Learning Module 8: Topics in Long-Term Liabilities and Equity

LOS 8a: explain the financial reporting of leases from the perspectives of the lessors and lessees

A lease is a contract between a lessor, the owner of an asset, and a lessee, the other party seeking to use the asset. Through a lease, the lessor grants the lessee the right to use the asset. In exchange for the right to use the asset, the lessee makes periodic lease payments to the lessor.

For a contract to contain a lease or be a lease, it must:

1. Have a specific underlying asset.
2. Give the customer the ability to stipulate for what purpose and how the underlying asset is used.
3. Give the customer the right to derive all economic benefits from the asset over the term of the contract.

Advantages of leasing an asset

- Leases can provide less costly financing for the lessee than purchases. They usually require little, if any, down payment and often go at lower fixed interest rates than those that would otherwise be incurred if the asset was purchased.
- The lessor may be better positioned to take advantage of tax benefits of ownership, such as depreciation and interest.
- The lessor enhances their ability to value and bear the risks associated with ownership, such as obsolescence, residual value, and disposition of an asset.
- The lessor may enjoy economies of scale for servicing assets.
- A negotiated lease contract may contain less restrictive provisions than other forms of borrowing.

Lessee's Perspective

A finance (or capital) lease is equivalent to a lessee's purchase of an asset directly financed by the lessor. On the other hand, an operating lease is an agreement that allows a lessee to use an asset for a period of time.

The economic substance of a finance lease is very different from that of an operating lease. Each type of lease also carries implications for financial statements for both the lessee and the lessor.

Finance Lease vs. Operating Lease

Under IFRS, the classification of a lease, either as a finance lease or an operating lease, is dependent on the transfer of the risks and rewards that are incidental to ownership of the leased asset.

If all the risks and rewards are substantially transferred to the lessee, the lease is classified as a **finance lease**, and the lessee will report the leased asset and lease obligation on its balance sheet. Otherwise, the lease will be reported as an **operating lease**, in which case the lessee reports neither an asset nor a liability but only reports the lease expense.

Finance Lease

A finance lease is economically similar to **borrowing money and buying an asset**. As a result, a company that enters into a finance lease, as the lessee, reports the leased asset and related debt (lease payable) on its balance sheet. On the income statement, the lessee reports interest expense on the debt, and if the acquired asset is depreciable, depreciation expense is also reported. The lessor will report the sale of an asset and a lease as a receivable.

For a finance lease, only the portion of the lease payment relating to interest expense potentially reduces the operating cash flow. The portion of the lease payment that reduces the lease liability appears as a cash outflow in the financing section.

Operating Lease

An operating lease is economically similar to **renting an asset**. As a result, a company that enters into an operating lease, as the lessee, will record a lease expense on its income statement during the period within which it uses the asset. No asset or liability will be recorded on its balance sheet. The lease payment is shown as an operating cash outflow on the lessees' statement of cash flows.

How Does This Affect Financial Statements?

A company reporting a lease as an **operating lease** will typically show **higher profits** in the early years and a **more robust solvency than a company reporting** a similar lease as a finance lease.

However, the company reporting the lease as a finance lease will show **higher operating cash flows** because the portion of the lease payment that reduces the carrying amount of the lease liability will be reflected as a financing cash outflow rather than an operating cash outflow.

In a finance lease, a lessee reports the leased asset and corresponding liability on their balance sheet. This scenario leads to higher reported assets and debt. The lessee will also recognize both depreciation and interest expenses, which could result in higher expenses in the early years of the lease.

In contrast, with an operating lease, lessees traditionally did not report the leased asset and liability on their balance sheet. They only recognized the lease payments as an expense evenly over the lease term, which could lead to lower reported assets, liabilities, and expenses especially in the early years of the lease. This accounting treatment distinction is why lessees might prefer operating leases, as they may result in more favorable financial ratios and appear less burdensome on the balance sheet and income statement, particularly in the early lease years.

However, note that recent updates to accounting standards, specifically IFRS 16 and ASC 842, now require the recognition of assets and liabilities for operating leases, altering this traditional distinction.

