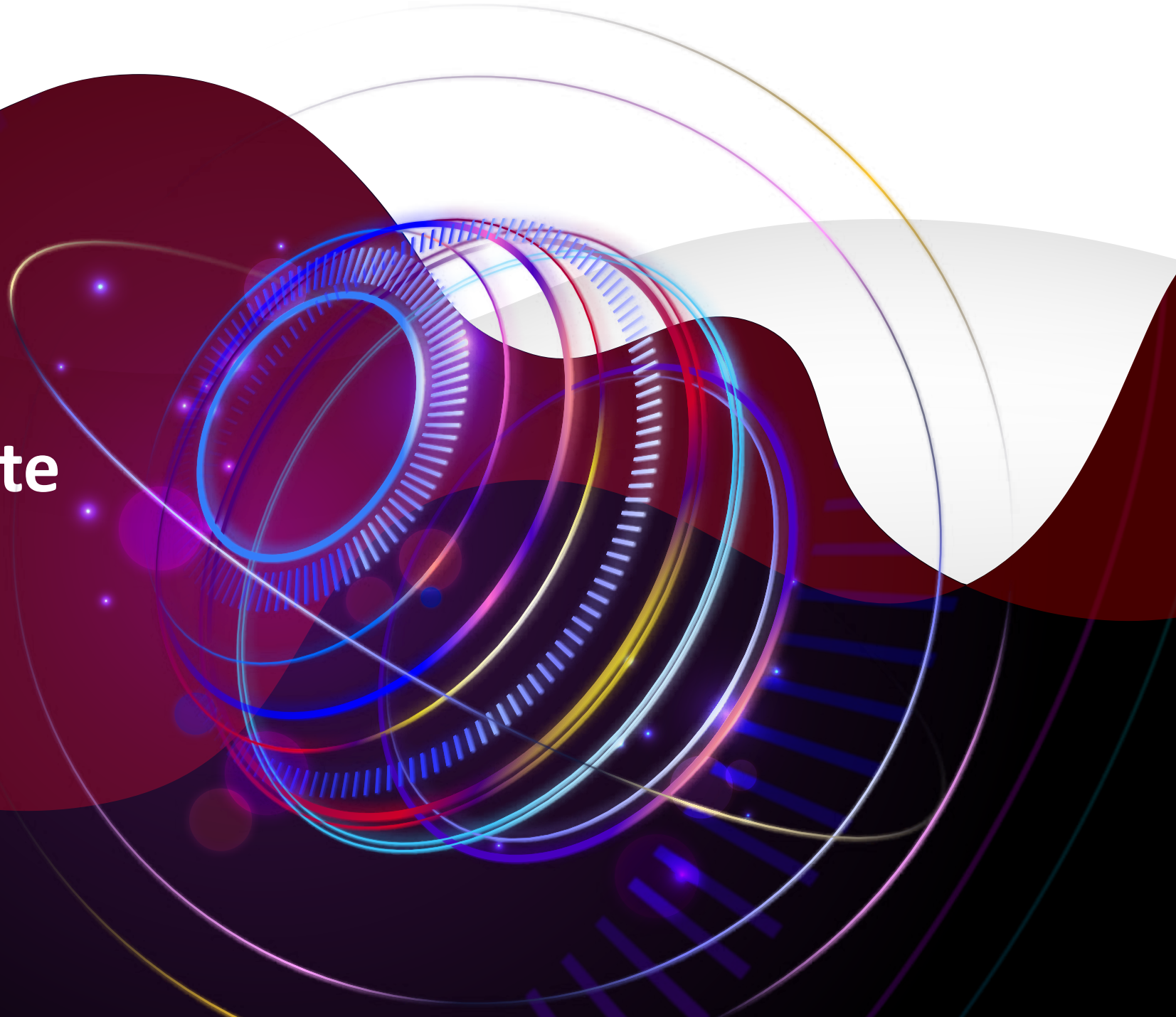


NANGIA & CO LLP
CHARTERED ACCOUNTANTS

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Foreword

We are pleased to present Assurance Gazette- January 2024 edition, featuring insights on the accounting treatment of share-based payments under IGAAP. In this edition, we meticulously explore the accounting intricacies of share-based payments, aiming to unravel the complexities surrounding these transactions. Additionally, the Gazette offers thorough coverage of the clarifications presented in the Exposure Draft related to the proposed amendments to IAS 32, IFRS 7, and IAS 1. These amendments are designed to address the challenges associated with classifying financial instruments that display characteristics of both debt and equity. The primary objective of these clarifications is to improve the precision of underlying classification principles, augment disclosures related to complex instruments, and specify presentation requirements for ordinary shareholders.

