Share based payments- Stepping into Ind AS

Accounting of share based payments has evolved globally from only disclosure based requirements (for employee awards) to accounting principles requiring an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions (employee and non-employee). Share-based payment awards (such as share options and shares) are common features of employee remuneration for directors, senior executives and other employees. As share-based payment awards became a larger component of employee and executive compensation, standard-setters came to believe that share-based payment awards are an integral component of a total compensation package. Read on to know more…

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In US GAAP, accounting for employee share-based payments was initially prescribed in Accounting Principle Board (APB), Opinion No. 25, *'Accounting for stock issued to Employees'* issued in 1972, which was based on intrinsic value on the grant date. APB 25 was replaced with Statement of Financial Accounting Standards (SFAS) 123 in 1995 which

introduced a choice to follow fair value method. The option was done away with in SFAS 123R in December 2004 and EITF 96-18 guided the accounting for share-based payments to non-employees. The SFAS 123R and the related EITF have since then been codified as ASC 718 and ASC 505-50.

Internationally, there was no accounting prescribed by International Accounting Standards Board (IASB) until International Financial Reporting Standards (IFRS) 2, *'Share-based Payment'* was issued in February 2004 (although the applicable International Accounting Standards (IAS) 19 *'Employee Benefits'* (1998) required some disclosures).

In India, there were two authoritative documents on employee share-based payments:

- SEBI's Employee Stock Option Scheme and Employee Stock Purchase Scheme Guidelines, 1999-Accounting of Employee Share-based payments was first prescribed in SEBI guidelines applicable to listed companies. The requirements of the guidelines were based on the concepts of SFAS 123 i.e. choice to follow either fair value method or intrinsic value (with pro-forma fair value disclosures).
- ICAI's Guidance Note on Employee Share-based Payments-applicable to companies other than listed companies to the extent it is contradictory to SEBI guidelines.

In October 2014, SEBI issued revised guidelines for accounting of ESOP, requiring the listed entities to follow the accounting treatment as per the ICAI's Guidance Note.

As part of convergence with IFRS, MCA has notified Indian Accounting Standard (Ind AS 102), Share-based Payment which is converged with IFRS on share-based payments (IFRS 2). While Ind AS 102 brings in some key additional guidance, it also introduces some significant differences with Guidance Note issued by ICAI which may have implementation challenges and will require attention:

Scope–extending to share-based payments to non-employees

The most common share-based payment arrangements are equity-settled grants made to employees, and one common example is the grant of employee share options. However, there may be other types of share-based payment transactions in which an entity receives goods or services and pays for those goods or services either in shares or equity instruments or by incurring a liability. The ICAI's Guidance Note does not specifically include share-based arrangement with non-employee in its scope. In the absence of any general principles or guidance, there was diversity in practice (including no expense being for some of such transactions).

Ind AS 102 applies to share-based payment transactions in which the entity receives or acquires goods or services. 'Goods' includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. Thus, Ind AS 102 extends the scope of share-based payment accounting even to share-based payments to non-employees. Although, recognition requirements for share-based payments to non-employees are similar to those for share-based payment transactions with employees, the measurement requirements differ in many respects. **For example**:

- Equity-settled share-based payment transactions with non-employees are generally measured at the fair value of the goods or services received (direct measurement), rather than at the fair value of the equity instruments granted at the time that the goods or services are received. If, in rare cases, the fair value of the goods or services received cannot be measured reliably, then the goods or services received are measured with reference to the fair value of the equity instruments granted (indirect measurement).

  When the fair value of the identifiable goods or services appears to be less than the fair value of the equity instruments granted, then this typically indicates that other consideration (i.e. unidentifiable goods or services) has also been (or will be) received.

  For both direct and indirect measurement, goods or services are measured when they

Overall, Ind AS 102 introduces significant changes to the existing requirements for accounting of share-based payment transactions. Companies should consider the impact of Ind AS on its share-based awards and also address the wider business implications.

are received (measurement date). Therefore, a single agreement with a non-employee can have multiple measurement dates, one for each delivery of goods or services.

- Goods or services received in cash-settled share-based payment transactions with non-employees are recognised when they are received. Such goods or services received and the liability incurred are generally measured at the fair value of the liability. The liability is re-measured at the end of each reporting period and at the date of settlement.