IFRS vs. US GAAP

IFRS and US GAAP stipulate that appropriate disclosures concerning operating and finance leases should be made. Due to the differences between these types of leases, however, some of the disclosure requirements are dissimilar.

In the case of finance leases, IFRS requires the balance sheet to present finance lease obligations in the line items labeled “Debt.”

IFRS also requires certain disclosures to be made in the notes. However, the layout of disclosure notes on the debt will vary across companies. Usually, the notes provide:

- A breakdown of the total debt reported on the balance sheet into two components: the amount of debt excluding finance lease obligations and the amount of finance lease obligations;
- Disclosures on the component of on-balance-sheet debt, excluding finance lease obligations and
- Information about all the lease obligations of a company, both finance and operating leases, including the present and future value of minimum finance lease payments.

Even though operating and finance leases are contractual obligations, only finance leases are reported on the balance sheet.

For operating leases, the disclosure notes will provide information on the commitments due to operating lease contracts, i.e., the nominal value of the future minimum payments and their maturity dates.

Lessors Perspective

If the lessor substantially transfers all the risks and rewards incidental to legal ownership, the lease is reported as a finance lease. Consequently, the lessor reports a lease receivable on its balance sheet and removes the leased asset from its balance sheet. Otherwise, if the lease is reported as an operating lease, the lessor keeps the leased asset on its balance sheet.

Both IFRS and US GAAP stipulate that appropriate disclosures concerning operating and finance leases should be made. Due to the differences between these types of leases, however, some of the disclosure requirements are dissimilar.

Lessor			
Operating Lease	Retains assets on the balance sheet.	Reports rent income reports depreciation expense on the leased asset.	Rent payments received are an operating cash inflow.
When the present value of lease payments equals the carrying amount of the leased asset (called a direct financing lease in US GAAP).	Removes assets from the balance sheet and recognizes lease receivables.	Reports interest revenue on lease receivables.	The interest portion of the lease payment received is either an operating or an investing cash inflow under IFRS and an operating cash inflow under US GAAP. The receipt of the lease principal is an investing cash inflow.
When the present value of lease payments exceeds the carrying amount of the leased asset (called a sales-type lease under US GAAP).	Removes assets and recognizes lease receivables.	Reports profit on sale and reports interest revenue on lease receivables.	The interest portion of the lease payment received is either an operating or an investing cash inflow under IFRS and an operating cash inflow under US GAAP. The receipt of the lease principal is an investing cash inflow.

a. US GAAP distinguishes between a direct financing lease and a sales-type lease, but IFRS does not. The accounting is the same for IFRS and US GAAP despite this additional classification under US GAAP.

b. If providing leases is part of a company's regular business activity, the cash flows related to the leases are classified as operating cash.

Question #1

Under an operating lease contract, a lessor would *most likely*:

A. Keep ownership of the asset and report the asset's depreciation.
B. Keep ownership of the asset, but the lessee must report the asset's depreciation.
C. Transfer ownership of the asset to the lessee but revoke ownership transfer if the lessee does not fulfill its contractual obligations.

Solution

The correct answer is A.

In an operating lease agreement, the lessor retains ownership of the leased asset and is responsible for any depreciation on the asset. The lessee simply uses the asset for a specified period, and at the end of the lease term, the asset is returned to the lessor. The lessee does not report depreciation for the asset; instead, they account for the lease payments as an operating expense over the lease term.

Question #2

Which of the following statements is the *most* accurate?

A. A finance lease is economically similar to renting an asset.
B. In a finance lease, the lessee reports a leased asset and lease obligation on its balance sheet.
C. An operating lease is equivalent to a lessee's purchase of an asset directly financed by the lessor.

Solution

The correct answer is B.

In a finance lease, the lessee recognizes the right-of-use asset and the corresponding lease liability on its balance sheet. This accounting treatment reflects the economic reality that the lessee has control over the asset and is obligated to make lease payments.