Decoding the Financial Landscape: Navigating Share-Based Transaction Accounting

Introduction

Share-based payments have emerged as a prevalent form of compensation, aligning employees' interests with those of the company's shareholders. These transactions involve granting equity or other financial instruments to employees or other entities in exchange for services rendered. However, navigating the accounting for share-based payment transactions is a complex endeavor that requires a meticulous understanding and adherence to relevant accounting standards.


Employee Stock Option Plans (ESOPs), Employee Stock Purchase Plans (ESPPs), and Stock Appreciation Rights (SARs) represent common structures of share-based payment arrangements.

Varieties of share-based transactions include:

- Equity- settled share-based payments:
- Cash-settled share-based payments;
- Transactions where either the enterprise or the supplier of goods or services can choose whether the transaction is to be equity- settled or cash-settled.

Before delving into a detailed discussion, it's crucial to understand several terms associated with share-based payments:

- 1. Share-based payment transaction:** is a transaction in which either the enterprise receive goods or services from supplier of those goods or services (including employee) in share-based arrangement or incurs an obligation to settle the transaction with the supplier in share-based arrangement if another group enterprise receives those goods or services.
- 2. Equity settled share-based payments:** either enterprises receive the goods or services for its own equity shares (including shares or share options) or receive the goods or services but has no obligation to settle the transaction with supplier.
- 3. Cash settled share-based payments:** where enterprises settle its obligations by transfer of cash or other assets to suppliers of goods and services.
- 4. Grant Date:** The date when the share-based payment arrangement is approved, establishing rights and obligations.
- 5. Vesting conditions:** means the conditions that determine the entitlement of receiving cash , other assets or equity instrument of the enterprise. A vesting conditions is either service condition or performance condition.
- 6. Vest:** means satisfying the vesting conditions and become entitle to receive cash, other assets and equity instruments of the enterprise.
- 7. Vesting period:** period in which vesting conditions are to be satisfied.

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8. **Exercise** is an application for issuance of equity instrument of enterprise against options vested.
 9. **Exercise Period** is the period after vesting period within which options should exercise.
 10. **Fair value:** value at which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.
 11. **Intrinsic value:** is the difference between fair value of shares and value that the counter party is required to pay for those shares.

Accounting treatment of share-based transactions:

Share-based payment plans can be accounted for using either the fair value method or intrinsic value method. An enterprise recognizes the expenditure for goods/services received in share-based arrangements when it gains control over the goods/services. This leads to a corresponding increase in equity for equity-settled transactions or a liability for cash-settled transactions.

A. Recognition and measurement under Fair value method:

1. Equity settled share-based transactions:

Enterprises measure goods/services received and increase equity at their fair value, unless this value cannot be reliably estimated. In such cases, the transaction is recognized at the fair value of granted equity instruments.

In case of Share-based transactions with parties other than employees, enterprise shall measure the fair value at the date when goods obtained, or services rendered by counterparty.

In case of Share-based transactions with employees, enterprise shall measure the fair value at the grant date.

Determination of fair value of equity instruments granted:

Fair value of equity instruments granted shall be measured based on market price of such shares if such price is available at measurement date. If market prices are not available, fair value shall be measured using valuation technique. The valuation technique shall be consistent with generally accepted valuation methodologies for pricing of financial instruments.

2. Cash settled shared-based transactions:

Enterprise shall measure the expenditure of goods or services received and liability incurred at fair value of liability. Until liability is settled, the enterprise shall remeasure the fair value of liability at the end of each reporting period and at the date of settlement. Such changes in fair value shall be recognised in profit and loss account for the period.

3. Shared-based transactions with choice of settlement:

Such arrangements have two components which includes a debt component (i.e. obligations to settle in cash) and equity component (i.e. obligations to settle in equity rather than cash). The enterprise shall account separately for the goods or services received in respect of each component of the share-based payment arrangement. For the debt component, the enterprise shall recognise the goods or services acquired, and a liability to pay for those goods or services, as the counterparty supplies goods or renders service. For the equity component (if any), the enterprise shall recognise the goods or services received, and an increase in equity, as the counterparty supplies goods or renders service. Fair value of equity component shall be measured as difference between the fair value of the goods or services received and fair value of the debt component at measurement date.

B. Recognition and measurement under intrinsic value method:

Share-based transactions can be accounted for under the intrinsic value method. For listed companies, intrinsic value is the amount by which the market price of underlying shares exceeds the option exercise price. For unlisted companies, share values are determined based on independent valuer reports.

