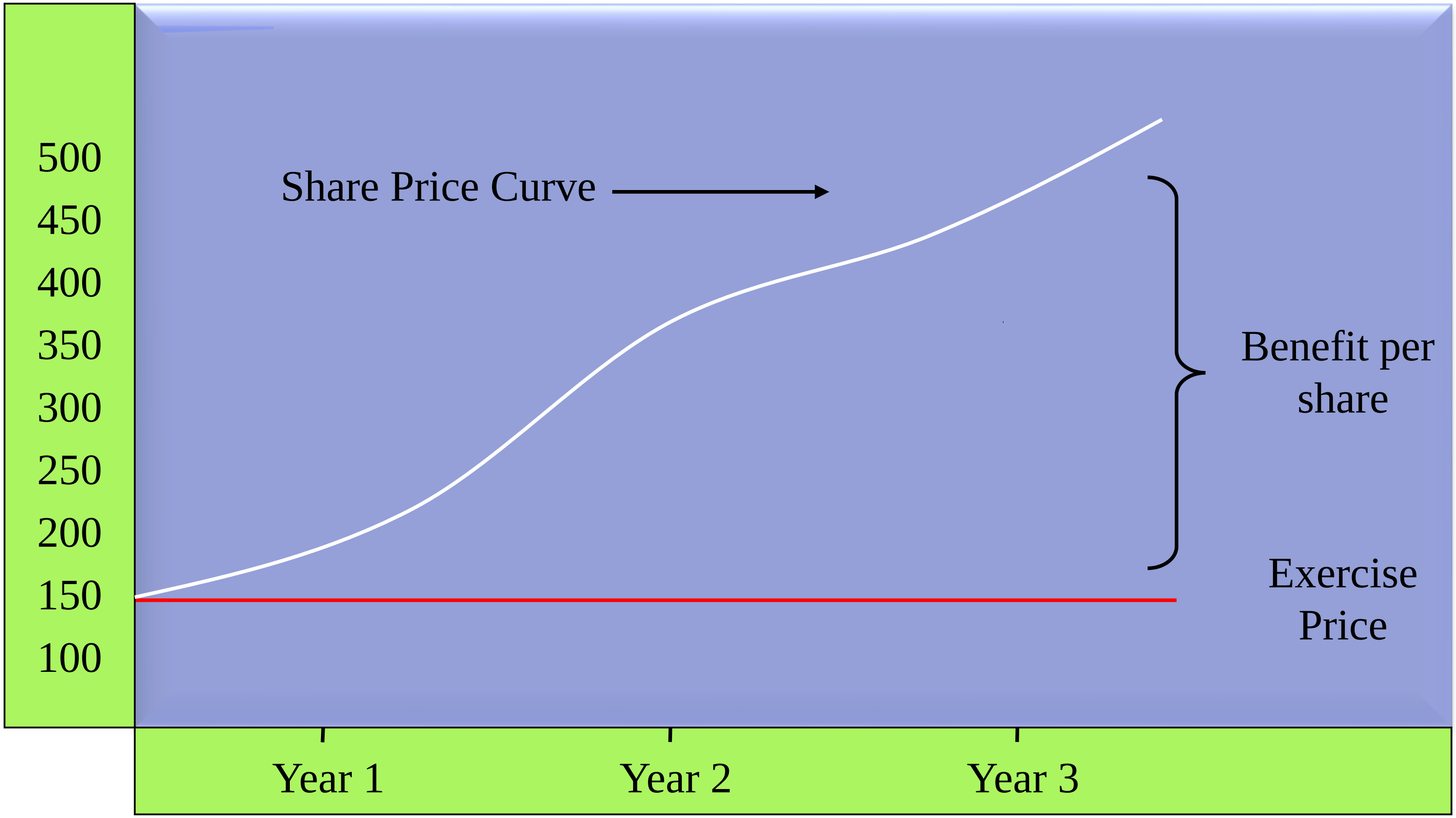
Years	1	2	3	4
% Vesting	25%	25%	25%	25%

	2021	2022	2023	2024	2025
Options Granted	200				
Vesting of Options		50	50	50	50

ESOP Lifecycle



How does Employee Benefits



Types of ESOPs

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ESOP	• Employee Stock Option Plan
ESPP	• Employee Share Purchase Plan
SAR	• Stock Appreciation Rights
Phanton	• Phantom Option

Types of ESOPs

ESOP

- Employee Stock Option Plan

- Options which can be converted into Equity Shares on a future date are granted.
- Conversion of Options in shares happen on completion of the lock in period (vesting period).
- Generally post conversion, there is no lock in period for the equity shares

Types of ESOPs

ESPP

- Employee Share Purchase Plan

- Shares are issued to employees at a certain price.
- These shares have a lock in period during which employee cannot sale the shares.
- Employee need to pay for the price on date of issue i.e. on the day the scheme is implemented.

