Accounting for Share-based Payments IFRS 2

June 2016

pwc

Agenda

- IFRS 2
  - Scope of IFRS 2
  - Grant date
  - Classification and measurement
  - Vesting period
  - Valuation
  - Group share-based payments
  - Illustrative examples

Scope

Scope

- Long-term incentives (LTIs) typically fall within IFRS 2 Share-based Payment or IAS 19 Employee Benefits

- IFRS 2 has in scope goods or services exchanged for:
  - Equity instruments of the entity or other group entity
  - Cash/other assets based on the value of equity instruments of the entity or other group entity

- Cash/assets provided in terms of a LTI which are not based on the fair value of group equity instruments are outside IFRS 2 scope –they are typically IAS 19 'Other long-term employee benefits'

- We will focus on IFRS 2 for the remainder of this session

Scope

Share based payment transaction =

Transactions in which the entity receives goods or services as consideration for ***equity instruments*** *of the entity (including* ***shares*** *or* ***share options****), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other* ***equity instruments*** *of the entity.*

Scope

Equity instruments =

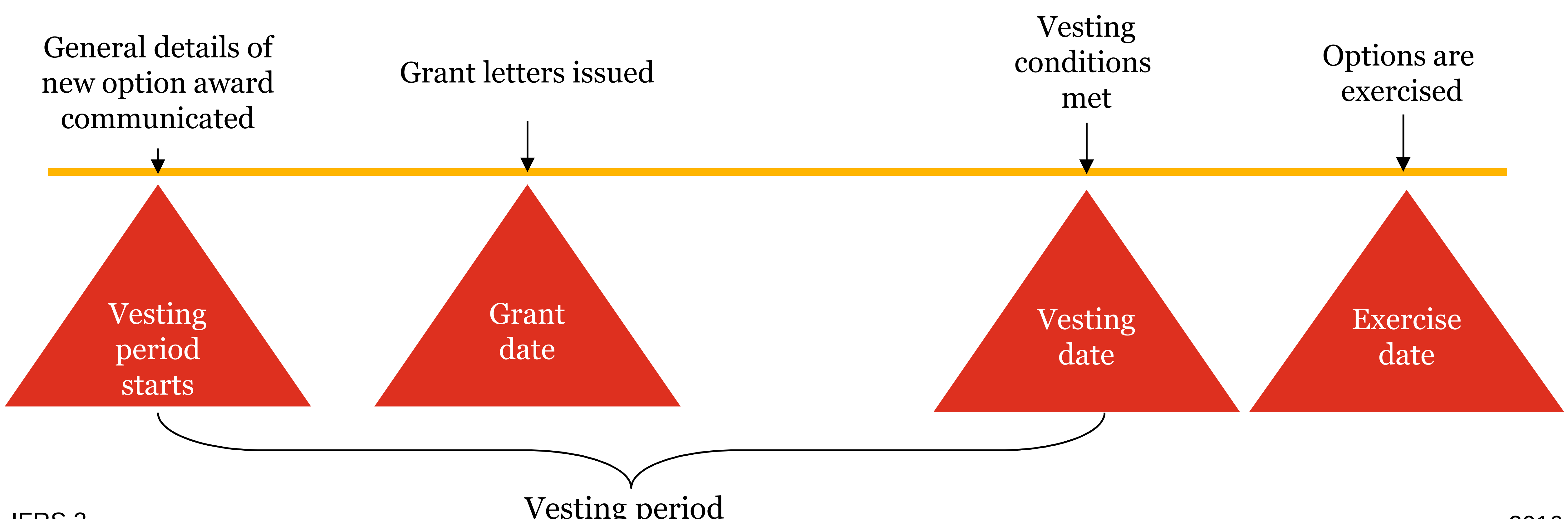
*A contract that evidences a **residual interest** in the assets of an entity after deducting all its liabilities*

*The share must be **equity***

Grant date

Grant date

- IFRS 2: "the date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a <u>shared understanding of the terms and conditions</u> of the arrangement"
- Grant date is the measurement date - service commencement date may be before the grant date
- An accrual may be required <u>before</u> the grant date based on an estimated grant date value



Classification and measurement

Classification

Equity settled: settled in equity instruments of the entity (or another entity in the group)

Cash settled: settled in cash, based on the price (or value) of the entity’s shares

Settlement alternatives:

- Counterparty (e.g. LTI participant) has choice:
  - Treat as compound instrument
  - Measure debt and equity as separate parts
- Company has choice:
  - Treat as equity-settled unless past practice or policy is to settle in cash

