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# Ind As 102 - Share Based Payment & Ind As 103 - Business Combination

The objective of Ind AS 102 is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

On 4 November 2020, ICAI issued two Guidance Notes (GN) formulated by the Research Committee. The GN is applicable to companies following accounting standards (AS) under the Companies (Accounting Standards) Rules, 2006, as amended under Section 133 of Companies Act, 2013. Entities following Ind AS are required to continue to follow Ind AS 102. The GN is applicable for plans with a grant date on or after 1 April 2021. Companies are not required to apply this GN to share-based payment to equity instruments that are not fully vested as of April 1, 2021.

Although the aim of the guidance note is to align with Ind AS 102, the guidance note only recommends the measurement of the cost of the share-based payment using the fair value method and continues to permit to account for the cost using the intrinsic value of options.

Important changes in the GN would likely have an impact on the measurement. These are:
It is no longer permitted to consider zero historical volatility in case of determining the fair value of an instrument involving an unlisted company. The guidance note now issued also mandates that in case of graded vesting (e.g. 25% shares over 4 years), each grant would be considered to be a separate award such that effectively there will be front-ending of costs in the P&L in earlier years.

**Question1:**

Which share-based payment arrangements are within the scope of Ind AS 102?

**Answer1:**

Ind AS 102 should be applied to every share-based payment arrangement. Identifying arrangements that fall within or outside of the scope of Ind AS 102 becomes more complex when:

- There is judgment involved in determining whether or not the associated contract for the purchase of goods/service is subject to Ind AS 32/Ind AS 109 (and represents a financial instrument),
- Equity instruments are issued in a business combination in exchange for both control of the acquiree entity and post-combination employee services, and
- Equity instruments are issued to employees of another entity within the group. Ind AS 102 contains the relevant guidance to be applied.

**Question 2:**

Are there any specific exclusions?

**Answer 2:**

Yes. Certain specific exclusions are:

- Shares issued to an employee in his/her capacity as a shareholder (e.g. right issue of shares to all shareholders, including employees who are shareholders),
- Shares issued in a business combination in exchange for control of the acquiree entity, and
- Shares issued for goods other than those needed to be used in the business and/or arrangements entered into for speculative purposes.

Share-based payments in a business combination Ind AS 103, 'Business combinations', provides guidance to determine accounting for replacement share awards issued in a business combination. The key issue is whether such awards should form part of the consideration for a business combination and therefore be included in the calculation of goodwill or whether they should be accounted for as an expense for post-combination services. Is it a share-based payment if an acquirer makes a grant in connection with a business combination? It depends on what the acquirer receives in return for the share-based awards:

- If the acquirer receives control of the acquired entity, the arrangement is excluded from the scope of Ind AS 102. Ind AS 103 requires the acquirer to measure the shares at their fair value on the date of exchange.

If the acquirer issues awards to employees in return for post-combination employee services (e.g. to encourage them to continue working for the acquiree after acquisition), Ind AS 102 applies. In practice, it may be difficult to determine whether the shares have been issued in return for control of the acquired entity (Ind AS 103) or for future employee service (Ind AS 102). Often, such grants are a mixture of both types, i.e. for acquiring control and for post-combination services, which means that both Ind AS 103 and Ind AS 102 will apply. Accordingly, in such situations, a portion of the fair value of the awards will be included in business combination accounting and the remaining portion will be considered for recognising employee share-based payment expense in the postcombination period. Typically, where the grant is made to employees of the acquired entity in their capacity as shareholders, it forms part of the cost of the business combination and falls outside the scope of Ind AS 102. On the other hand, in cases where the grant requires the provision of post-combination services, Ind AS 102 applies. It is also important to note that the cancellation, replacement or modification of existing share-based payment arrangements as result of a business combination should be accounted for under Ind AS 102.

**Different types of share-based payment:**

| Equity-settled sharebased payments | Cash-settled sharebased payments | Choice of settlement |
|---|---|---|
| Transactions in which the entity (a) receives goods or services as consideration for its own equity instruments (including shares or share options), or (b) receives goods or services but has no obligation to settle the transaction with the supplier The issue of options to employees that give them the right to purchase the entity's shares at a discounted price in exchange for their services is one of the examples of equity-settled share-based payments. | Transactions in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity Share appreciation rights that entitle employees to cash payments based on the increase in the employer entity's share price are one of the examples of cash-settled share-based payments. | Transactions in which the entity receives or acquires goods or services, and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments. |

**What is the appropriate accounting treatment for vesting conditions?**

The following table summarises the implications of various vesting and non-vesting conditions in accounting for share-based payments. This is often a complex area requiring careful analysis of the key terms of the plan, especially when there are conditions other than the straightforward service vesting condition.