C. Treatment of vesting and non-vesting conditions:

1. Vesting Conditions:

Vesting conditions other than market conditions are not taken into account for estimating the fair value of shares or share options at measurement date, however these conditions shall be taken into account for subsequent adjustment based on the best available estimate of numbers options that are expected to be vest at each reporting date and on vesting date, enterprise shall revise the estimate to equal the numbers options that ultimately vested.

2. Non-vesting Conditions:

Non-vesting conditions are taken into account for estimating the fair value of shares or share options at measurement date.

Disclosure Requirements:

IGAAP mandate comprehensive disclosures in financial statements regarding share-based payment transactions. This includes details on measurement methods, fair value assumptions, the impact on financial statements, and the effect on the company's financial position.

Nangia's Take

Accounting for share-based payments involves complexities that necessitate a deep understanding of accounting standards and valuation methodologies. Proper recognition, measurement, and disclosure are crucial to providing transparent and accurate financial information to stakeholders.

Exposure Draft on Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1

Introduction

Indian Accounting Standards (Ind AS) are based on the IFRS Standards issued by the International Accounting Standards Board (IASB) of IFRS Foundation. The IASB, before issuing the new/amendments to IFRS Standards, issues consultative documents [such as Discussion Paper (DP), Exposure Draft (ED) etc] seeking public comments from across the globe. The Accounting Standards Board (ASB) of ICAI with the aim to provide an opportunity to the various stakeholders in India to raise their concerns at the initial International Standard-setting stage itself, invites comments on the consultative documents issued by the IASB. Recently, the IASB has issued the **Exposure Draft on Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1**.

In view of challenges in classifying complex financial instruments that combine some characteristics of both debt—financial liabilities—and ordinary shares—equity instruments, the proposals in the Exposure Draft include:

1. **Clarification** of the underlying classification principles of IAS 32 to help companies distinguish between financial liabilities and equity;
2. **Disclosures** to further explain complexities around instruments that have both financial liability and equity characteristics; and
3. **Presentation requirements for amounts**—including profit and total comprehensive income—attributable to ordinary shareholders separately from amounts attributable to other holders of equity instruments.

Proposed Amendment to IAS 32, IFRS 7 and IAS 1

The IASB has proposed amendments to IAS 32 to clarify:

- a. The effects of relevant laws or regulations (such as statutory or regulatory requirements applicable to a financial instrument) on the classification of financial instruments.
- b. The 'fixed-for-fixed' condition in paragraph 16(b)(ii) of IAS 32 for classifying a derivative that will or may be settled in an issuer's own equity instruments.
- c. The requirements in paragraph 23 of IAS 32 for classifying financial instruments containing an obligation for an entity to purchase its own equity instruments.
- d. The requirements in paragraphs 25 and 28 of IAS 32 for classifying financial instruments with contingent settlement provisions.
- e. The effect of shareholder discretion on the classification of financial instruments; and
- f. The circumstances in which a financial instrument (or a component of it) is reclassified as a financial liability or an equity instrument after initial recognition

The IASB has proposed amendments to the objective and scope of IFRS 7 Financial Instruments: Disclosures and other amendments to the Standard to improve the information disclosed about:

- a. The nature and priority of claims against an entity arising from financial liabilities and equity instruments within the scope of IAS 32.
- b. The terms and conditions of financial instruments, including those with both financial liability and equity characteristics.
- c. Compound financial instruments.
- d. The potential dilution of ordinary shares.
- e. Reclassifications of financial liabilities and equity instruments.
- f. Instruments containing obligations to purchase an entity's own equity instruments; and
- g. Financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in the entity's net assets.

The IASB has also proposed amendments to IAS 1 Presentation of Financial Statements to require an entity to present additional information about amounts attributable to ordinary shareholders. These proposed amendments affect an entity's statement of financial position, statement(s) of financial performance and statement of changes in equity.

Conclusion

The ASB has invited public comments on the Exposure Draft until February 10, 2024, providing an opportunity for stakeholders to express concerns during the standard-setting stage.

Nangia's Take

The International Accounting Standards Board (IASB) stands as a beacon in the global financial landscape, tirelessly working to ensure the transparency and reliability of accounting standards. In its pursuit of excellence, the IASB recognizes the invaluable perspectives that diverse stakeholders bring to the table. As part of this commitment to inclusivity, the IASB has extended an invitation to the public at large to actively participate in shaping the future of accounting standards. We believe that these clarifications are important on this complex subject.

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