Measurement–Intrinsic value method rarely available

The ICAI's Guidance Note recognises two methods of accounting for employee share-based payments, viz., the fair value method and the intrinsic value method. Nevertheless, in case an entity follows the intrinsic value method, it is required to give fair value disclosures. Further, it also allows volatility of unlisted company to be considered zero for measurement of fair value of share-based awards.

However, Ind AS 102 permits only the fair value method for measuring the share-based payment transaction; intrinsic value can be used only in rare circumstances. Uncertainty about the future market price will not be a reason for not being able to measure the fair value reliably and using intrinsic value method. Further, it does not provide exception to use volatility as zero in a fair valuation model for measuring the fair value of share-based awards.

Recognition–Straight-lined attribution not permissible for graded vesting

Consistent with ICAI's Guidance Note, Ind AS 102 requires recognition of share-based payment to employees over the vesting period. However, in case the option/shares are granted under graded vesting plan with only service conditions, the Guidance Note provides an option to recognise the share-based compensation cost on a straight-line basis over the requisite service period for the entire award (i.e. over the requisite service period of the last separately vesting portion of the award) provided the amount of compensation cost recognised at any date must at least equal the portion of the grant-date value of the award that is vested at that date.

Ind AS 102 does not retain the above option for graded vesting. Assuming that the only vesting condition is service from grant date to vesting date of each tranche, then as per Ind AS 102, each installment is accounted for as a separate share-based payment. For example, if an employee is granted a total of 100 options with 25 options vesting at the end of the third, fourth, fifth and sixth years, then each tranche of 25 options would be accounted for separately. As a result, even though all grants are measured at the same grant date, there will be several fair values and the total cost recognised each period will be different, because both the grant date fair values and the vesting periods are different. Application of the graded vesting method to grants that vest in installments results in the recognition of a higher proportion of cost in the early years of the overall plan. This effect is sometimes referred to as 'front-end loading'.

Accounting for group settled share-based compensation plans

The ICAI's Guidance Note provides that it also applies to transfers of shares or stock options of the parent of the enterprise, or shares or stock options of another enterprise in the same group[1] as the enterprise, to the employees of the enterprise. However, it does not give guidance on how to account for such transactions in the financial statements of each group entity. Ind AS 102 provides specific guidance on accounting for group settled share based payments.

Ind AS 102 introduces the notions of a receiving entity, settling entity and reference entity. The share-based payment in which the receiving entity, the settling entity and the reference entity are in the same group from the perspective of the ultimate parent is a group share-based payment transaction from the perspective of both the receiving and the settling entities.

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[1] 'Group' is the parent and its subsidiaries.

The underlying principle of the requirements is that compensation cost should be recognised by the company whose employees receive the option

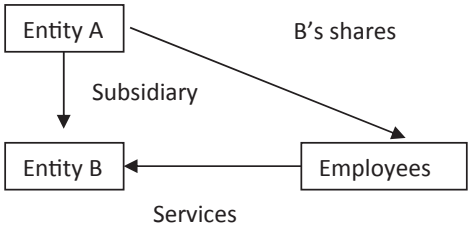
A share-based payment transaction is classified from the perspective of each reporting entity rather than by making a single classification determination at the consolidated financial statements of the group. Classification of the share-based payment transaction depends on the nature of the award granted and whether the entity has an obligation to settle the transaction. If the entity has either an obligation to settle in its own equity instruments or no obligation to settle at all, then the transaction is accounted as equity settled. A settling entity, that is not the receiving entity, classifies a share-based payment transaction as equity-settled if it settles it in its own equity instruments; otherwise, it classifies the transaction as cash-settled.

The following table summarises the classification principles:

Obligation to settle? \ Nature of the award	Own equity instruments	Cash or other assets
Yes	Equity-settled	Cash-settled
No	Equity-settled	Equity-settled

As per the above, a single share-based payment transaction could be classified as equity-settled in the financial statements of a subsidiary that receives the services and cash-settled in the group's consolidated financial statements, or vice versa.

The above requirements may be understood through the following example:
Entity A grants share based payment to the employees of subsidiary B. The payment will be settled in equity instruments of B.



