

8. ACCOUNTING FOR EMPLOYEE STOCK OPTION PLAN

PROBLEM NO: 1

Journal Entries:

Date	Particulars	Debit (Rs.)	Credit (Rs.)
15.03.2013	Bank A/c (9,500X40) Dr.	3,80,000	
To	Employee Compensation Expenses A/c (W.N.1) Dr.	8,55,000	
31.03.2013	To Equity Share Capital A/c (9,500 X 10)		95,000
	To Securities Premium A/c (9,500 X 120)		11,40,000
	(Being allotment to employees of 9,500 Equity Share of Rs. 10 each at a premium of Rs. 120 per share in exercise of stock options by employees)		
31.03.2013	Profit & Loss A/c Dr.	8,55,000	
	To Employee Compensation expenses A/c		8,55,000
	(Being transfer of employee compensation expenses to P & L A/c)		

WORKING NOTES:

1. Market Price per Share Rs. 130
- Exercising price per option Rs. 40
- Intrinsic Value of each option Rs. 90
- No.of Options exercised by employees Rs. 9,500
- Value of Compensation expenses to be recognized = 9500 X Rs. 90
= Rs. 8, 55,000.

PROBLEM NO: 2

Date	Particulars	Debit (Rs.)	Credit (Rs.)
15.03.2013	Bank A/c Dr.	2,40,000	
To	Employee Compensation Expenses A/c Dr.	4,32,000	
31.03.2013	To Equity Share Capital A/c		48,000
	To Securities Premium A/c		6,24,000
	(Being allotment to employees of 4,800 Equity Share of Rs. 10 each at a premium of Rs. 130 per share at an exercise price of Rs.50 each)		
31.03.2013	Profit & Loss A/c Dr.	4,32,000	
	To Employee Compensation expenses A/c		4,32,000
	(Being transfer of employee compensation expenses to P & L A/c)		

Working Note:

1. Employee Compensation Expenses = Discount between Market Price and option price = Rs. 140 – Rs. 50 = Rs. 90 per share = Rs. 90 x 4,800 = Rs. 4,32,000/- in total.
2. The Employees Compensation Expense is transferred to Securities Premium Account.
3. Securities Premium Account = Rs. 50 – Rs. 10 = Rs. 40 per share + Rs. 90 per share on account of discount of option price over market price = Rs. 130 per share = Rs. 130 x 4,800 = Rs. 6, 24,000/- in total.

PROBLEM NO: 3

Fair value of an option = Rs. 28

Difference between Fair value and Issue Price =Rs. 28 – Rs. 25 = 3.

Number of employees accepting the offer = 400 employees x 50% = 200 employees

Number of shares issued = 200 employees x 100 shares/employee = 20,000 shares

Employee Compensation Expenses recognized in 2014-15 =20,000 shares x Rs. 3 = Rs. 60,000

Securities Premium A/c = Rs. 28 – 10 = Rs. 18 per share = 20,000 x 18 = Rs. 3,60,000

Journal Entries:

Date	Particulars	Debit (Rs.)	Credit (Rs.)
30.04.2014	Bank A/c (20,000 shares X Rs.25) Dr.	5,00,000	
	Employee Compensation Expenses A/c Dr.	60,000	
	To Equity Share Capital A/c		2,00,000
	To Securities Premium A/c		3,60,000
	(Being stock purchase option accepted by 200 employees for 100 shares each at Rs.25 per share on a fair value of Rs.28 per share)		

Note: Employees compensation expenses amounting Rs. 60,000 will ultimately be charged to profit & loss account.

PROBLEM NO: 4**Journal Entries in the Books of 'S' Ltd.**

Date	Particulars	Debit (Rs.)	Credit (Rs.)
31.03.2011	Employees Compensation exp. A/c Dr.	12,000	
	To Employee Stock Options O/S A/c		12,000
	(Being Compensation exp. Recognized in respect of 1000 options granted to employees on SLM basis over 2 ½ years)		
31.03.2011	P & L A/c Dr.	12,000	
	To Employees Compensation exp. A/c		12,000
	(Being Compensation exp. Transferred to P & L A/c)		
31.03.2012	Employees Compensation exp. A/c Dr.	12,000	
	To Employee Stock Options O/S A/c		12,000
	(Being Compensation exp. Recognized)		
31.03.2012	P & L A/c Dr.	12,000	
	To Employees Compensation expenses A/c		12,000
	(Being Compensation expenses transferred to P & L A/c)		
31.03.2013	Employees Compensation expenses A/c Dr.	6,000	
	To Employees stock options outstanding A/c		6,000
	(Being balance of compensation expenses amortized)		
31.03.2013	P & L A/c Dr.	6,000	
	To Employees Compensation expenses A/c		6,000
	(Being Compensation expenses transferred to P & L A/c)		
31.07.2013	Bank A/c (1000 X Rs. 60) Dr.	60,000	
	Employees stock options O/S A/c (1,000 X Rs.30)	30,000	