A is incorrect because a finance lease is more similar economically to purchasing an asset than renting, as the lessee assumes both the benefits and risks of ownership.

C is incorrect because an operating lease does not equate to an asset purchase by the lessee. The lessor retains ownership of the asset in an operating lease, and the lessee does not record the asset on its balance sheet (under traditional operating lease accounting).

LOS 8b: explain the financial reporting of defined contribution, defined benefit, and stock-based compensation plans

Employee Compensation

Employee compensation packages are structured to achieve various objectives, including meeting employees' liquidity needs, retaining them, and motivating their performance. Common components of employee compensation include salary, bonuses, health, and life insurance premiums, defined contribution and benefit pension plans and share-based compensation.

Salary addresses employees' liquidity needs. Bonuses, typically paid in cash, link pay to performance, motivating and rewarding employees for achieving short or long-term goals. Non-monetary benefits, such as health and life insurance, housing, and vehicles, facilitate employees' job performance. Salary, bonuses, and non-monetary benefits generally vest (i.e., employees earn the right to the consideration) immediately or shortly after they are granted.

For financial reporting, a company records compensation expenses on the income statement in the period when the compensation vests. Immediate or short-term vesting simplifies the accounting for salary, most non-monetary benefits, and bonuses. When an employee earns the salary or bonus, an expense is recorded at the fair value of the compensation, and a cash outflow or accrued compensation liability (a current liability) is recognized. Expenses and cash outflows for short-term compensation are often well-matched.

Deferred Compensation

While salaries,bonuses, and non-monetary benefits tend to vest immediately, deferred compensation vests over time, providing employees with retirement savings and financial benefits and serving as a retention and alignment tool for employers.

Financial reporting for deferred compensation plans is more complex than for immediately vesting compensation due to measurement challenges and the time lag between employee service and cash outflows. Employees might earn compensation in the current period but receive it in the future, with the amount based on factors such as future salary or the employer's stock price, requiring management judgment and assumptions.

Pensions and other post-employment benefits are common types of deferred compensation. Two common pension plans are defined contribution and defined benefit plans.

Defined Contribution Plans

In a Defined Contribution (DC) pension plan, financial reporting is relatively straightforward. The employer's obligation is limited to the contributions it has agreed to make to the plan. In each period, the employer records an expense for the amount of its contribution to the employees' pension funds. Since the employer has no further obligations regarding the amount that will be available to employees upon retirement, there are no liabilities recorded on the balance sheet relating to the pension plan beyond any contributions that are due but have not yet been paid on the balance sheet date.

The contributions are generally reported as an operating expense in the employer's income statement. The exact line item can vary but is often included under “Employee Benefit Expenses” or a similar category. In terms of cash flow, these contributions are classified as operating activities, reflecting the cost of employing labor for the period. Unlike defined benefit plans, the employer does not need to make assumptions about future salary levels, years of service, or other actuarial assumptions, and there is no concern about underfunded or overfunded pension liabilities.

On the employee's side, the contributions made by the employer are added to the employee's pension fund assets, which are invested and will be used to provide retirement benefits to the employee. The employee typically has some choice regarding how the assets in their pension fund are invested and bears the investment risk, meaning the benefits received upon retirement depend on the investment performance of the pension fund assets. Comprehensive disclosures about the plan assets, including investment strategies and major categories of plan assets, are generally not required in the employer's financial statements under a defined contribution plan.

Defined Benefit Plans

Under a defined-benefit pension plan, a company promises future benefits to employees during retirement. For example, a company might promise employees annual pension payments equal to 50% of their final salary until death. To measure this obligation, the company must make several assumptions, such as the employee's expected salary at retirement and their life expectancy post-retirement. The company estimates these future payments and discounts them to present value using a discount rate equivalent to the yield on a high-quality corporate bond.

Most defined-benefit pension plans are funded through assets held in a separate legal entity, typically a pension trust fund. The company makes contributions to the fund, which are invested until needed to pay retirees. If the fair value of the plan's assets exceeds the present value of the estimated pension obligation, the plan has a surplus, and the company reports a net pension asset on its balance sheet. Conversely, if the present value of the estimated pension obligation is greater than the fair value of the plan's assets, the plan has a deficit, and the company reports a net pension liability on its balance sheet.