| | Vesting conditions | | | Non-vesting conditions | | |
|---|---|---|---|---|---|---|
| | Service Conditions | Performance conditions | | | | |
| | | Performance conditions that are market conditions | Other performance conditions | Neither the entity nor the counterparty can choose whether the condition is met | Paying contributions towards the exercise price of a share-based payment | Continuation of the plan by the entity |
| **Example Conditions** | Requirement to remain in service for three years | Target based on the market price of the entity's equity instruments | Initial public offering with a specified service requirement | Employee will receive shares if a commodity index increases by a minimum percentage. (E.g. 50%) | Paying contributions towards the exercise price of a share-based payment | Continuation of the plan by the entity |
| **Include in grant value date fair value?** | **No** | **Yes** | **No** | **Yes** | **Yes** | **Yes*** |
| **Accounting treatment if the condition is not met after the grant date and during the vesting period** | **Forfeiture.** The entity revises the expense to reflect the best available estimate of the number of equity instruments expected to vest. | **No change to accounting.** The entity continues to recognise the expense over the remainder of the vesting period. | **Forfeiture.** The entity revises the expense to reflect the best available estimate of the number of equity instruments expected to vest | **No change to accounting.** The entity continues to recognise the expense over the remainder of the vesting period | **Cancellation.** The entity recognises immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period. | **Cancellation.** The entity recognises immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period. |

***In the calculation of the fair value of the share-based payment, the probability of continuation of the plan by the entity is assumed to be 100%**

The coronavirus outbreak may significantly impact how employees of the entity are remunerated. The outbreak will also affect various estimates and actuarial assumptions that the management has been making in measurement of employee benefit obligations. For instance, there may be an impact on discount rate used to discount employee benefit obligations and future salary growth rates may no longer hold good. Entities considering layoffs might have to provide for termination benefits if they are committed to a restructuring plan on the reporting date or can no longer withdraw benefits of those offers. Entities may also have to modify their existing employee stock option plans ("ESOP") to ensure that employees are fairly compensated for the decrease in share prices.

**Question 3:**

An entity has rolled out an employee stock option plan (ESOP). Vesting conditions of ESOP include that an employee should be in employment as on 31 March 2020 and share price of the entity should achieve a certain growth as on 31 March 2020. Due to significant volatility, share price of the entity has come down and no shares are expected to vest. How should the entity account for it?

**Answer**

Ind AS 102 Share-based Payment requires that market conditions upon which vesting (or exercisability) is conditioned should be taken into account when estimating the fair value of the equity instruments granted. For grants of equity instruments with market conditions, the entity is required to recognize the goods or services received from a counterparty who satisfies all other vesting conditions, irrespective of whether the market condition is satisfied. Accordingly, subsequent accounting of the option will not change whether or not share price targets are achieved. This is because possibility of non-achievement of the share price target has already been captured in grant date fair value of the option. The entity should account for expenses in the current period based on the number of employees who have satisfied service conditions (along with other vesting conditions, if any).

**Question 4:**

Due to significant decrease in share price of the entity, it has reduced exercise price of its ESOP. How should this modification be accounted for?

**Answer**

As the entity has reduced exercise price of the option, it will result in increase in fair value of the equity instruments granted. The entity should include the incremental fair value granted (difference between fair value, as on the modification date, of the modified equity instrument and that of the original equity instrument) in the measurement of the amount recognized for services received over the remaining vesting period. Had such modifications increased the exercise price or otherwise reduced fair value of the option granted, the entity would have continued accounting for ESOP without taking into account such modification.

**Question 5:**

An entity has a number of equity settled share-based payment schemes for its employee across different categories. During last financial year i.e. 2018-19, the entity had granted equity shares to senior management which will vest on April 30, 2021, and one of the conditions for final eligibility of equity shares is based on target market price of the entity's share by the end of the financial year 2020-21 i.e. March 31, 2021.

Considering the current scenario affected by global pandemic, the entity expects to experience a severe depressed economic environment in its business sector and substantial decline in its financial performance and cash flows over next two years and, therefore, consequential decline in the market price of its equity shares. As of March 31, 2020, the share price of the entity's equity share is much below the target price required under the employees' share-based payment scheme. How should the entity consider this development in the accounting for its equity settled share-based payments for the current financial year 2019-20?

**Answer**

Equity settled share-based payments are subject to the accounting requirements of Ind AS 102 Share-based Payments. The eligibility condition of the scheme mentioned above i.e. condition of the equity shares of the entity reaching a target price at the financial year March 31, 2021, is part of a vesting condition which is market condition as defined in Appendix A of Ind AS 102.

According to paragraph 21 of Ind AS 102, Market Conditions such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. The standard further states that the entity shall continue to recognise the services received, provided other vesting conditions are satisfied, irrespective of whether the market condition is satisfied at each reporting date.

It may also be noted that the fair value of the shares granted is determined at the grant date and it is not revised subsequently. Therefore, neither increases nor decreases in the fair value of the equity instruments after grant date affect the equity share based payment cost recognised by the entity (other than in the context of measuring the incremental fair value transferred if a grant of equity instruments is subsequently modified).

In summary, entities having significant share-based payment arrangements are likely to report higher expense upon the adoption of Ind AS 102.

