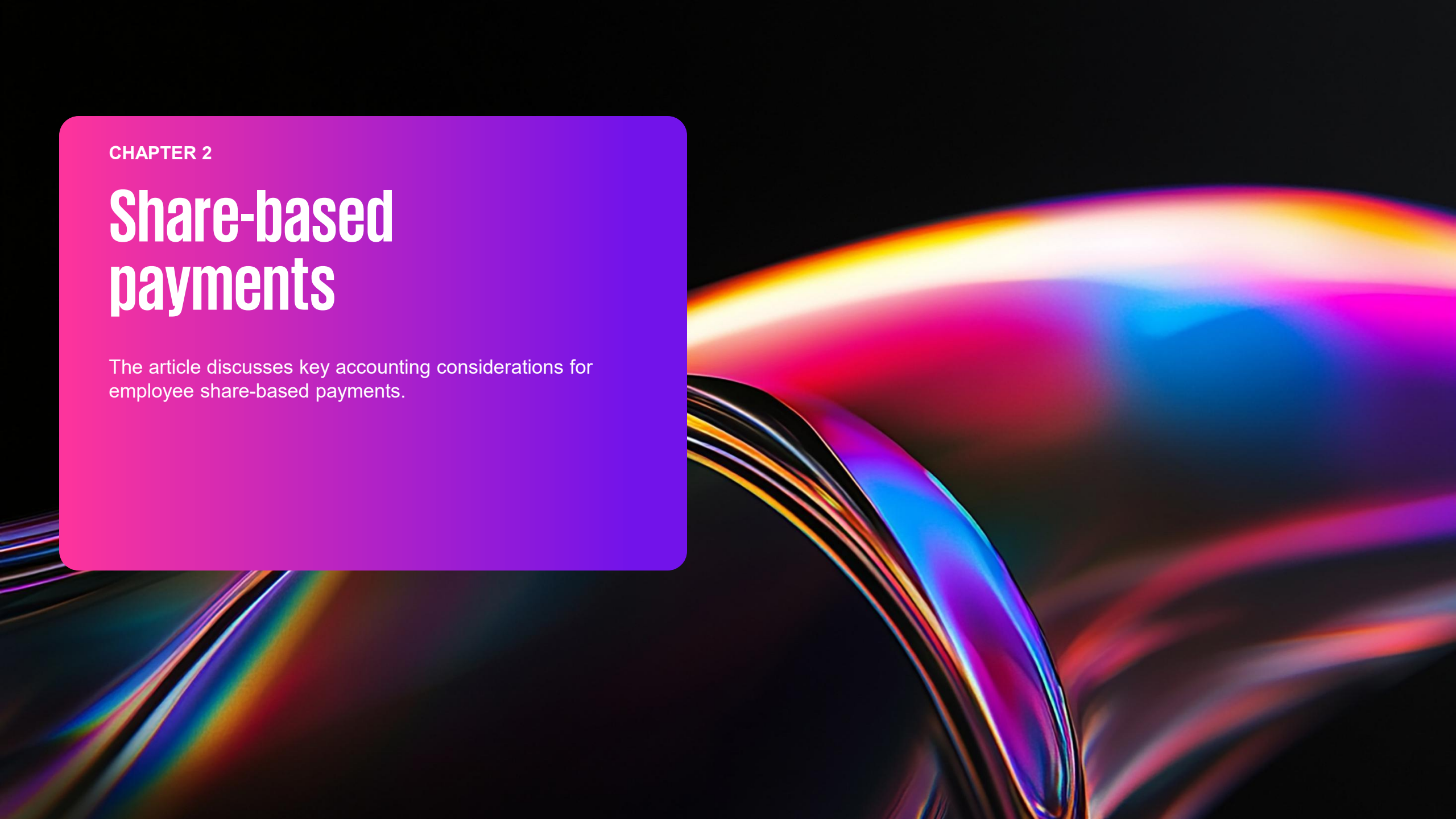

CHAPTER 2

Share-based payments

The article discusses key accounting considerations for employee share-based payments.