Types of ESOPs

SAR

- Stock Appreciation Rights

- A stock appreciation right (SAR) is a form of bonus compensation given to employees that is equal to the appreciation of company share price over an established time period.
- These increase in share price is paid to employee in cash.
- Employee is not required to pay exercise price nor can he become shareholder of the company at any point of time in future.

Types of ESOPs

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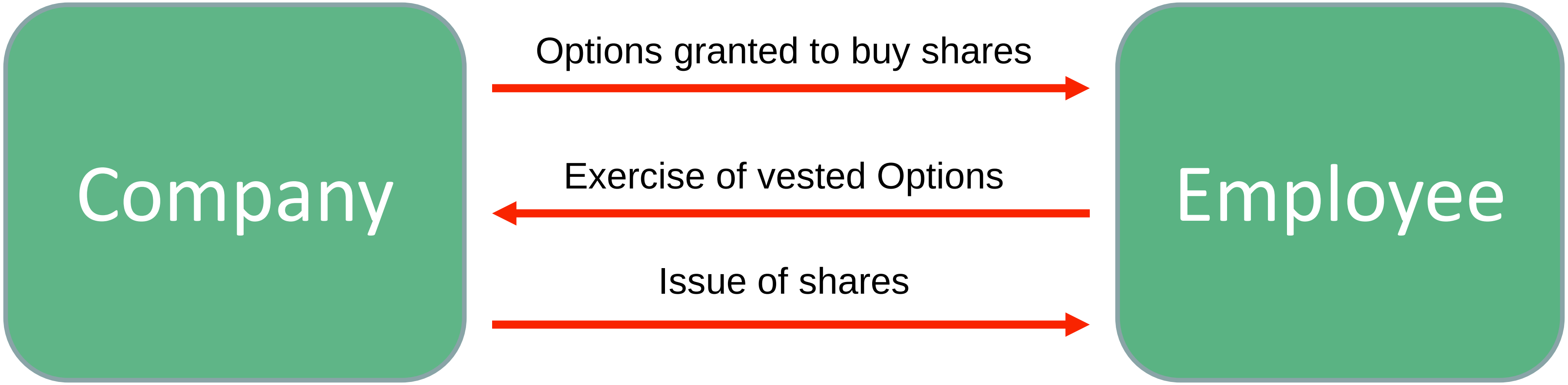
Phantom