Classification – the differences

Equity-settled

- Recognise the asset or expense with a credit in equity
- Instrument value not remeasured

Cash-settled

- Recognised the asset or expense with a credit in liabilities
- Remeasured at each reporting date

Measurement

Equity settled

- Awards are valued at grant date and expensed over the vesting period.
- Instrument valuation takes into account market (share price related) conditions
- Not re-measured after grant date
- At each reporting date the number of instruments expected to vest is updated to reflect non-market conditions (e.g. attrition and HEPS)

Value per instrument × Number of instruments = IFRS 2 expense

Instrument value and market conditions - only measured at grant

Service and other non-market conditions - measured at every reporting period

Cash settled

- Fair value of award is determined at every reporting period and all conditions (market and non-market conditions) are remeasured
- Similar approach followed for IAS 19 ‘Other long-term employee benefits’

Vesting period

Vesting period

- Period over which service and performance conditions are to be met
- Accounting expense spread over the vesting period
- Staggered vesting requires specific attention:
  - E.g. assume award which vests 50% in year 3 and 25% in each of years 4 and 5
  - Each 'tranche' should be accounted for as a separate award:
    - 50% recognised over 3 years
    - 25% recognised over 4 years
    - 25% recognised over 5 years

Valuation

Valuation

	Measured at	Only if not possible, then at
Equity settled	Fair value of instruments granted (at grant date)	Intrinsic value of instruments granted
Cash settled	Fair value of liability incurred (re-measured)	

Option valuation models

Valuation Model	Advantages	Disadvantages
Black-Scholes	✓ Easy to use ✓ Appropriate only for very simple employee options	x Not suitable for valuation of complex plans x Cannot handle early exercise patterns or market vesting conditions
Binomial	✓ Flexible and relatively easy to use model ✓ Able to value more complex plans	x Generally not suitable for valuation of plans with market vesting conditions
Monte-Carlo	✓ Can value market vesting conditions ✓ Can value complex exercise patterns	x Complicated to set-up and use

Valuation

Option valuation assumptions increases (all models)	**Impact on fair value**
• Share price	⇧
• Strike price	⇩ ⇩
• Volatility	⇧ ⇧ ⇧
• Expected life	⇧ ⇧
• Dividends	⇩
• Risk free rate of return	⇧

Market performance conditions, post-vesting restrictions and non-vesting conditions should also be taken into account

Group share-based payments

Group-settled share-based payments

The entity receiving the goods or services will recognise the transaction as equity-settled only if:

- the awards granted are its own equity instruments; or
- it has no obligation to settle the transaction

In all other circumstances, the entity will measure the transaction as cash-settled.