Defined-Benefit Plans Under IFRS

Under IFRS, alterations in the net pension asset or liability are categorized into three broad components. The first two, recognized as pension expenses on the income statement, are **employees' service costs and the net interest expense or income accrued on the initial net pension asset or liability**.

The service cost is the present value of the increase in the pension benefit an employee earns by providing an additional year of service, including any effects from plan changes, known as past service costs. Net interest expense or income represents the time-induced change in the present value of the net defined benefit pension asset or liability, calculated as the product of the net pension asset or liability and the discount rate.

The third component, "remeasurements," is recognized in other comprehensive income and includes actuarial gains and losses and the actual return on plan assets less any return included in the net interest expense or income. These remeasurements are not amortized into profit or loss over time.

Actuarial gains and losses emerge when changes occur in the assumptions used for estimating pension obligations, such as employee turnover, mortality rates, retirement ages, and compensation increases.

The actual return on plan assets, encompassing interest, dividends, and other income, including realized and unrealized gains or losses, generally differs from the amount recorded in net interest expense or income. This discrepancy arises as the actual return includes diverse asset classes, whereas the net interest calculation is based on a rate reflective of a high-quality corporate bond yield.

Defined-Benefit Plans Under US GAAP

Under US GAAP, variations in net pension asset or liability each period consist of five components, with some recognized immediately in profit and loss and others in other comprehensive income and subsequently amortized into profit and loss over time. The components acknowledged on the income statement in the period incurred include (I) **employees' service costs** for the period, (II) **interest expense accrued on the initial pension obligation**, and (III) **the expected return on plan assets**, which diminishes the recognized expense.

The remaining two components, (IV) **past service costs** and (V) **actuarial gains and losses**, follow a different accounting treatment. Past service costs are reported in other comprehensive income in the period they arise and later amortized into pension expense over the employees' future service period covered by the plan.

Similarly, actuarial gains and losses are initially recognized in other comprehensive income and then amortized over time into pension expense, permitting companies to “smooth” the impact on pension expense over time for these elements. Although US GAAP allows companies to recognize actuarial gains and losses in profit and loss instantly, this practice is not mandatory.

In terms of classification, pension expense on the income statement aligns with a functional basis similar to other employee compensation expenses. For manufacturing firms, pension expenses related to production employees augment inventory and are expensed through the cost of sales (cost of goods sold). For non-production employees, these expenses are recorded under selling, general, and administrative expenses. Despite its significance, pension expense is typically not directly reported on the income statement, and detailed disclosures are inclusively presented in the financial statement notes.

Share-Based Compensation

Share-based compensation is another type of deferred compensation that aims to align employees' interests with those of shareholders. Unlike pension plans, share-based compensation is typically concentrated among senior-level employees such as executives and directors.

Both IFRS and US GAAP require companies to disclose key elements of management compensation in their annual reports, with regulators possibly requiring additional details. These disclosures help analysts understand the nature and extent of compensation, including share-based payment arrangements during the reporting period.

For financial reporting, under both IFRS and US GAAP, companies estimate the fair value of share-based compensation at the grant date and recognize it as compensation expense over the vesting period. Changes in stock price after the grant date do not affect financial reporting. The specifics of financial reporting depend on the type of plan. Two common forms of equity-settled share-based compensation are stock grants and stock options.

Advantages and Disadvantages of Share-Based Compensation

Share-based compensation has the advantage of potentially requiring no cash outlay, as it aims to align employee interests with those of shareholders. However, it is treated as an expense and reduces earnings even when no cash is exchanged.

Share-based compensation has several drawbacks. Issuing shares to employees dilutes existing shareholders. Additionally, recipients may have limited control over the company's market value, meaning share-based compensation might not always incentivize the desired behavior and could improperly reward or penalize performance. For instance, increased ownership might lead managers to avoid risks, fearing a significant drop in market value and personal wealth, which could result in less profitable projects. Conversely, awarding stock options could lead to excessive risk-taking, as options have skewed payouts that reward the upside while limiting the downside to zero, prompting managers to pursue high-risk, high-reward investments.