- Phantom Options

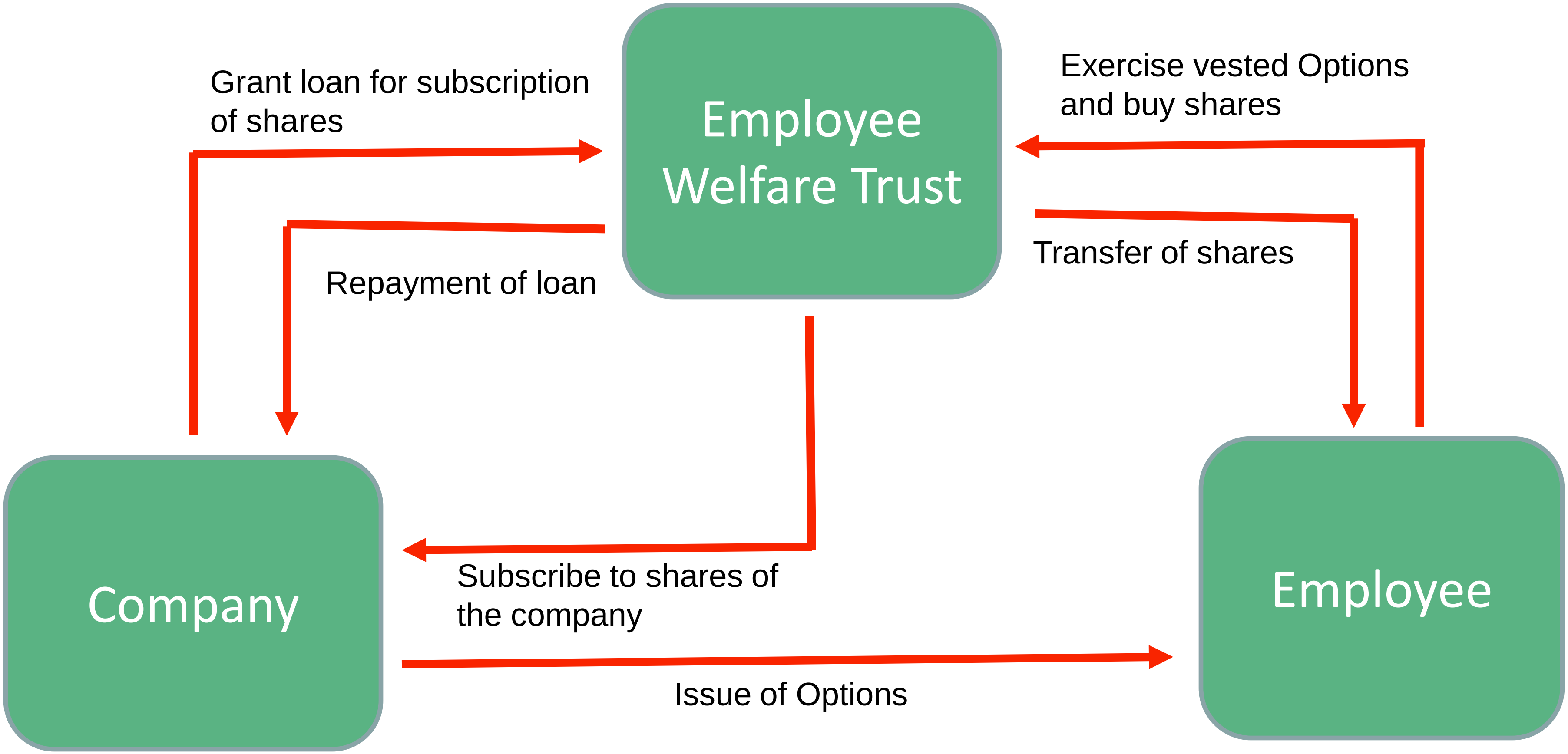
- A Phantom Option is a form of SAR where appreciation of company share price over an established time period is paid in form of free shares to the employees.
- Employee is not required to pay exercise price.