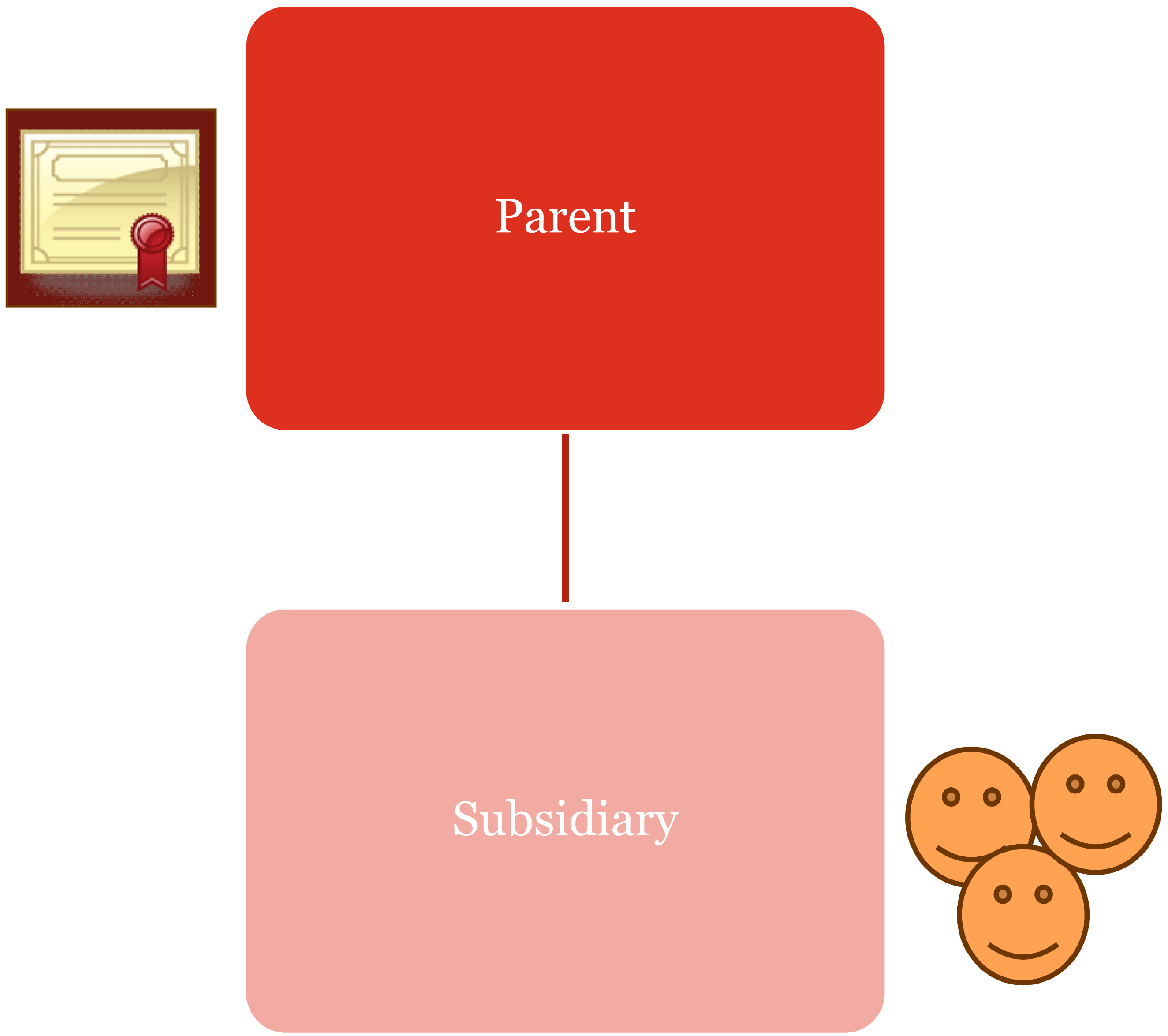
Counterparty receives	Cash-settled	Equity-settled
Own equity instruments	n/a	Yes
Equity instruments of any other group entity	Obligation to settle	No obligation to settle
Cash*	Obligation to settle	No obligation to settle

* based on share price of any group company

Practical application

1

Subsidiary employees receive awards in parent shares. Parent has the obligation to settle.



Parent

- Equity-settled
- Dr Investment in Sub
- Cr SBP reserve (equity)

Subsidiary

- Equity-settled
- Dr SBP expense
- Cr Capital contribution (equity)

