SETTLEMENT IN THE ENTITY'S OWN EQUITY INSTRUMENTS

DECONTAREA ÎN PROPRIILE INSTRUMENTE DE CAPITALURI PROPRII ALE ENTITĂȚII

DANIELA SIMTION[1], ROXANA LUCA[2]

[1]Faculty for Agricultural Sciences, Food Industry and Environmental Protection, Lucian Blaga University, Oituz, Romania, simtiondaniela@yahoo.com
[2]Faculty for Business Administration, Academy of Economic Studies, Bucharest, Romania

Abstract: *Some financial instruments take the legal form of equity, but are liabilities in substance and others may combine these features associated with equity instruments with those associated with financial liabilities.*

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INTRODUCTION

An entity may have a contractual right or a contractual obligation to receive or to deliver a number of its own shares or other equity instruments that range so that the fair value of their entity's own equity instruments which are received or are delivered is equal to the value of the contractual right or the contractual obligation.

MATERIALS AND METHODS

Such a contractual right or such a contractual obligation may refer to a fixed amount or to a value that fluctuates partially or totally as a response

to changes in a variable, other than the market price for their entity's own equity instruments

For example:

- the rate of interest,
- the price of a merchandise or
- the price of a financial instrument).

A contract which will be settled by the entity, by receiving or delivering a fixed number of its own equity instruments in exchange for a fixed cash amount or another financial asset, is an equity instrument.

RESULTS AND DISCUSSIONS

For example, an issued share option, that gives the partner the right to buy a fixed number of the entity's shares for a fixed price or for a stated sum of money of a bond's loan, is an equity instrument.

Fair value changes of a contract, resulting from ranges in the market interest rate which do not affect the cash amount or other financial assets to be delivered or received, or the number of equity instruments which are to be received or delivered, when setteling the contract, do not prevent the contract to be an equity instrument.

Any received return service (such as the premium received for an issued share option or a warrant on the entity's own shares) is added directly to equity.

Any paid return service (such as the premium paid for a purchased option) is deducted directly from equity.

Fair value changes of an equity instrument are not being recognized in financial statements.

A contract that contains an obligation for an entity to purchase its own equity instruments in exchange for cash or another financial asset generates a financial liability for the present value of the amount paid (for example: for the present value of the forward repurchase price, the price for exercising the option or another repurchase value). This happens if the contract itsself is an equity instrument.

An example is the entity's obligation under a forward contract to purchase its own equity instruments in exchange for cash. When the financial liability is initially recognized, its fair value – the present value of the repurchase value – it is classified under equity. If the contract expires without delivery, the carrying amount of the financial liability is reclassified under equity.

The contractual obligation of an entity to purchase its own equity instruments generates a financial liability for the present value of the repurchase value, even if the obligation to purchase is conditioned by the partner who exercises his repurchase right (for example: an issued put option, which gives the partner the right to sell the entity's own equity instruments, to the entity, in exchange for a fix price).

A contract that will be settled by the entity receiving or delivering a fixed number of its own equity instruments in exchange for a varying amount of cash or another finacial asset is a financial asset or a financial liability.

The following examples illustrate how to classify different types of contracts regarding the entity's own equity instruments.

1). A contract that will be settled by the entity, receiving or delivering a fixed number of its own shares without any future rewards, or that changes a fix number of shares without any future rewards, or that changes a fix number of its own shares in exchange for a fix amount of cash or other financial assets, is an equity instrument.

Accordingly any compensation received or paid for such a contract is directly added or deducted directly from equity. An example would be a share option issued, through which the partner is entitled to purchase buy a fix number of the entity's shares in exchange for a fix amount of cash.

However if this contract requires the entity to purchase (repurchase) its own shares in exchange for cash or another financial asset at a fix, determinable or upon request date, the entity recognizes a financial liability at the present value of the amount repurchaseed.

An example would be the obligation of an entity under a forward contract to repurchase a fix number of its own shares in exchange for a fix amount of cash.

2). The obligation of an entity to purchase its own shares paid with cash generates a financial liability having the present value of the repurchased amount, even if the number of shares that the entity is obliged to repurchase is not fix or the obligation is conditioned by the partners exercising their repurchasing rights. An example of a conditional obligation is an issued option that requires the entity to repurchase its own shares and to pay cash if the counterparty exercises his option.

3). A contract that will be settled in cash or another financial asset is a financial asset or a financial liability, even if the amount of cash or other financial assets to be received or delivered is based on changes in the market's price for the entity's equity. An example would be a share option settled net through cash.

4). A contract that will be settled in a variable number of an entity's own shares and whose value is equal to a fix amount or to an amount based on changes in an underlying variable (for example: the price of a merchandise) is a financial asset or a financial liability. An example is an issued option to purchase gold, which if exercised is being settled net in their own instruments by the entity that provides a number of instruments equal in value to the contract value.

Such a contract is a financial asset or a financial liability, even if the underlying variable is the entity's share price, rather than gold. Similarly, a contract that will be settled through a fix number of the entity's own shares, but the rights attached to those shares will be changed so that the settlement value is equal to a fix amount connected to the changes of the underlying variable, is a financial asset or a financial liability.

CONCLUSIONS

1). When an entity has an obligation to purchase its own shares in exchange for cash (as is the case of a forward contract for purchasing its own shares), there is a financial liability for the cash amount that the entity is obliged to pay.

2). When an entity uses its own equity instruments as a money standard in a contract in order to receive or to pay a variable number of shares, whose value is equal to a fix value or to one based on changes in an underlying variable (for example: the price of a merchandise), the contract is not an equity instrument, but a financial asset or a financial liability.

In other words, when a contract is settled by a variable number of the entity's own equity instruments for a variable amount of cash or another financial asset, the contract is no longer an equity instrument, but a financial asset or a financial liability.

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