THE STANDARD STANCE

Navigating Ind AS 102, Share-Based Payments: Unraveling the Key Accounting Considerations

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INTRODUCTION

In today's era of the booming start-up culture, stock options are often used as a power tool and a common form of compensation used by the management to attract and retain talent and align employee interest with the shareholders' interest. Earlier, this phenomenon was found only in listed companies; however, with the emergence of new-age entrepreneurs, more and more unlisted companies are also resorting to stock-based compensations.

Ind AS (Indian Accounting Standard) 102, 'Share-based Payment', establishes the accounting treatment for all share-based payments whether granted to the employees or other suppliers of goods or services. The accounting prescribed in Ind AS 102 is largely aligned with the requirements of IFRS (International Financial Reporting Standards) 2.

While Ind AS 102 is a comprehensive standard covering accounting requirements for various aspects of share-based payments, this document lists down some of the key requirements in brief that management should take into account while entering into any transaction concerning share-based payments.

KEY ACCOUNTING CONSIDERATIONS FOR SHARE-BASED PAYMENTS

Identification of equity-settled vs cash-settled plans

A share-based payment transaction is classified either as an equity-settled or cash-settled share-based payment transaction. The equity-settled share-based payment transaction is a transaction in which an entity receives goods and services as consideration for its own equity instruments. The cash-settled share-based payment transaction occurs when an entity receives goods or services and incurs a liability to the supplier that is based on the price (or value) of the entity's equity instruments, or that of another group entity.

The incorrect classification of a share-based payment as equity-settled instead of cash-settled can lead to significant errors in the financial statements. This is because equity-settled and cash-settled share-based payments are measured differently. The equity-settled share-based payment transactions are measured at the fair value of the equity instruments granted at the grant date. The fair value is never remeasured. The grant date fair value is recognised over the vesting period.

The fair value of the liability for cash-settled transactions is re-measured at each reporting date and at the date of settlement. Any changes in fair value are recognised in profit or loss for the period. The remeasurement during the vesting period would result in the catch-up adjustment for the prior period so that the liability is equal to a defined proportion of the total fair value of the liability at each reporting date. In other words, the fair value of the liability would generally be recorded in the profit or loss over the vesting period with the catch-up adjustment at each reporting date to factor in the change in the fair value of the liability due to remeasurement.

Consequently, while the value attributed to an equity-settled share-based payment is fixed at the fair value of the instrument at the grant date, cash-settled share-based payments result in the recognition of a liability that must be remeasured at each reporting date until the liability is ultimately settled in cash (or another asset).

Example:

On 1 January 20X1, the managing director (MD) in Entity A, a family-owned business, is awarded a share-based payment of 1,000 shares which represents 10% of Entity A's share capital. The shares are issued with the condition that the company will buy the shares back at fair value on the MD's retirement or death, or if he is a 'good leaver' (that is, his departure is not due to incompetence or because he has been convicted of a serious crime, in which case the shares will be forfeited for nil consideration). On the date on which the share-based payment is granted, Entity A is valued at INR 1 million.

Entity A incorrectly classifies the arrangement as an equity-settled share-based payment and recognises an expense of INR 100,000 (representing 10% of Entity A valuation of INR 1 million).

The following incorrect journal entry was recorded:

Debit: Share-Based Payment Expense	INR 100,000
Credit: Equity	INR 100,000

However, the buyback clause means that Ind AS 102 requires the transaction to be classified as a cash-settled share-based payment because the company would have to settle the transaction by making a cash payment. The outstanding liability would be remeasured to fair value at the end of each reporting period, with any changes in fair value recognised in profit or loss. Assume that, on 30 June 20X1, the fair value of Entity A has risen to INR 2 million. Entity A would recognise a share-based payment expense, and record a liability, of INR 200,000 (10% of INR 2 million). The correct journal entry is:

Debit: Share-Based Payment Expense	INR 200,000
Credit: Liability	INR 200,000

The liability would be remeasured to fair value at each reporting date with an associated charge (or, if the share price fell, credit), being generally recorded in profit or loss.

Transaction with settlement alternative

It is common for share-based payment transactions to provide either the entity or the counterparty with the choice of settling the transaction either in shares (or other equity instruments) or in cash (or other assets). The accounting differs depending on whether the choice rests with the counterparty or an entity.

- If the counterparty has the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound instrument, which needs to split into liability component (representing the counterparty's right to settle in cash) and equity component (representing counterparty right to settle in equity). To split both the components, the liability component is measured first. Next, the fair value of the equity component is measured. Generally, to determine the fair value of the equity component, the grant-date fair value of the cash alternative that would have to be forfeited is subtracted from the fair value of the equity alternative. Any positive difference equals the fair value of the equity component.
- Where the entity has a choice of settlement, the accounting treatment is binary – in other words, the whole transaction is treated either as cash-settled or as equity-settled, depending on whether the entity has a present obligation to settle in cash. If the present obligation exists, then accounting for cash-settled plans would follow. If the entity does not have the present obligation to settle in cash, it is an equity-settled award.

Example:

An entity grants to an employee the right to choose either to receive a cash payment equal to the value of 1,000 equity shares or to receive 1,200 equity shares. The grant is conditional upon the completion of three years of service.

At the grant date, the entity's share price is INR 50 per share. An entity estimates that the grant date fair value of the equity alternative is INR 48 per share. The grant date fair value of the equity alternative is INR 57,600 (1,200 shares × INR 48). The grant date fair value of the cash alternative is INR 50,000 (1,000 shares × INR 50). Therefore, the fair value of the equity component excluding the right to receive cash INR 7,600 (INR 57,600 – INR 50,000).

Having established a fair value for the liability and equity component as specified above, the entity accounts for the liability component according to the rules for cash-settled transactions and the equity component according to the rules for equity-settled transactions.