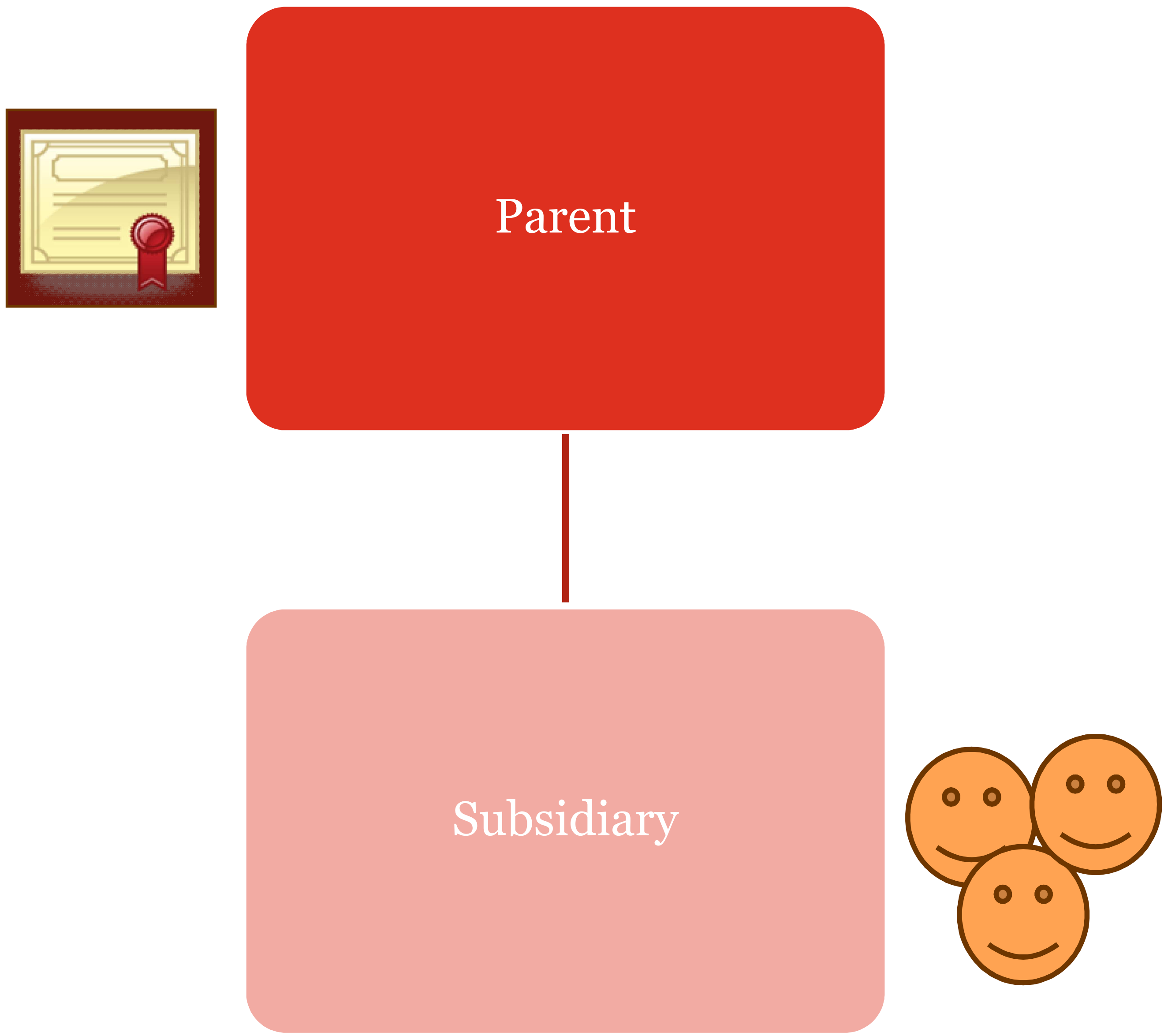
Group

- Equity-settled
- Dr SBP expense
- Cr SBP reserve (equity)

Practical application

2

Subsidiary employees receive awards in parent shares. Subsidiary has the obligation to settle.