Introduction

India's capital markets have witnessed significant growth in recent years as reflected in the rising number of Initial Public Offers (IPOs) and private equity (PE) investments across a wide range of sectors. Alongside this growth, employee remuneration arrangements have also evolved, with entities increasingly using conventional employee stock options as well as arrangements linked to share prices, entity's performance, IPOs and other exit events. Such arrangements may be used to reward employees for their performance, retain talent, and align employee interests with those of shareholders and investors. The accounting for these arrangements is not always straightforward. Their legal form or commercial description may not, by itself, determine the appropriate accounting. Instead, an entity needs to carefully evaluate the underlying terms and economic substance of the arrangement to determine whether it falls within the scope of Ind AS 102, *Share-based Payment* (the Standard), and, if so, how the arrangement should be classified and accounted for.

Additionally, entities should evaluate the legal and regulatory requirements applicable to such arrangements, including the Companies Act, 2013 and, in the case of listed entities, the relevant SEBI regulations and associated disclosure obligations. This article explores some of the accounting considerations that commonly arise in applying the Standard to employee arrangements and focuses on identifying the appropriate accounting model and understanding the nature of the arrangement, including:

- distinguishing between Ind AS 102 and Ind AS 19, *Employee Benefits;*
- evaluating employee share purchase plans;
- determining whether awards are equity-settled or cash-settled;
- assessing vesting and settlement conditions linked to IPOs or other exit-related conditions; and
- assessing arrangements involving loans advanced to employees for acquiring shares of the entity.

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Ind AS 102 vs Ind AS 19: assessing whether an award reflects changes in equity value

Incentives/compensation to employees may be paid either in cash or in equity shares. When equity shares are issued to employees for their services, the transaction is covered within the scope of Ind AS 102. Similarly, most performance-based cash incentives/payments to employees for their services would be covered by Ind AS 19.

The accounting analysis becomes more nuanced when settlement is made in cash and the amount payable is linked to the entity's performance, share price or equity value. Such arrangements do not automatically fall within the scope of Ind AS 102 and may need to be assessed to determine whether they should be accounted for under Ind AS 102 or Ind AS 19.

This classification determines the applicable recognition and measurement requirements. A cash-settled share-based payment is measured at fair value in accordance with Ind AS 102 and re-measured at each reporting date until settlement, with changes recognised in the statement of profit and loss. An 'other long-term employee benefit' under Ind AS 19 is measured using the projected unit credit method (an actuarial technique) and re-measured at each period-end.

When the amount paid under an award equals the increase in the share price over a specified period of time, it can be said that the counterparty directly participates in the changes in the fair value of the underlying equity instrument. In such a case, it may be said that the amount of compensation is determined based on the price or value of the equity instruments. When the amount paid under the plan is not directly linked to the changes to the entity's share price, application of judgement would be required to determine if the award is likely to reflect the fair value of the entity's share price.

Example

A Company enters into an arrangement with its employee under which the employee will receive a cash payment based on the positive difference in a fixed Earnings before interest, tax, depreciation and amortisation (EBITDA) multiple between the start of Year 1 and end of Year 3. The employee is required to be in service at the end of Year 3 to receive the payment.

The Company is required to evaluate whether the formula approximates the value of the Company's equity instruments. At the start of year 1, the Company determined that the fixed multiple is in line with EBITDA multiples used in practice to estimate total equity value of similar entities. However, the Company expects that the EBITDA multiple required to be applied to estimate the total equity value of the Company will change over time as market conditions change and the business grows. Therefore, since the EBITDA multiple is not likely to fairly represent the movement in equity value of the company at the time of payment, it may not be considered as a share-based payment under Ind AS 102.

Source: Adapted from KPMG Insights into IFRS, 23rd Edition 2026/27

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Ind AS 102 vs Ind AS 19: assessing whether an award reflects changes in equity value (contd.)

Similarly, there could be other terms such as the existence of a cap, floor, or payments linked to share-price bands. These additional terms do not, by themselves, determine the classification; rather, the specific terms of the arrangement and the nature of the share-price linkage need to be assessed.