The classification of this award in the separate financial statements of Entity A and Entity B, and the consolidated financial statements of Entity A will be as follows:

- Separate financial statements of Entity A: Since Entity A has an obligation to settle the share based payment award but not by issuing its own equity instruments, therefore, it will be classified as cash settled in the separate financial statements of Entity A. Entity A will not recognise any compensation cost. In case it does not push down the cost to Entity B, the debit should be to 'Investment in Subsidiary' on the logic that the amount is holding company's contribution to the capital of the subsidiary.
- Separate financial statements of Entity B: Since Entity B does not have an obligation to settle the share-based payment award, it classifies it as equity settled in its financial statements. Thus, the related compensation cost will be recognised by Entity B even though it does not have the obligation to issue shares. Entity A may or may not push down/ recharge the compensation cost to Entity B. In case there is no recharge by Entity A, it is appropriate that the corresponding credit in such a situation by Entity B is to an account head that represents the fact that in substance, the parent is making a kind of contribution of capital which is not accompanied by a further issue of shares of the subsidiary to the parent. Accordingly, the credit may be to capital reserve.
- Consolidated financial statement of Entity A: Since Entity A has an obligation to settle the share based payment transaction in equity shares of the group, it classifies the transaction as an equity settled in its consolidated financial statements.

ESOP plans are quite often administered through a trust set up for this purpose. A plan sponsor may transfer or sell sufficient shares to enable a trust to meet obligations under share-based payment arrangements not only for current periods but also for future periods.

Re-charge arrangement between parent and subsidiary for awards granted by parent to subsidiary's employee

Neither Guidance Note nor Ind AS 102 provides guidance for accounting of re-charge arrangement between parent entity and subsidiary entity for share-based payment to employees of subsidiary

entity by parent entity for the separate financial statements of subsidiary. As appropriate approach seems to be to ascertain if there is a clear link between the recharge and the share-based payment. Clear link is considered to be established if recharge value is also measured pursuant to intrinsic value/fair value of share-based awards irrespective of the date of measurement of such re-charge liability (i.e. either grant date, vesting date or exercise date). If clear link exists, recharge is offset against the capital contribution for share-based payment in the separate financial statement of subsidiary. However, if clear link is not established, re-charge is accounted for either as distribution by subsidiary or expenses like any other management charge. Guidance from ICAI will be helpful to ensure consistency in accounting for re-charge arrangements.

Plan administered through trust

ESOP plans are quite often administered through a trust set up for this purpose. A plan sponsor may transfer or sell sufficient shares to enable a trust to meet obligations under share-based payment arrangements not only for current periods but also for future periods.

In case of share-based awards administered through a trust, the erstwhile SEBI Employee Stock Option Scheme (ESOS) and Employee Stock Purchase Scheme (ESPS) Guidelines, 1999 required the accounts of the listed company to be prepared as if the company itself is administering the awards. This was also considered by the Expert Advisory Committee of the ICAI in one of its opinion basis which the trust was considered as an extension of the company. Thus listed companies in India were required to incorporate the transactions of trust in the separate and thereby consolidated financial statements.

The unlisted companies follow ICAI's Guidance Note which recommends that irrespective of the arrangement for issuance of the shares under the employee share-based payment plan, the enterprise should recognise in its separate financial statements the expense on account of services received from the employees in accordance with the recommendations contained in the Guidance Note. However, it does not permit other transactions of the trusts to be recognised in the separate financial statements of the company (unlike the erstwhile SEBI guidelines). Further,

it also prohibits consolidating such trust for consolidated financial statements of the company prepared in accordance with AS 21, '*Consolidated Financial Statements*'. In October 2014, SEBI issued revised guidelines for accounting of the employee stock option plan (ESOP), aligning its accounting treatment with the Guidance Note issued by ICAI.

Ind AS 102 does not provide any specific guidance for accounting of entity's shares held by employee share trust and funding arrangements between an entity and the trust. From the perspective of the entity's separate financial statements, there can be two views:

- Treat the trust as a branch/agent of the entity: Under this treatment, the accounting in the entity's separate financial statements is the same as the accounting in the consolidated financial statements.
- Account for the trust as a legal entity separate from the entity but as a subsidiary of the entity.

Accordingly, a clarification from ICAI for accounting for the transactions of the trust from the perspective of separate financial statements would be welcome. For the consolidated financial statements of the company administrating employees shared based payment through trust, share-based payment trust needs to be evaluated for consolidation on the parameters prescribed in Ind AS 110, '*Consolidated Financial Statements*'. ■