Implementation Modes

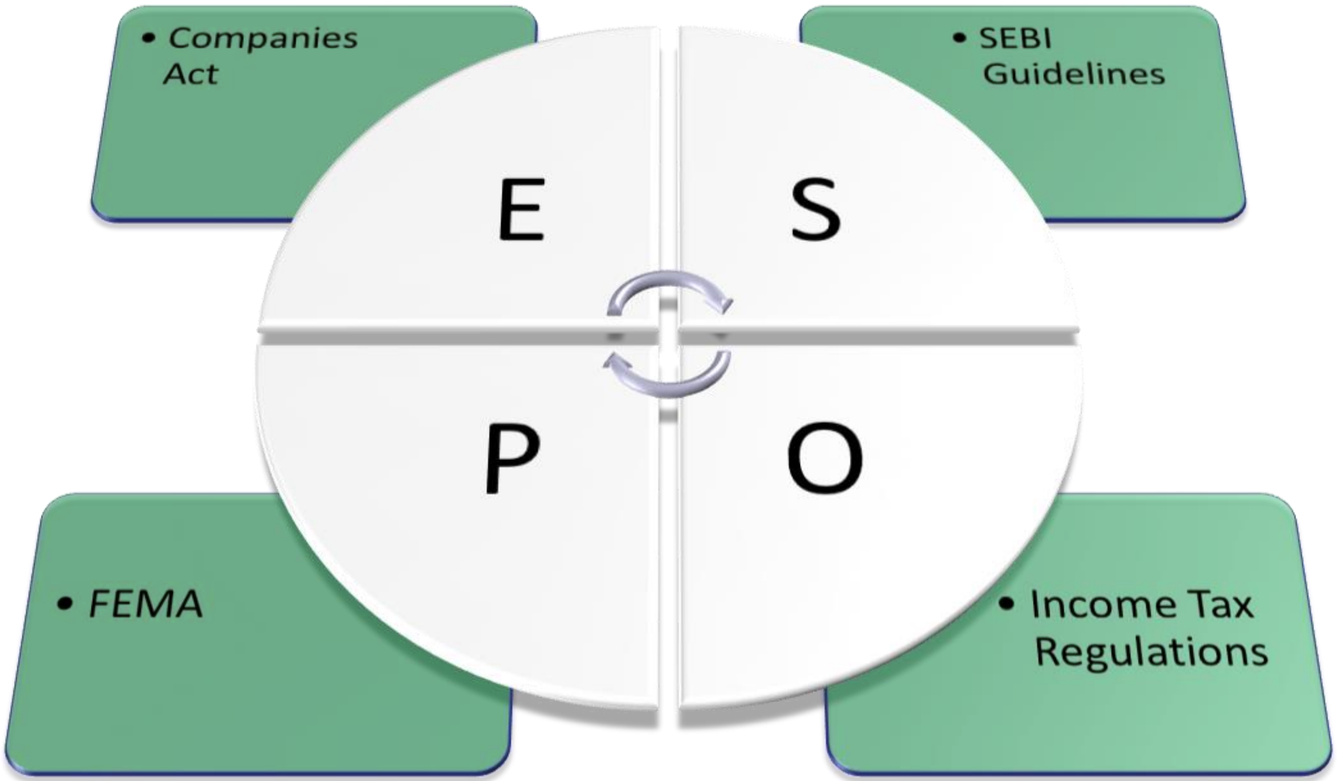
Direct Route



Trust Route


Employee Welfare Trust
Grant loan for subscription of shares
Repayment of loan
Exercise vested Options and buy shares
Transfer of shares
Company
Subscribe to shares of the company
Issue of Options
Employee

Applicable Rules & Regulations



Companies (Share Capital & Debenture) Rules 2014

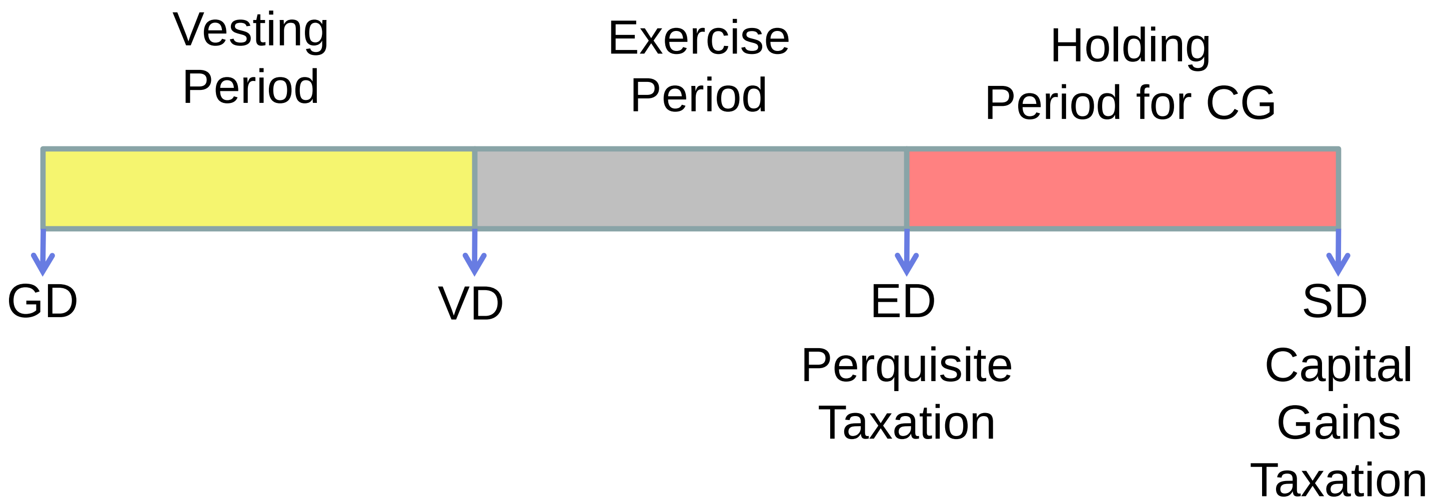
- Applicability
- Eligibility
- Shareholders approval
  - Special Resolution
  - Separate resolution for grant to Subsidiary / Holding employees or to identified employees equal to or grater than 1% of issued capital.
- Pricing & Lock in
- Accounting for ESOPs as per AS / ICAI guidance note.
- Annual disclosures in Directors' Report
- Register to be maintained.
- Administration.

SEBI (Share Based Employee Benefits) Regulations 2014

- Same like Companies Act regulations.