The assessment should consider the substance of the arrangement and whether the amount ultimately payable is linked to the price or value of the entity's equity instruments in a manner that brings the arrangement within the definition of a cash-settled share-based payment. This classification impacts the corresponding accounting treatment and the relevant presentation/disclosure requirements.

While we consider the above principles to determine the accounting principles and the standard to apply for incentives/cash payments awarded to employees, a similar question may arise where employees are awarded shares (or when employees acquire shares), i.e., does the arrangement represent a straightforward employee share purchase, or does it contain a share-based payment for employee services?

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Classification of Employee Stock Options Plan (ESOPs) vs Employee Share Purchase Plans (ESPP)

When employees are allotted shares in return for a cash consideration, entities should evaluate whether these plans represent option plans or share purchase plans, by considering the various terms of the scheme/plan.

In an ESPP, employees are usually entitled to buy shares at a discounted price (the benefit being passed on to the employee is the discount), while an ESOP would contain an option to buy the entity's shares on a future date for a fixed price (the employee gets the benefit of future gains in the share price, subject to the terms of the plan which could include various service conditions and performance conditions).

The distinction between an ESPP and an ESOP arrangement is not always straightforward and requires an assessment of the specific features of the plan. Relevant factors include whether the shares are issued immediately or whether employees are granted rights or options that vest over a period of service, as well as the existence of restrictions on the shares, holding requirements, or other conditions linked to continued employment. It is also important to consider whether the offer is made broadly to all shareholders or exclusively to employees, and whether the benefit represents compensation for employee services rather than a simple discounted share purchase.

Examples of features that may indicate an option include a plan with lookback features (where employees are able to buy shares at a discount and choose whether the discount is applied to entity's share price at the date of grant or share price at the date of purchase), a plan where employees are allowed to decide after a significant period of time whether to participate in the plan, a plan in which employees are allowed to cancel their participation before or at the end of a specified period and obtain a refund of amounts paid into the plan, etc. This evaluation affects the determination of the grant date, the measurement approach, and the number of instruments recognised as per the Standard.

If the arrangement is, in substance, an ESOP (i.e., contains an option), the grant date fair value of the award is recognised as an employee compensation expense over the vesting period. By contrast, a true ESPP generally involves an immediate purchase of shares at a discount and does not give rise to compensation expense over a future vesting period. The accounting distinction is illustrated through the example below:

Example 1

An employee subscribes to fresh equity shares by paying a discounted price for a short window and the scheme does not require the employee to be in employment post this transaction. Further, there are no buy-back conditions or restrictions attached to the shares that are allocated to the employee. This would be considered as an ESPP and the discount provided to the employee is recognised as compensation cost when the employee subscribes to these shares.

Source: KPMG in India analysis, 2026

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Classification of Employee stock options plan (ESOPs) vs Employee share purchase plans (ESPP) (contd.)

Example 2

In year 1, Company T grants a right to its employees to buy shares at a 20 per cent discount from its share price. This grant is made to 100 employees and 70 employees exercise them. If the substance of the offer is ESPP, then the grant date is when the employee accepts the offer and the recognition is based on the number of employees who accept the offer i.e., 70. Conversely, if the substance of offer is an option grant, then grant date is not dependent on explicit acceptance and the recognition is based on 100 employees to whom this option is extended and not on 70 employees on the date of grant.

Source: KPMG Share-based payments IFRS 2 handbook, October 2023 edition

Example 3

An employee subscribes to fresh equity shares by paying an amount that equals the fair value of the share on the grant date. The employee is required to remain in continuous employment for a specific period. If the employee leaves before the expiry of the specified term, then they are required to sell the share back at the lower of fair value or the amount paid.

In this instance, due to the conditions attached to the scheme, the employee can benefit from the increase in the share price only upon completion of the service conditions, i.e., continuous employment. Therefore, this scheme would be considered as an ESOP. However, in this case, it may be possible to say that the grant date fair value is nil, since the amount paid by the employee equals the fair value of the share on that date. Nevertheless, since this represents an ESOP, related disclosures under Ind AS 102 would be required to be made in the financial statements by the entity, including the description of the key terms, determination of fair value of the award.

