



ESOPs vs SARs

Valuation requirements as per Ind AS 102

K P A C

- **Share-based payment plans** are widely used to reward, attract and retain the right talent. **Employee Stock Option Plans (ESOPs)** and **Share Appreciation Rights (SARs)** are the two most commonly used instruments in this space.
- Issuance of such instruments is required to be accounted under **IND AS 102 or Guidance Note on Share based Payments (2020)**, as may be applicable to the Company.
- Whilst both ESOPs and SARs help in aligning interests between employees and shareholders, the **measurement, recognition and financial reporting** of the two instruments **differs significantly**.
- **ESOPs** are typically categorised as an **Equity settled Instrument** whilst **SARs**, being cash-settled instrument are treated as a **Liability** in the books.
- In this article, we discuss the treatment of the two instruments as per IND AS 102 covering:
 - Nature of Instruments for Accounting purposes
 - Measurement and Valuation requirements of both ESOPs and SARs; and
 - Overall comparison of the two instruments
- We believe this article would be useful for all **finance professionals as well as auditors** dealing with ESOP and SAR accounting as part of their work.



Measurement and valuation of share-based payment instruments depends upon whether they are **Equity Settled Instruments** or **Cash Settled Instruments**. Below table gives general categorization of ESOPs and SARs for this purpose:

ESOPs (Equity Settled)

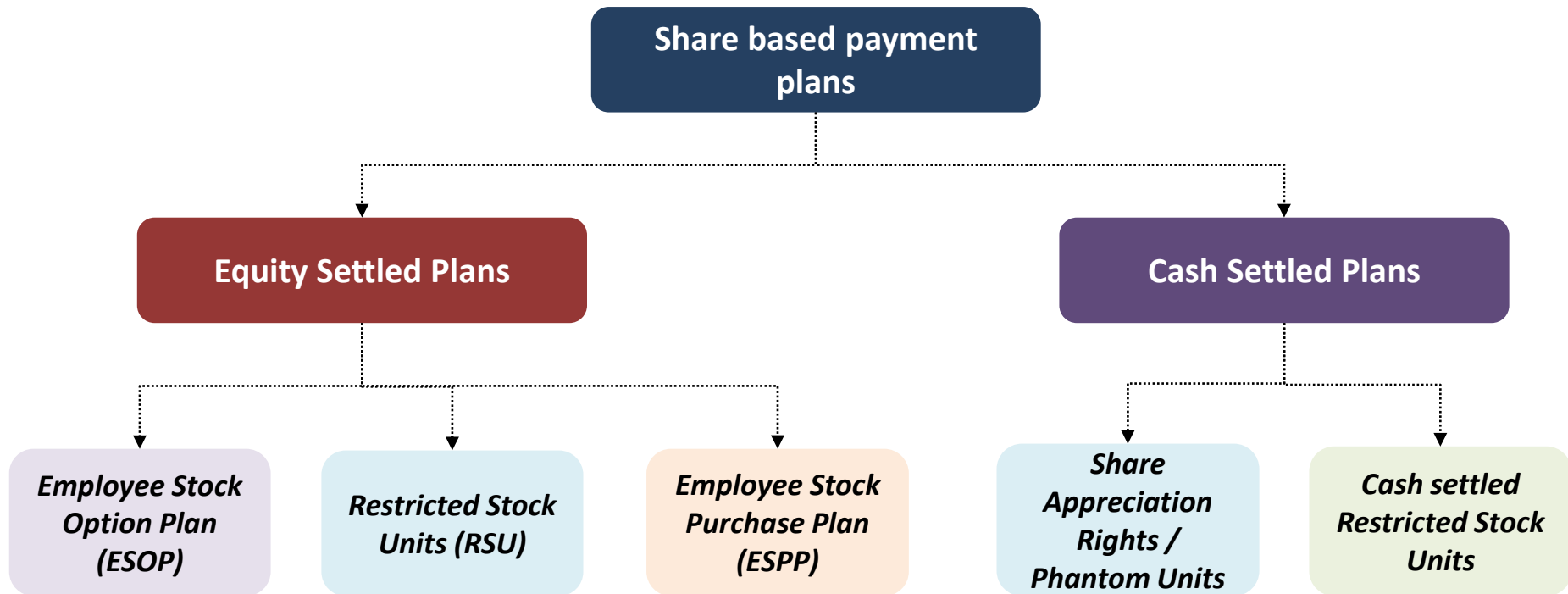
- Typically **settled by issuance of shares** to employees on exercise, hence categorized as **Equity Settled Instrument**.
- Leads to **immediate dilution** in shareholding
- **ESOP charge** recognized in Income statement **over vesting period** and correspondingly shown in **Balance Sheet** under the head **'Equity'**.

