Share based payments

Definition of share-based payment

A share-based payment is a transaction in which the entity receives goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity. The accounting requirements for the share-based payment depend on how the transaction will be settled, that is, by the issuance of (a) equity, (b) cash, or (c) equity or cash.

- IFRS 2 *Share-based Payment* requires an entity to recognize share-based payment transactions (such as granted shares, share options, or share appreciation rights) in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. Specific requirements are included for equity-settled and cash-settled share-based payment transactions, as well as those where the entity or supplier has a choice of cash or equity instruments.

- IFRS 2 was originally issued in February 2004 and first applied to annual periods beginning on or after 1 January 2005.

Recognition and measurement

- The issuance of shares or rights to shares requires an increase in a component of equity.
- IFRS 2 requires the offsetting debit entry to be expensed when the payment for goods or services does not represent an asset.
- The expense should be recognised as the goods or services are consumed.
- For example, the issuance of shares or rights to shares to purchase inventory would be presented as an increase in inventory and would be expensed only once the inventory is sold or impaired.

Measurement guidance

Depending on the type of share-based payment, fair value may be determined by the value of the shares or rights to shares given up, or by the value of the goods or services received:

- **General fair value measurement principle.** In principle, transactions in which goods or services are received as consideration for equity instruments of the entity should be measured at the fair value of the goods or services received. Only if the fair value of the goods or services cannot be measured reliably would the fair value of the equity instruments granted be used.

Measurement guidance

- **Measuring employee share options.** For transactions with employees and others providing similar services, the entity is required to measure the fair value of the equity instruments granted, because it is typically not possible to estimate reliably the fair value of employee services received.

Measurement guidance

- **When to measure fair value - options.** For transactions measured at the fair value of the equity instruments granted (such as transactions with employees), fair value should be estimated at grant date.

Measurement guidance

- **When to measure fair value - goods and services.** For transactions measured at the fair value of the goods or services received, fair value should be estimated at the date of receipt of those goods or services.

IAS 37 — Provisions, Contingent Liabilities and Contingent Assets

- **Provision:** a liability of uncertain timing or amount.
- **Liability:** present obligation as a result of past events

settlement is expected to result in an outflow of resources (payment)

- **Contingent liability:**

❖ a possible obligation depending on whether some uncertain future event occurs, or

❖ a present obligation but payment is not probable or the amount cannot be measured reliably

- **Contingent asset:**
  - a possible asset that arises from past events, and
  - whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

The objective of IAS 37

- Is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

- The key principle established by the Standard is that a provision should be recognised only when there is a liability

Recognition of a provision

- An entity must recognize a provision if, and only if: [IAS 37.14]

A present obligation (legal or constructive) A constructive obligation arises if past practice creates a valid expectation on the part of a third party, for example, a retail store that has a long-standing policy of allowing customers to return merchandise within, say, a 30-day period has arisen as a result of a past event (the obligating event),

An obligating event is an event that creates a legal or constructive obligation and, therefore, results in an entity having no realistic alternative but to settle the obligation.

- payment is probable ('more likely than not'), and
- The amount can be estimated reliably.

Recognition of contingent liability

- Since there is common ground as regards liabilities that are uncertain, IAS 37 also deals with contingencies. It requires that entities should not recognise contingent liabilities – but should disclose them, unless the possibility of an outflow of economic resources is remote.
- For example, if a parent guarantees a daughter's first car loan, the parent has a contingent liability. If the daughter makes her car payments and pays off the loan, the parent will have no liability. If the daughter fails to make the payments, the parent will have a liability.

Recognition of contingent Assets

- Contingent assets should not be recognised – but should be disclosed where an inflow of economic benefits is probable.
- An example of a contingent gain and contingent asset might be a lawsuit filed by Company A against Company B for infringement of Company A's patent. If it is probable that Company A will win the lawsuit and receive an estimated amount of money, it has a contingent asset and a contingent gain.