	To Equity share capital A/c (1,000 X Rs.10)		10,000
	To Securities Premium A/c (1,000 X Rs.80)		80,000
	(Being 1000 options exercised at a price of Rs.60)		

WORKING NOTES:

Value of each option market price – exercising price = Rs.90- Rs.60 = Rs.30

Value of total options = 1000 X Rs.30 = Rs.30,000

The above expenses were written off over 2 ½ years on SLM Basis

First year = Rs.12,000 ; Second year = Rs.12,000

Third year =Rs.6, 000.

PROBLEM NO: 5

i. Value of options = 1,250 x (Rs.200 – Rs.80) = Rs.1,50,000

ii. Amount to be recognised = Rs.1,50,000 / 3 = Rs.50,000 each year.

**In the books of HCL
Journal**

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
31 st March, 2013	Employee Compensation Expense A/c Dr. To Employee stock option outstanding A/c (Being expenses in respect of ESOP recognised for the year-1)		50,000	50,000
31 st March, 2013	P & L A/c Dr. To Employee Compensation Expenses A/c (Being Employee Compensation Expenses for the year transfer to P & L A/c)		50,000	50,000
31 st March, 2014	Employee Compensation Expense A/c Dr. To Employee stock option outstanding A/c (Being expenses in respect of ESOP recognised for the year-2)		50,000	50,000
31 st March, 2014	P & L A/c Dr. To Employee Compensation Expenses A/c (Being Employee Compensation Expenses for the year transfer to P & L A/c)		50,000	50,000
31 st March, 2015	Employee Stock Options Outstanding A/c Dr. To General reserve A/c (W.N.1) (Being the reversal of compensation accounting on lapse of 450 options)		36000	36,000
31 st March, 2015	Employee Compensation Expense A/c Dr. To Employee stock option outstanding A/c (Being expenses in respect of ESOP for the period provided for eligible employees) (50000/1250X800)		32,000	32,000
31 st March, 2015	P & L A/c Dr. To Employee Compensation Expenses A/c (Being Employee Compensation Expenses for the year transfer to P & L A/c)		32,000	32,000
31 st August, 2015	Bank A/c (800 x Rs.80) A/c Dr. Employee Stock Options Outstanding A/c Dr. To Equity Share Capital A/c (800 X 10) To Securities Premium A/c (800 X 190) (Being the exercise of 800 options)		64,000 96,000	8,000 1,52,000

Dr. Employee Stock Options Outstanding Account

Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
31 st March, 2013	To Balance c/d	50,000	31 st March, 2013	By Employee Compensation Expense A/c	50,000
		50,000			50,000
31 st March, 2014	To Balance c/d	1,00,000	1 st April, 2013	By Balance B/d	50,000
			31 st March, 2014	By Employee Compensation Expense A/c	50,000
		1,00,000			1,00,000
31 st March, 2015	To General reserve	36,000	1 st April, 2014	By Balance B/d	1,00,000
	To Balance C/d	96,000	31 st March, 2015	By Employee Compensation Expense A/c	32,000
		1,32,000			1,32,000
	To Equity share capital	8,000	1 st April, 2015	By Balance B/d	96,000
	To Securities premium	1,52,000	31 st Aug, 2015	By Bank A/c	64,000
		1,60,000			1,60,000

DISCLOSURE IN THE BALANCE SHEET:

- Employee Stock Options Outstanding will appear in the Balance Sheet as part of reserves and surplus on shareholders' equity as per Schedule III.

WORKING NOTE:

a. $\frac{\text{Value of Compensation}}{\text{Total Number of Options}} \times \text{Number of Options Not Exercised}$

$$= \frac{\text{Rs. } 1,00,000}{1,250} \times 450 = \text{Rs. } 36,000$$

PROBLEM NO: 6

In The Books Of 'P' Ltd.