Share-based payment to the non-employee

It is often misunderstood that the requirement for accounting for share-based payment transactions kicks in only when stock options are issued to the employees. Ind AS 102's scope is not restricted to transactions with employees. For example, if an external supplier of goods or services is paid in shares or cash based on the price/ value of the equity instruments of the entity or group entity, Ind AS 102 must be applied.

Ind AS 102 contains a rebuttable presumption that, for transactions with parties other than employees, the share-based payment shall be valued based on the fair value of the goods or services received, not the fair value of the shares or options issued. It is only where the fair value of the goods or services received cannot be reliably determined that the fair value of the equity instruments issued should be used.

Interestingly, the above requirement is different from equity-settled share-based payment to the employee which requires the company to measure the fair value of the services received by reference to the fair value of the equity instrument granted. Therefore, companies need to be careful about the above requirements while making share-based payments to the non-employees.

Example:

Company A acquires equipment from Company B. Company A proposes to pay Company B in shares, rather than in cash. It provides Company B with 50,000 shares, and its share price on the date that the equipment is delivered is INR 2 per share. The retail price of the equipment is INR 50,000. Company A should ignore the fair value of the consideration i.e., INR 100,000 (50,000 shares multiplied by INR 2/ share), and recognise the cost of the equipment based on the fair value of the goods received. It would therefore recognise the following entry:

Dr Property Plant and Equipment	INR 50,000
Cr Issued Capital	INR 50,000

Share-based payment transactions among group entities

In large multinational organisations, it is often the case that employees of a subsidiary will receive part of their remuneration in the form of shares in the parent, or less commonly in shares of some other group entity. In such circumstances, Ind AS 102 requires the entity that has received the benefit of the services to recognise an expense. This is so even if the equity instruments issued are those of another group entity. The transaction is also a share-based payment in the scope of Ind AS 102 from the perspective of the parent's separate financial statements, even though it is the subsidiary that receives the services from the employees.

Example:

A parent entity grants 100 equity instruments (fair value INR 300) to the employee in a subsidiary. The award will be settled through the issuance of shares if the employee remains employed for three years. The parent entity has the obligation to deliver the shares and there is no obligation to deliver the shares on the subsidiary.

In the subsidiary's financial statements, the award is accounted as equity-settled because the subsidiary does not have an obligation to settle the award. An expense and a corresponding credit to equity are recognised over the 3-year vesting period. The credit-to-equity is a capital contribution from the parent because the parent is compensating the subsidiary's employees at no expense to the subsidiary. In the parent's separate financial statements, a debit to 'investment in subsidiary', and a corresponding stock reserve (at grant date fair value) is recognised at each reporting date.

The above is the plain vanilla example included herewith to explain the concept; however, in reality, there could be a lot of complexities involved depending upon the terms of the group share-based payment. For example, there would be a different accounting treatment if there is a recharge arrangement in place wherein the subsidiary company would reimburse the cost incurred by the parent company for awarding stock options to the subsidiary's employees. Therefore, terms of the group share-based payment should be analysed properly to ensure appropriate accounting in the books of each entity within the group.

Cancellation of the stock options

In merger and acquisition transactions, it is common for the acquiree company to cancel the stock options awarded to its employees. In most cases, the acquiree company pays cash to its employees in lieu of cancelling the stock options. It is also quite common for the entities to cancel the stock options awarded to the employees where the conditions for an award have become so onerous as to be virtually unachievable, or (in the case of an option) where the share price has fallen so far below the exercise price of an option that it is unlikely that the option will ever be 'in the money' to the holder during its life of the option. The cancellation or settlement of stock options has the following accounting implications:

- treated as an acceleration of vesting, and any 'unamortized grant date expense' is recognised immediately. For example, if equity instruments have INR 150 fair value at the grant date and vest over three years, the annual expense is INR 50. However, if the arrangement is cancelled after one year, an immediate write-off of the remaining INR 100 is required.
- any compensation paid up to the fair value of the award at the cancellation date is accounted for as a deduction from equity, as being equivalent to the redemption of an equity instrument; any compensation paid over the fair value of the award at the cancellation date is accounted for as an expense in profit or loss.

Modification of share-based award

When an award is modified, the entity must as a minimum recognise the cost of the original award, as if it had not been modified (i.e. at the original grant date fair value, spread over the original vesting period, and subject to the original vesting conditions). This applies unless the award does not vest because of failure to satisfy a vesting condition that was specified at the grant date.

In addition, a further cost must be recognised for any modifications that increase the award's fair value. This additional cost is spread over the period from the modification date until the vesting date of the modified award, which might not be the same as that of the original award.

Example:

An entity grants 100 share options to its chief executive officer (CEO). The vesting of share options is conditional upon the CEO remaining in service over the next three years. The entity estimates that the fair value of each option is INR 15. By the end of year one, the entity's share price has dropped, and the entity reprices its share options. The repriced share options vest at the end of year three. The entity estimates that, at the date of repricing, the fair value of the original share options granted, i.e., before taking into account the repricing, is INR 5 and that the fair value of each repriced share option is INR 8. Ind AS 102 requires the entity to recognise:

- the cost of the original award at the grant date (INR 15 per option) over a three-year vesting period beginning at the start of year one, plus;
- the incremental fair value of the repriced options at the repricing date (INR 3 per option, being the INR 8 fair value of the repriced option less the INR 5 fair value of the original option) over a two-year vesting period beginning at the date of repricing.

CONCLUSION

Accounting for share-based payment is a complex area. Navigating share-based payment accounting under Ind AS 102 requires a nuanced understanding of the standard. A thorough grasp of Ind AS 102 is essential for ensuring the integrity of financial statements in an ever-evolving business landscape.

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