Parent

- No impact

Subsidiary

- Cash-settled
- Dr SBP expense
- Cr C-S liability

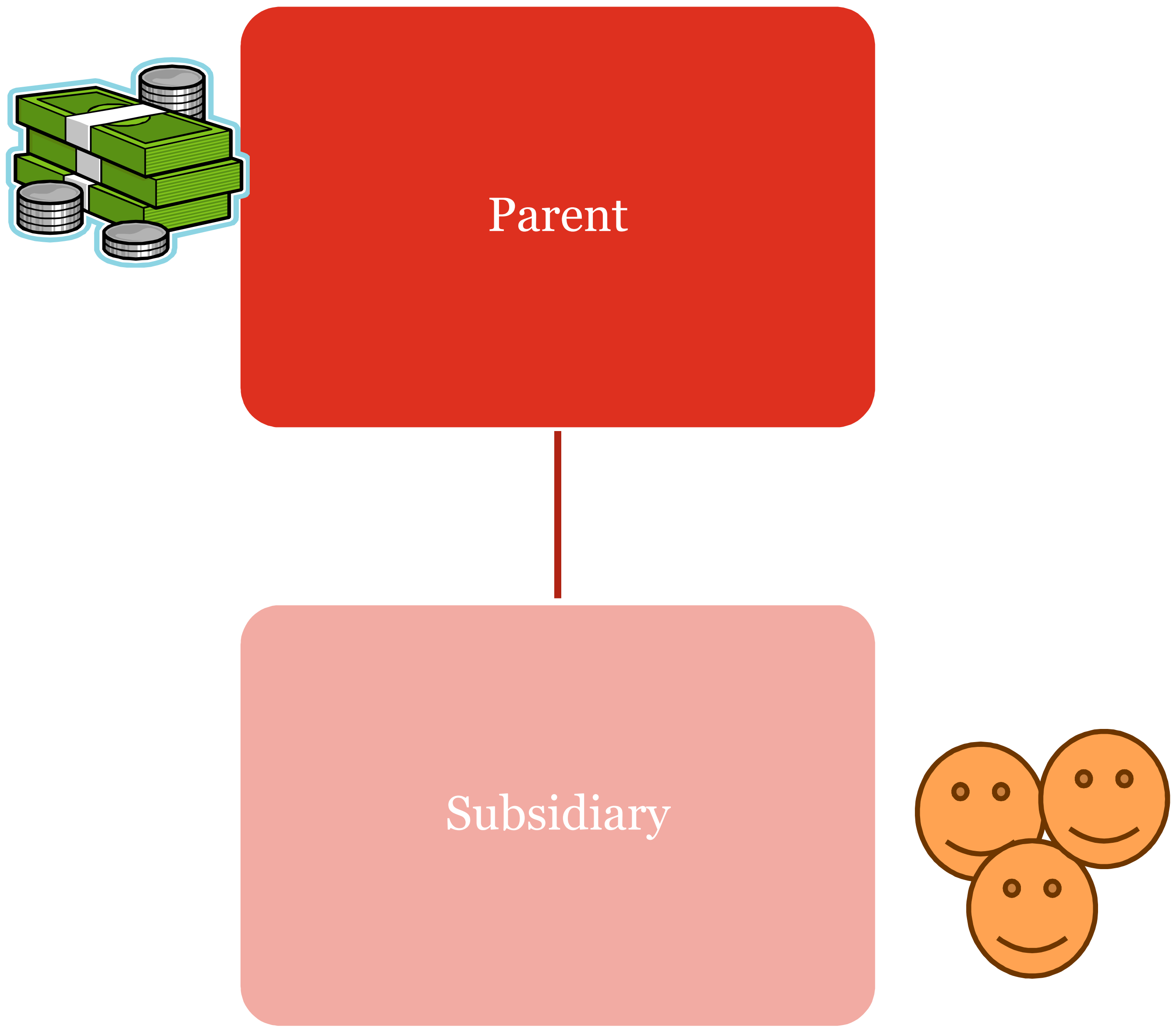
Group

- Equity-settled
- Dr SBP expense
- Cr SBP reserve (equity)

Practical application

3

Subsidiary employees receive cash share appreciation rights (SAR) based on Parent's share price. Parent has obligation to settle.



Parent

- Cash-settled
- Dr Investment in Sub
- Cr C-S liability

Subsidiary

- Equity-settled
- Dr SBP expense
- Cr SBP reserve (equity)

Group

- Cash-settled
- Dr SBP expense
- Cr C-S liability

Illustrative examples

Example 1

Management team share options

Prima granted its management team share options with a fair value of R900 000 on 1 July 2012. The management team will only become entitled to the options if they are still employed on 30 June 2015. On 30 June 2013, Prima expects only 90% of the management team to remain in the employ of Prima until 30 June 2015. On 30 June 2014, Prima expects only 80% of the management team to remain in the employ of Prima until 30 June 2015. On vesting date, only 70% of the management team remained and all of them exercised their options.

Example 1

Management team share options

30 June 2013		
Dr Employee benefit expense (900 000x 1/3 x 90%)	270 000	
Cr Share based payment reserve (equity)		270 000

Cumulative SBP reserve
270 000

30 June 2014		
Dr Employee benefit expense (900 000 x 2/3 x 80%) – 270 000	210 000	
Cr Share based payment reserve (equity)		210 000

Cumulative SBP reserve
480 000

30 June 2015		
Dr Employee benefit expense (900 000 x 70%) – 480 000	150 000	
Cr Share based payment reserve (equity)		150 000
Dr Cumulative SBP reserve (equity)	630 000	
Cr Share capital (equity)		630 000

Cumulative SBP reserve
630 000

Re-allocation in equity

Example 2

Managing director share appreciation rights
Prima issued 10 000 unconditional share appreciation rights (SARs) that vest immediately to its managing director on 1 July 2012. The SARs will be settled in cash. At that date it is estimated, using an option pricing model, that the fair value of a SAR is R12. The managing director is entitled to exercise the share appreciation right any time up until 30 June 2015. The managing director exercises his rights on 30 June 2015. The fair values of the SARs rights increased over time as follows:

Date	**Fair value (ZAR)**
30 June 2013	12,50
30 June 2014	12,90
30 June 2015	13,80

Example 2

Managing director share appreciation rights

1 July 2012		
Dr Employee benefit expense (10 000 x 12)	120 000	
Cr Share based payment liability		120 000

Liability on balance sheet
120 000

30 June 2013		
Dr Employee benefit expense (10 000 x [12.50-12])	5 000	
Cr Share based payment liability		5 000

Liability on balance sheet
125 000

30 June 2014		
Dr Employee benefit expense (10 000 x [12.90-12.50])	4 000	
Cr Share based payment liability		4 000

Liability on balance sheet
129 000

Example 2

Managing director share appreciation rights (continued)

30 June 2015		
Dr Employee benefit expense (10 000 x [13.80 – 12.90])	9 000	
Cr Share based payment liability		9 000

Liability on balance sheet
138 000

Dr Share based payment liability	138 000	
Cr Cash		138 000

Settlement of liability

Questions?