Stock Grants

A company can grant stock to employees in several ways: outright, with restrictions, or contingent on performance.

- **Outright Stock Grants:** For outright stock grants, the company reports compensation expense based on the fair value of the stock on the grant date, typically the market value. This expense is spread over the period benefiting from the employee’s service, known as the service period. Unless specific conditions apply, such as requiring three years of future service before vesting, the service period is assumed to be the current period.

- **Restricted Stock Grants:** Restricted stock grants require employees to return the shares if certain conditions are not met, such as remaining with the company for a set period or achieving performance goals. The compensation expense for restricted stock grants is measured as the fair value of the shares at the grant date and is allocated over the employee’s service period.

- **Performance Shares:** These are shares granted contingent on meeting performance goals. The amount of the grant is typically based on performance measures other than stock price changes, such as accounting earnings or return on assets. This approach addresses employees' concerns about stock price volatility, but it may incentivize manipulating accounting numbers. The compensation expense equals the fair value of the shares at the grant date and is spread over the service period.

Stock Options

Similar to stock grants, the compensation expense related to option grants is reported at fair value under both IFRS and US GAAP. The fair value of these options must be estimated using an appropriate valuation model.

While the fair value of stock grants is usually based on the market value at the grant date and also adjusted for dividends before vesting, the fair value of option grants needs to be estimated. This is because employee stock options typically have features that differ from traded options, making market prices unsuitable for measurement. Choosing the right valuation model is critical in estimating fair value.

Common models include the Black-Scholes option pricing model and binomial models. Accounting standards do not mandate a specific model but require that the chosen method should:

1. Align with fair value measurement principles,
2. Be grounded in established financial economic theory,
3. Reflect all substantive characteristics of the award.

Once a valuation model is chosen, companies must determine the model's inputs, which typically include the exercise price, stock price volatility, estimated life of the option, estimated forfeiture rate, dividend yield, and the risk-free interest rate. Different assumptions combined with various valuation models can significantly affect the estimated fair value of employee stock options.

Accounting for Stock Options

In accounting for stock options, the value of options granted to employees as compensation must be expensed ratably over the period during which services are provided. Several key dates are involved in this process: the grant date, vesting date, exercise date, and expiration date.

- **Grant Date:** This is when the options are initially granted to employees. The service period, which is typically the time between the grant date and the vesting date, is when compensation expense is recognized. The grant date is also when the compensation expense is measured if the number of shares and the option price are known. If the value of the options depends on events occurring after the grant date, the compensation expense is measured when those events are known.

- **Vesting Date:** This is the date when employees can first exercise their stock options. Vesting can occur immediately or over a specified period. If the options vest immediately, the expense is recognized on the grant date. If the options vest after a specified service period, the compensation expense is allocated over that period. For options conditional on achieving performance or market conditions, the expense is recognized over the estimated service period.

- **Exercise Date:** This is when employees exercise their options and convert them into stock.

- **Expiration Date:** If the options are not exercised, they expire at a predetermined date, usually 5 or 10 years from the grant date.

When an option is exercised, the market price at that time is not considered. The expense is calculated based on the fair value at the grant date and is recognized over the vesting period.

The accounting for option exercise is akin to stock issuance. Upon exercise, the company increases its cash for the exercise price paid by the option holder and credits common stock for the par value of the issued stock. Additional paid-in capital is increased by the difference between the par value of the stock and the sum of the grant date fair value of the option and the cash received.

The main accounting requirements for stock options are:

1. Recognize compensation expenses based on the fair value of the option on the grant date. Since no cash is exchanged at the grant, the corresponding entry is additional paid-in capital.
2. Spread the grant date fair value as compensation expense over the vesting period.
3. upon exercise, increase equity by the grant date fair value of the options plus the cash received from the employee.