SARs (Cash Settled)

- Typically **settled by paying** appreciation in share price above a defined level in **cash**, hence treated as **Cash Settled Instrument or Liability**.
- **No dilution** in shareholding
- **Provision for SARs** recognized in Income statement **till settlement** and correspondingly shown in **Balance Sheet** under the head **Liabilities and Provisions**.

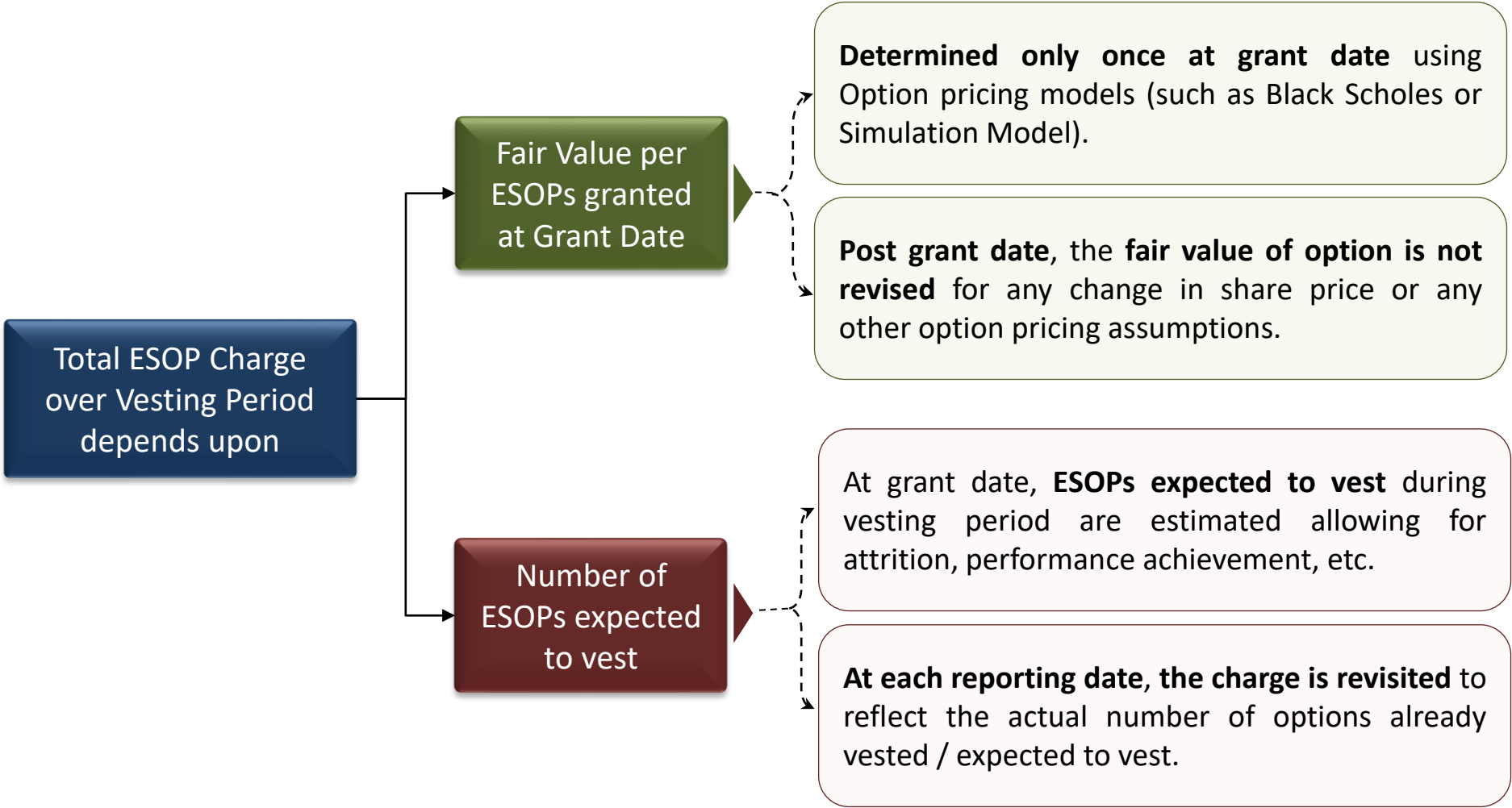
Note that many ESOP and SAR plans also carry an **option to be settled either in Cash or Equity**. Actual categorization in such cases depends on **how the Company intends to settle** such instruments (i.e., by issuance of shares or payment of cash), past settlement precedence (if available) and may even warrant a **hybrid treatment** (i.e., partly Equity and partly Cash settled).