- Following exceptions:
  - Applicable only to listed companies.
  - Administration of the scheme to be done by Compensation Committee (Majority member to be independent director)

ESOP Taxation



- On Exercise
  Difference between the prevailing price and exercise price taxed as perquisite

- On sale of shares
  Difference between selling price and price as on date of exercise taxable as Capital Gains

When is FEMA Applicable?

- When a foreign company wishes to grant Options
  - to its employees working in India.
  - to the employees of Indian Subsidiary Company.

- When a Indian company grants Options
  - to its employees working overseas.
  - to employees of overseas holding company / joint venture / wholly owned subsidiary.

ESOPs of Foreign Securities

- Resident individuals can acquire foreign securities under stock option scheme of its overseas parent / subsidiary company provided:
  - The Options are issued to the employee under Cashless Employee Stock Option Scheme / does not involve any remittance from India.

- An Indian company in knowledge based industry may allow its resident employees to purchase foreign securities under the ADR/GDR linked stock option scheme provided it is in accordance with applicable guidelines.

ESOPs of Foreign Securities

- *Example: 100 Options are granted with an exercise price of $10 USD. The fair market value as on date of exercise is $25 USD per share.*

  Under Cashless exercise, employee exercises 100 Options and simultaneously sells 40 shares to pay the exercise price. Thus employee gets net 60 shares because of cashless exercise mechanism.

- In case of RSU since exercise price is Nil, by default it is like cashless exercise only.

Cashless Exercise Procedure

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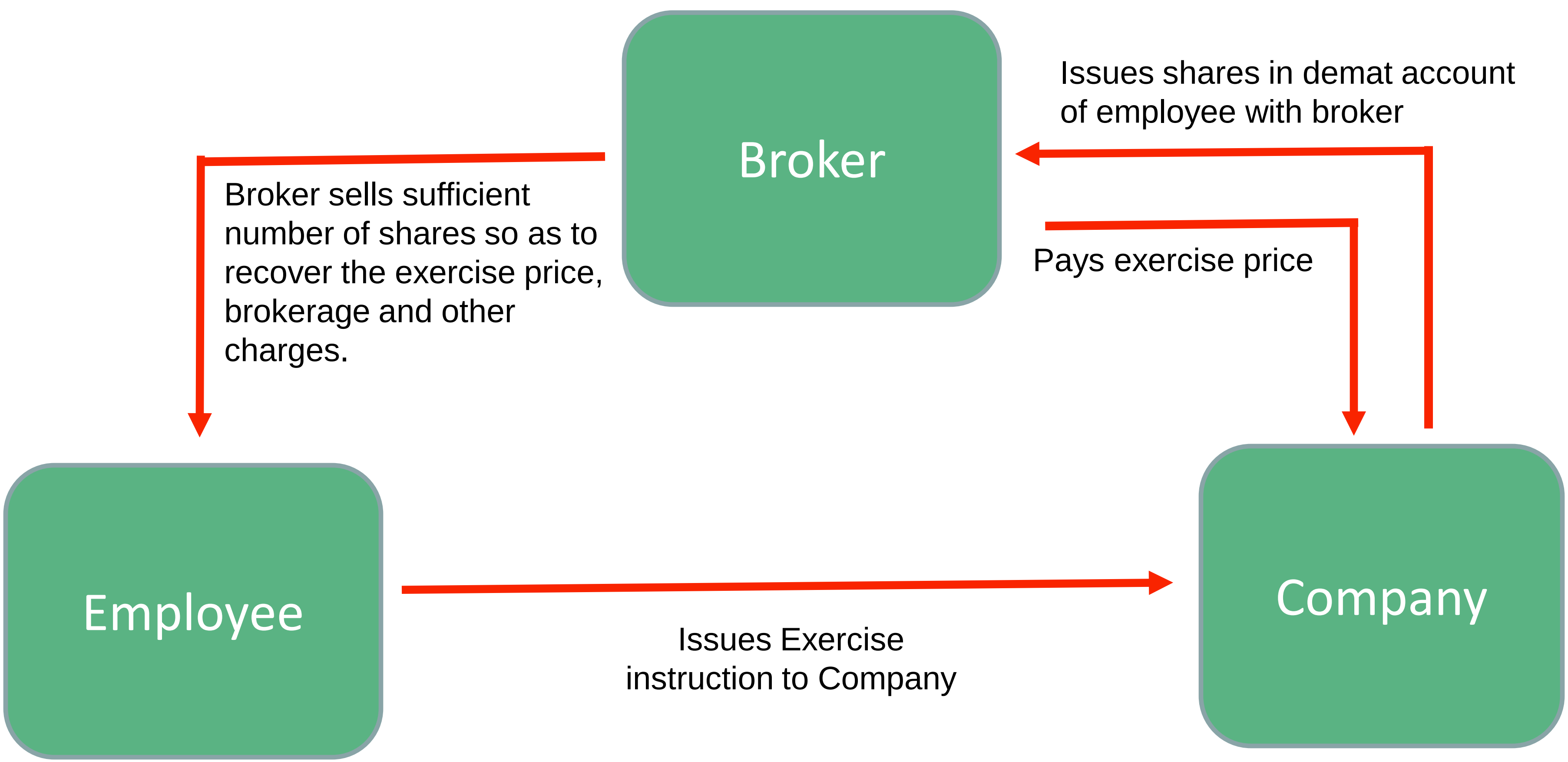