As the expense is recognized over the vesting period, it reduces retained earnings. The corresponding increase in paid-in capital ensures there is no net impact on total equity.

Other Types of Share-Based Compensation

Stock grants and stock options allow employees to gain ownership in the company. Other forms of share-based compensation, such as stock appreciation rights (SARs) or phantom stock, provide compensation based on changes in share value without requiring employees to hold the shares. As such, these are known as cash-settled share-based compensation.

SARs compensate employees based on the increase in the company's share price, motivating employees and aligning their interests with shareholders. Two additional advantages of SARs include:

- Limited risk aversion: Employees have limited downside risk and unlimited upside potential, similar to stock options.
- No dilution of shareholder ownership.

On the other hand, SARs are valued at fair value, and the compensation expense is spread over the employee's service period. Phantom share plans are similar but differ in that compensation is based on hypothetical stock performance rather than the company's actual stock.

Question 1

Which statement is *most likely* correct about the financial reporting of defined benefit pension plans under IFRS?

A. Actuarial gains and losses are recognized as pension expenses over time.
B. The service cost component includes interest income on plan assets.
C. The net pension asset or liability changes have three components recognized on the income statement.

Solution

The correct answer is C.

Under IFRS, the change in the net pension asset or liability each period is generally viewed as having three components, two of which (service costs and net interest expense or income) are recognized as pension expense on the income statement. The third component, remeasurements, is recognized in other comprehensive income and is not amortized into profit or loss over time.

A is incorrect because under IFRS, actuarial gains and losses (part of remeasurements) are recognized immediately in other comprehensive income, not recognized as pension expenses over time.

B is incorrect because the service cost component does not include interest income on plan assets. Instead, it represents the present value of the increase in pension benefits earned by employees during the current period, and it does not have a direct connection with the interest income on plan assets. The interest income on plan assets is part of the net interest on the net defined benefit liability (asset), which is another component separate from the service cost.

LOS 8c: describe the financial statement presentation of and disclosures relating to long-term liabilities and share-based compensation

Presentation and Disclosure of Leases

Both IFRS and US GAAP state that the purpose of lease disclosures is to provide financial statement users with information to evaluate the amount, timing, and uncertainty of cash flows related to leases.

On the balance sheet, the non-current assets section typically includes a "right of use" asset, while the non-current (long-term) liabilities section usually includes the lease liability. However, some companies might not have separate line items for leases due to the size of leased assets and obligations and may report leases under “Other assets” or “Other liabilities.”

Additionally, lessees and lessors must disclose quantitative and qualitative information about their leases, including significant judgments made to comply with lease accounting standards. They must also disclose the amounts recognized in the financial statements related to leases and their locations on those statements.

Lessee Disclosure

Under IFRS 16, lessee disclosures include the following for the current reporting period:

- Carrying amount of right-of-use assets by asset class and the end of the reporting period by class of underlying asset.
- Total cash outflows for leases
- Interest expense on lease liabilities
- Depreciation charges for right-of-use assets by asset class
- Additions to right-of-use assets

Additionally, lessees should disclose a maturity analysis of lease liabilities separately from other financial liabilities such as bonds and loans. They should also provide additional quantitative and qualitative information about their leasing activities to help users of financial statements assess the nature and future cash outflows of these activities. This analysis should include:

- the nature of the lessee's leasing activities.
- future cash outflows to which the lessee is potentially exposed but are not reflected in the measurement of lease liabilities.
- restrictions or covenants imposed by leases.
- sale and leaseback transactions.

Lessor Disclosure

IFRS 16 specifies different disclosure requirements for lessors. Like lessees, lessors must provide information (either in the notes or the financial statements) that allows users to assess the impact of leases on the lessor's financial position, performance, and cash flows.

At a minimum, lessors should disclose the following regarding finance leases:

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- Finance income on the net investment in the lease.
- Income relating to variable lease payments not included in the measurement of the lease.

For the operating leases, lease income, with separate disclosure for income related to variable lease payments not based on an index or rate, should be disclosed.