Below charts shows the instruments typically classified as Equity settled and Cash Settled:



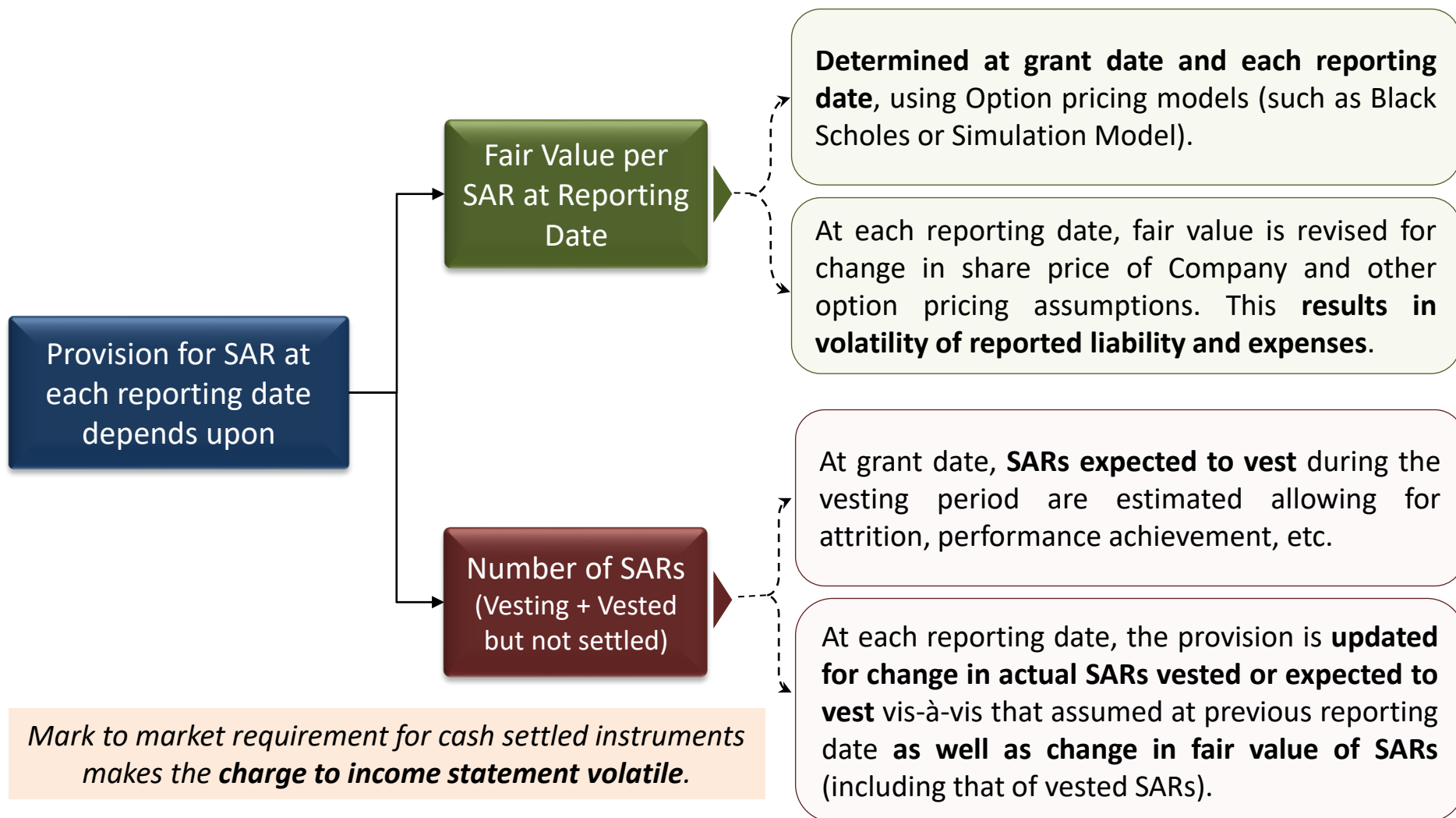
Note that the above is a general categorization. Actual categorization depends on **how the Company intends to settle** such instruments (i.e., by issuance of shares or payment of cash), past settlement precedence (if available) and may even warrant a **hybrid treatment** (i.e., partly Equity and partly Cash settled).