ESOPs to overseas Employees

- An Indian company is permitted to issue ESOPs to non resident employees of its holding company / joint venture / wholly owned overseas subsidiary subject to the following conditions:
  - The ESOP scheme is in accordance with regulations issued under SEBI Act 1992 / rules notified by Central Government under the Companies Act 2013.
  - The ESOP is in compliance with the sectoral cap applicable to the said company.
  - Issue of ESOP in a company where investment by non resident is under approval route requires prior Government approval.
  - Issue of ESOP to a citizen of Bangladesh / Pakistan requires prior Government approval.

RBI Reporting

- If Options are granted to any non resident employee then
  - Company need to submit ESOP form on SMF portal within 30 days of grant of Options.
  - Company also need to submit ESOP form on SMF portal within 30 days of issue of shares on exercise of Options.

ESOP Accounting

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Accounting Method	
GN issued by ICAI	Ind AS 102
Intrinsic Value Method or Fair Value Method	Option Value = Value calculated using any binomial model eg: Black Scholes Method

- Aggregate Option Value to be amortised over the vesting period on SLM.

Intrinsic Value Method

- Market price as on the date of grant – Rs.100/-
- Exercise price per Option – Rs.25/-
- Number of Options Granted – 1000
- Vesting period – 100% after 3 years
- Date of Grant – 1^{st} April 2013

- Intrinsic Value = 100 – 25 = 75 per Option
- Aggregate ESOP Cost = 1000 x 75 = 75,000
- ESOP cost to be debited to P&L
  - In 2013-14: (75000 / 1095 days) x 365 days = 25000

Accounting in case of Graded Vesting

Accounting in case of Graded Vesting

- Vesting period – 25% at the end of every 12 months (i.e. equal vesting over 4 years)

- Details of vesting of Options:
  1. 25 Options vest at the end of 1 year from date of grant.
  2. 25 Options vest at the end of 2 years from date of grant.
  3. 25 Options vest at the end of 3 years from date of grant.
  4. 25 Options vest at the end of 4 years from date of grant.

Treat each vesting as a separate grant and calculate the accounting impact.

Accounting in case of Graded Vesting

- New Example:
  1. 25 Options granted on 1/4/19 which vesting 100% after 1 year.
  2. 25 Options granted on 1/4/19 which vesting 100% after 2 years.
  3. 25 Options granted on 1/4/19 which vesting 100% after 3 years.
  4. 25 Options granted on 1/4/19 which vesting 100% after 4 years.

- Previous Example:

  100 Options granted with 25% vesting at end of every 12 months (i.e. equal vesting over 4 years)

  Treat each vesting as a separate grant and calculate the accounting impact.

Fair Value of Option

- Fair value of Options to be calculated using any binomial valuation method which takes into consideration the following:
  - Fair market price of share as on the date of grant
  - Exercise price
  - Volatility in share price
  - Expected Life
  - Risk free interest rate
  - Dividend yield

- Generally Black Scholes model is used for arriving at Fair Value of the Option.

Accounting Entries

- At the end of each year (For amortization of ESOP cost)

  Employee Compensation Expense A/c

  To Deferred Employee Compensation Expense A/c

- At the time of Exercise of Options

  Bank A/c

  Employee Stock Option Outstanding A/c

  To Share Capital A/c

  To Share Premium A/c

- If Options lapse

  Employee Stock Option Outstanding A/c

  To Employee Compensation Expense A/c

Questions

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