Additionally, lessors must provide qualitative and quantitative information about their leasing activities, helping users understand the nature of these activities and how the lessor manages risks associated with any rights retained in the underlying leased assets.

For instance, regarding finance leases, lessors should explain significant changes in the carrying amount of the net investment and provide a maturity analysis of receivable lease payments. This analysis should show undiscounted lease payments to be received annually for at least the first five years and a total amount for any remaining years.

On the other hand, regarding the operating leases, lessors should disclose disaggregated information about each class of property, plant, and equipment subject to operating leases. They should also provide a maturity analysis of lease payments, showing undiscounted lease payments to be received annually for at least the first five years and a total amount for the remaining years.

Presentation and Disclosure of Postemployment Plans

Disclosures for defined benefit and defined contribution pension plans are typically provided in the notes to the financial statements, with disclosures for defined benefit plans being more detailed.

International Accounting Standard 19 (IAS 19) requires issuers to disclose the amount recognized on the income statement during the period for defined contribution plans. However, regulators may mandate more extensive disclosures.

IAS 19 outlines the following objectives for disclosures of defined benefit pension plans:

- Explain the characteristics and associated risks of the defined benefit plans.
- Identify and explain the amounts in the financial statements related to the defined benefit plans (i.e., the net pension asset or liability).
- Explain how the defined benefit plans might affect the entity's future cash flows in terms of amount, timing, and uncertainty.

While IAS 19 is principles-based and allows issuers discretion in meeting disclosure objectives, it specifies several required disclosures, such as:

- The nature of the benefits provided, the regulatory framework of the plan, governance, and risks associated with the plan.

- A reconciliation from the opening to the closing balance of the net pension asset or liability, with separate reconciliations for plan assets and the present value of the defined benefit obligation, including service costs, interest income or expense, remeasurements, past service costs, contributions to the plan, and other components.

- A sensitivity analysis indicating how changes in significant assumptions, like the discount rate used to measure the defined benefit obligation, would affect the financial statements.

- The composition of plan assets by category, such as equity securities, fixed-income securities, and real estate.

- Indications of how the defined benefit pension plans impact the entity's future cash flows.

Presentation and Disclosures of Share-Based Compensation

Companies are mandated to disclose information about their share-based compensation programs to help users of the financial statements understand the nature and scope of these arrangements, including current and expected future cash flows and expenses.

These disclosures are typically included in the notes to the financial statements. According to IFRS 2, required disclosures include:

- **Description of Share-Based Payment Arrangements:** Covers general terms and conditions, such as vesting requirements, the maximum term of options granted, and the method of settlement (cash or equity).

- **Details on Options: Specifically, t**he number and weighted average exercise price of options, including:
    - Number outstanding at the beginning of the period.
    - Number granted during the period.

    - Number forfeited during the period.
    - Number exercised during the period.
    - Number expired during the period.
    - Number outstanding at the end of the period.
    - Number exercisable at the end of the period.
- **Other Equity Instruments:**
    - The number and weighted average fair value of other equity instruments (besides share options) granted during the period.
    - Information on how the fair value of these equity instruments was measured.

Question #1

Which of the following disclosures is required for lessees under IFRS 16?

A. The details of net interest expense on lease liabilities.
B. The depreciation charges for right-of-use assets by asset class.
C. The future market value projections of leased assets.

Solution

The correct answer is **B.**

Under IFRS 16, lessees are required to disclose depreciation charges for right-of-use assets by asset class as part of their current reporting period disclosures.

Question #2

Which of the following is generally a goal of a share-based compensation plan?

A. Recruiting new staff members
B. Increasing executive pay
C. Aligning employees' interests with managerial objectives

Solution

The correct answer is **A.**

Share-based compensation plans are typically designed to attract new employees by offering them a share in the company's future success as part of their compensation package. These plans also aim to retain and motivate existing employees by aligning their interests with the goals of the company. By giving employees a stake in the company, share-based compensation plans encourage employees to contribute to the company's growth and profitability, benefiting both the employees and the company in the long term.