Journal Entries:

Date	Particulars	Debit (Rs.)	Credit (Rs.)
31.03.2011	Employees Compensation exp. A/c Dr.	80,000	
	To Employee Stock Options O/S A/c		80,000
	(Being Compensation exp. Recognized for 6 months in respect of employees stock options on SLM basis) [8000 x (170-80)/4 ½ years X 6m/12m=80,000]		
31.03.2011	P & L A/c Dr.	80,000	
	To Employees Compensation exp. A/c		80,000
	(Being Compensation exp. Transferred to P & L A/c)		
31.03.2012	Employees Compensation exp. A/c Dr.	1,60,000	
	To Employee Stock Options O/S A/c		1,60,000
	(Being Compensation exp. Recognized for the full year)		
31.03.2012	P & L A/c Dr.	1,60,000	
	To Employees Compensation expenses A/c		1,60,000
	(Being Compensation expenses transferred to P & L A/c)		
31.03.2013	Employees Compensation expenses A/c Dr.	80,000	
	To Employee Stock Options O/S A/c		80,000

	(Being Compensation expenses recognized in respect of 4000 options for full year) [4000 x (170-80)/4 ½ years X Full year]		
31.03.2013	P & L A/c Dr.	80,000	
	To Employees Compensation expenses A/c		80,000
	(Being Compensation expenses transferred to P & L A/c)		
31.03.2013	Employees Stock Options O/s A/c Dr.	1,20,000	
	To General Reserve A/c		1,20,000
	(Being excess compensation expenses transferred to General Reserve A/c) [(80,000 + 1, 60,000) X 4,000 / 8,000 = 1, 20,000.]		
31.03.2014	Employees Compensation expenses A/c Dr.	80,000	
	To Employee Stock Options O/S A/c		80,000
	(Being Compensation expenses recognized in respect of stock options of 4000)		
31.03.2014	P & L A/c Dr.	80,000	
	To Employees Compensation expenses A/c		80,000
	(Being Compensation expenses transferred to P & L A/c)		
31.03.2015	Employees Compensation expenses A/c Dr.	80,000	
	To Employee Stock Options O/S A/c		80,000
	(Being Compensation expenses recognized in respect of stock options of 4000)		
31.03.2015	P & L A/c Dr.	80,000	
	To Employees Compensation expenses A/c		80,000
	(Being Compensation expenses transferred to P & L A/c)		
30.09.2015	Bank A/c (3000 X Rs. 80) Dr.	2,40,000	
	Employees stock options O/S A/c (3000 X Rs.90)	2,70,000	
	To Equity share capital A/c (3000 X 10)		30,000
	To Securities Premium A/c (3000 X 160)		4,80,000
	(Being 3000 employees stock options exercised at an exercise price of Rs.80 each)		
30.09.2015	Employees Stock Options O/s A/c Dr.	90,000	
	To General Reserve A/c		90,000
	(Being balance in ESOS transferred to General Reserve A/c)		

WORKING NOTES :

1. Fair value of each option Rs.170 - Rs.80 = Rs.90
2. Amount Transferred to General Reserve

$$\text{On 01.12.2012 4000 Unvested options} = (80,000 + 1,60,000) \times \frac{4000}{8000} = \text{Rs. } 1,20,000$$

$$\text{On 30.09.2015 1000 Unexercised lapsed options} = 1000 \times \text{Rs.90} = \text{Rs.90,000.}$$

PROBLEM NO: 7

Since the exercise price varies depending on the outcome of a performance condition which is not a market condition the effect of that performance condition (i.e. the possibility that the exercise price might be Rs.40 and the possibility that the exercise price might be Rs.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 and revises the transaction amount to reflect the outcome of that performance condition at the end of every year based on the information available at that point of time.

Calculation of compensation expenses to be charged every year

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

PROBLEM NO: 8

Year	Calculation	expenses for the period (Rs.)	Cumulative expense (Rs.)
1	55,200 options × 75% × Rs. 12 × 1/3 years	1,65,600	1,65,600
2	(55,200 options × 75% × Rs. 12 × 2/3 years) - Rs. 165,600	1,65,600	3,31,200
3	(55,200 options × 75% × Rs. 12 × 3/3 years) - Rs. 331,200	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.

Copyrights Reserved
To **MASTER MINDS**, Guntur

THE END