Source: KPMG in India's analysis, 2026

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Equity-settled vs cash-settled share-based Plans (SBPs)

Where an arrangement is determined to be an SBP, the next step is to identify the nature of the entity's settlement obligation. This determines whether the award is classified as equity-settled or cash-settled and, consequently, the applicable measurement requirements.

The classification of an SBP as either equity-settled or cash-settled is based on the nature of the entity's obligation to the counterparty. If the transaction is settled in equity instruments, then the transaction is classified as equity-settled. Equity-settled awards are measured once at grant date, with no subsequent remeasurement.

In contrast, cash-settled liabilities are remeasured to fair value every reporting date through the statement of profit and loss until settlement. Consequently, such arrangements may lead to volatility in reported earnings.

There are multiple classification related issues which may arise in practice. Questions may arise, for example, where an arrangement becomes cash-settleable upon the occurrence of an event outside the control of both the entity and the employee (contingently settled), or where buy-back clauses are embedded with redemption features in the arrangement. The following scenarios illustrate some of these classification considerations.

a) Buy-back clauses

Private equity investors may prefer shares to be held only by current employees , as they may not wish external parties or former employees to benefit from subsequent increases in the value of the entity. To implement this policy, they may include buy-back clauses in their SBP plans. Buy-back clauses can take different forms, such as mandatory redemptions and options exercisable by the employee, the employer or both. Such clauses are often triggered when an employee exits the entity or upon the occurrence of an exit event.

A buy-back feature does not, by itself, result in the award being considered as a cash-settled share-based payment. The classification such SBP arrangements having buy-back features depend on the nature of the buy-back clause. The entity is required to determine whether it has a present obligation to settle the award in cash. If the entity has such a present obligation, then the transaction is accounted for as a cash-settled SBP; otherwise, it is accounted for as an equity-settled SBP.

In other words, where the employer has an option to buy-back shares, but the entity neither intends nor has a past practice of settling the arrangement in cash, and has the ability to settle it in equity, the arrangement would generally be considered as equity-settled SBP. Where these conditions are not met and the entity has a present obligation to settle in cash, the arrangement would be classified as cash-settled.

Example

Company X grants shares to its employees for a cash payment. The employees can require Y, a shareholder of Company X, to purchase the shares. Further, Company X has a call option over the shares but has no past practice or stated policy of exercising it.

In this case, the employees' put option does not create a cash-settlement obligation for Company X because the obligation to purchase the shares rests with Y, a shareholder of the Company X. Accordingly, from Company X's perspective, the existence of the put option does not, by itself, preclude equity-settled classification.

Source: KPMG in India's analysis, 2026

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Equity-settled vs cash-settled SBPs (contd.)

b) Contingently cash settleable SBPs

In some cases, an award may become cash settleable upon the occurrence or non-occurrence of a specified event which may be outside the entity's control. This raises the question of whether such an award should be treated as equity-settled or cash-settled.

The Standard does not provide any specific guidance for awards whose settlement depends on the occurrence or non-occurrence of an event outside the entity's control. In determining the appropriate classification of such awards, one consideration may be applying the liability recognition principles in Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, including the probability of a cash outflow. The arrangement may be classified as either cash-settled or equity-settled depending on which settlement outcome is considered probable. This assessment may need to be revisited at each reporting date as facts and circumstances change. A change in the probability of the settlement outcome may therefore require reconsideration of the classification of the award.

For instance, an entity grants an award to its employees that will be settled in equity shares if an IPO occurs within five years of the grant date, provided the employees remain in service until the IPO date. If the IPO does not occur within the five-year period, then the award will be settled in cash.

At the end of year 1, if the entity determines that it is not considered probable that the IPO will occur within the defined period, then the award may be classified as cash-settled. Subsequently, if circumstances change and, at the end of year 2, an IPO before the end of year 5 if considered probable, the classification of the award may need to be reconsidered. In such circumstances, the award may be reclassified from cash-settled to equity-settled award. This would result in the reversal of the cash-settled liability through the statement of profit and loss. The cumulative expense for employee services received up to the date of reclassification would be recognised based on the requirements applicable to an equity-settled award using grant date fair value, with a corresponding credit to equity.