ESOPs are required to be valued on fair value basis, determined at grant date and the corresponding charge recognized over the vesting period, as depicted in chart below:



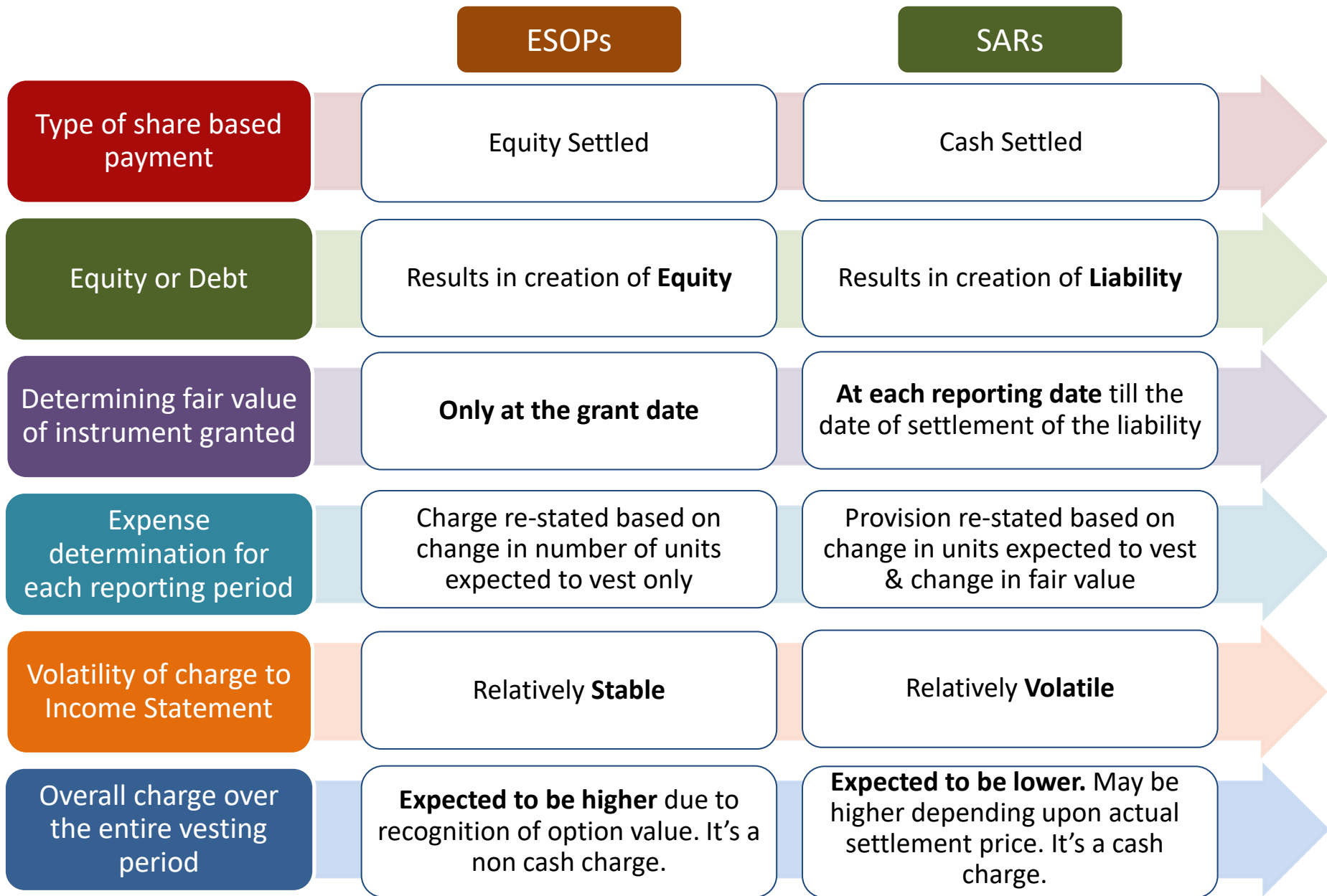
Note that recognition of ESOP charge over the vesting period is dependent on the actual vesting schedule and will be discussed in subsequent article.

SARs are required to be valued on fair value basis, determined at each reporting date and the corresponding provision accounted for till the settlement of SARs, as depicted in chart below:



Note that provision for SAR during the vesting period is dependent on the actual vesting schedule and will be discussed in subsequent article.

ESOPs vs. SARs: Comparison of valuation basis



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