**Key GAAP differences**

What are the key differences from Indian GAAP?

Under Indian GAAP, an entity could have used the intrinsic value method or the fair value method of accounting. However, Ind AS requires all types of share-based payments and transactions to be measured at fair value and recognised over the vesting period. Further, costs with respect to awards granted with graded vesting will have to be recognised on an accelerated basis under Ind AS, which could have been recognised on a straight-line basis under Indian GAAP.

**To conclude:**

The entity shall recognise an amount for services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates, based on the fair value determined at the grant date.

However, companies with share-based payments whose vesting depends on achieving non-market performance conditions – e.g. earnings per share targets – may need to revise their estimate of the number of instruments expected to vest, which would impact the charge in the profit and loss account over the remaining vesting period.

## Ind AS 103 – Business Combination

Ind AS 103 provides guidance on accounting for business combinations under the acquisition method (acquisition accounting), with limited exceptions. A business combination is a transaction or other event in which an acquirer obtains control of one or more business.


**Business Combination**- A transaction or other event in which an acquirer obtains control of one or more businesses.

**Business** - "an integrated set of activities and assets conducted and managed for providing….return to investor or economic benefit to stakeholders….generally consists of inputs and processes applied to those inputs, and resulting in outputs that are, or will be used to generate revenues".

The acquirer in a business combination can elect, on a transaction-by-transaction basis, to measure 'ordinary' Non-Controlling Interest (NCI) at fair value, or at their proportionate interest in the net assets of the acquiree, at the date of acquisition. All other components of NCI (such as equity components of convertible bonds and options under share-based payments arrangements) shall be measured at fair value or in accordance with other relevant Ind ASs.

Goodwill is recognized at the date of acquisition, measured as a residual. Goodwill previously recorded by the acquiree is not recorded as a separate asset by the acquirer. When the residual is a deficit (gain on a bargain purchase), it is recognized in other comprehensive income and accumulated in equity as capital reserve after reassessing the values used in the acquisition accounting.

## Acquisition Date –Some issues

- Agreement entered into on 23rd May but it may provide that date of control effective from 1st April
- Agreement provides that effective date of transfer is 1st April but it is subject to shareholder approval on 1st May
- Shares are acquired on April 1 but the same need to be registered with regulators. They are registered on 1st June
- Public offer for purchase of 75% shares made, 51% shares received on 23rd May and offer closes on 31st May

## Date of Exchange V/S Acquisition Date

- Date of exchange is date of each exchange transaction whereas acquisition date is date of obtaining control of acquiree.
- Valuation is based on date of exchange but all the components that existed at the date of acquisition are recognised.

## Measurement Period

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized and additional assets and liabilities that existed at the acquisition date to reflect new information obtained.

The measurement period ends as soon as the acquirer receives the information it was seeking or learns that more information is not obtainable.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

| AS 14 | IND AS 103 |
|---|---|
| There are 2 methods of accounting:<br>1) Pooling of Interest Method and<br>2) Purchase Method | Prescribes only **acquisition method,** which is an extension of purchase method. |
| Does not deal with reverse acquisitions | Deals with reverse acquisitions |
| Goodwill arising on amalgamation in the nature of purchase has to be amortised over a period of max. 5 years | Goodwill is not amortised but tested for impairment on annual basis in accordance with IND AS 36 on impairment of assets |
| Deals only with mergers and amalgamations | Defines business combination, which has a wider scope |
| The acquired assets and liabilities are recognised at their existing book values or at fair values under the purchase method. | The acquired identifiable assets, liabilities and non-controlling interest to be recognised at fair value under acquisition method. |
| Does not provide specific guidance on this aspect. | The consideration includes any asset or liability resulting from a contingent consideration arrangement. |
| On other hand, the existing AS 21 states that the minority interest is the amount of equity attributable to minorities at the date on which investment in a subsidiary is made. | For each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. |
| There is no specific guidance on acquisition related costs. | Acquisition related costs to be charged to the statement of Profit and loss. Costs to issue debt or equity securities shall be recognised in accordance with IND AS 32 and 109. |

## Differences from IFRS

IFRS requires that for each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

AS 14 requires that the goodwill arising on amalgamation in the nature of purchase is amortised over a period not exceeding five years.

IFRS deals with reverse acquisitions whereas the existing AS 14 does not deal with the same.
As per IFRS, the consideration includes any asset or liability resulting from a contingent consideration arrangement. No guidance in AS 14. IFRS gives guidance on Preexisting relationships on which AS-14 is silent.

IFRS 3 requires a bargain purchase gain on business combination to be recognized in profit or loss for the period. However, Ind-AS 103 requires the same to be recognized in OCI and accumulated in equity as capital reserve. However, if there is no clear evidence of bargain purchase, companies will recognize the gain directly in equity as capital reserve, without routing the same through OCI.

## To conclude:

IFRS 3 Business Combinations excludes common control business combinations from its scope. However, Ind-AS requires such combinations to be accounted using the pooling of interest method.