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Vesting conditions linked to IPO

Classification determines how an award is accounted for and whether it is remeasured annually. The accounting also depends on the conditions that determine whether and when the employee becomes entitled to the award. This is particularly relevant where vesting is linked to an IPO or another exit event. Private equity transactions often involve a planned exit within 3-5 years of investment. Therefore, it is common for SBP arrangements to include a condition that an individual will only be unconditionally entitled to the award if an exit event such as an IPO occurs. An IPO condition affects SBPs in different ways depending on whether the employee is required to be in service when the exit occurs and if the exit is required to occur at a minimum price.

Where the plan requires the employee to be in employment when the IPO occurs, it will be considered as a service condition i.e., a vesting condition. However, if the employment condition does not exist, the IPO condition will be considered as a non-vesting condition. This assessment is relevant as it impacts the accounting treatment of the award. A non-vesting condition is considered in the determination of the grant date fair value, whereas the effect of service condition is considered at the end of each reporting period to determine the number of options that will ultimately vest.

Where an IPO represents a non-market performance condition and the timing of the IPO may accelerate vesting, the arrangement may have a variable vesting period. For example, an award may vest on completion of a specified service period or earlier if an IPO occurs, while the employee remains in service. In such situations, the expected vesting period is based on the vesting alternative considered most likely to occur and is reassessed as expectations regarding the IPO change. If an earlier IPO becomes the most likely outcome, the expected vesting period is reduced, and the cumulative share-based payment expense is adjusted accordingly. If the most likely vesting alternative subsequently changes, then the accounting is updated to reflect the revised vesting path and subsequently the vesting period.

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Shares funded by loans

Another feature commonly seen in employee SBPs is that employees may acquire shares in the entity using a loan provided by the entity itself. Although such an arrangement may legally take the form of a share purchase together with a loan, the accounting depends on the substance of the loan arrangement, particularly the entity's rights and intention to recover the amount advanced from the employee.

In order to determine the appropriate accounting treatment, one needs to consider whether the entity has a right to full recourse over the loan and if the entity will enforce that right. Indicators that may support the conclusion that a loan is full recourse include:

- The loan is reported by the entity to a credit agency in the same manner as commercial loans;
- The entity requests financial information from the employee to assess the employee's ability to repay the loan;
- The entity has an ongoing process for monitoring the collectability of the loan; and
- where relevant, the entity has a history of collection in full of other employee loans, such as housing loans.

Where a full recourse exists, the arrangement is accounted for as an issue of shares together with a loan receivable. This does not, however, preclude the arrangement from containing a share-based payment component, for example, where the shares are issued at a discount or the loan contains features such as interest being waived on achievement of a specified target. Similarly, a below-market interest rate may itself represent an employee benefit and, depending on whether the loan is integral to the share purchase arrangement, may fall within Ind AS 102 or be accounted for separately as an employee benefit.

Conversely, where the entity does not have full recourse, or has full recourse but would not enforce that right, the arrangement is accounted for as an in-substance option. In that case, the share issue and loan receivable are not recognised at inception. Until exercise of the options, the shares issued to employees are treated as treasury shares and the accounting for the share issue occurs when the employee settles the loan.

Conclusion

Equity-linked remuneration arrangements are becoming increasingly mature and complex. While these plans are often designed to align management incentives with shareholder value creation, their accounting analysis requires careful consideration of the underlying rights, obligations and economic substance of the arrangement rather than its legal form or commercial description. As these arrangements evolve, management should consider the accounting consequences alongside the commercial objectives at the design stage, rather than as a separate assessment once the terms have been finalised.

This makes a cohesive, cross-functional approach particularly important. Finance, legal, human resources, tax and valuation teams, together with relevant shareholders or investors, should have a common understanding of how the arrangement is intended to operate in practice. Terms relating to vesting, settlement alternatives, buy-backs, exit events, employee funding and recovery of loans can each influence the accounting outcome, and therefore should be considered collectively rather than in isolation. Early assessment and well-considered approach at the design stage can help align the commercial objectives of the arrangement with its accounting outcomes and support consistent and transparent financial reporting as these arrangements evolve.

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