**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
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 shared understanding of the terms and conditions of the arrangement”
- Grant date is the measurement date - service commencement date may be before the grant date
- An accrual may be required before 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

Equity settled

Cash settled

Measured at

Fair value of instruments granted (at grant date)

Only if not possible, then at

Intrinsic value of instruments granted

Fair value of liability incurred (re-measured)
## Option valuation models

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

### Option valuation assumptions increases

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Impact on fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share price</td>
<td>↑</td>
</tr>
<tr>
<td>Strike price</td>
<td>↓ ⬅️ ⬅️</td>
</tr>
<tr>
<td>Volatility</td>
<td>⬇️ ⬆️ ⬆️ ⬆️</td>
</tr>
<tr>
<td>Expected life</td>
<td>⬆️ ⬆️</td>
</tr>
<tr>
<td>Dividends</td>
<td>⬇️</td>
</tr>
<tr>
<td>Risk free rate of return</td>
<td>⬆️</td>
</tr>
</tbody>
</table>

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.

<table>
<thead>
<tr>
<th>Counterparty receives</th>
<th>Cash-settled</th>
<th>Equity-settled</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own equity instruments</td>
<td>n/a</td>
<td>Yes</td>
</tr>
<tr>
<td>Equity instruments of any other group entity</td>
<td>Obligation to settle</td>
<td>No obligation to settle</td>
</tr>
<tr>
<td>Cash*</td>
<td>Obligation to settle</td>
<td>No obligation to settle</td>
</tr>
</tbody>
</table>

* based on share price of any group company
Practical application

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**

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

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

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>30 June 2013</strong></td>
<td><strong>Dr</strong> Employee benefit expense (900 000 x 1/3 x 90%)</td>
<td>270 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share based payment reserve (equity)</td>
<td>270 000</td>
</tr>
<tr>
<td><strong>30 June 2014</strong></td>
<td><strong>Dr</strong> Employee benefit expense (900 000 x 2/3 x 80%) – 270 000</td>
<td>210 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share based payment reserve (equity)</td>
<td>210 000</td>
</tr>
<tr>
<td><strong>30 June 2015</strong></td>
<td><strong>Dr</strong> Employee benefit expense (900 000 x 70%) – 480 000</td>
<td>150 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share based payment reserve (equity)</td>
<td>150 000</td>
</tr>
<tr>
<td></td>
<td><strong>Dr</strong> Cumulative SBP reserve (equity)</td>
<td>630 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share capital (equity)</td>
<td>630 000</td>
</tr>
</tbody>
</table>

**Cumulative SBP reserve**

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 2013</td>
<td>270 000</td>
</tr>
<tr>
<td>30 June 2014</td>
<td>480 000</td>
</tr>
<tr>
<td>30 June 2015</td>
<td>630 000</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Date</th>
<th>Fair value (ZAR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 2013</td>
<td>12,50</td>
</tr>
<tr>
<td>30 June 2014</td>
<td>12,90</td>
</tr>
<tr>
<td>30 June 2015</td>
<td>13,80</td>
</tr>
</tbody>
</table>
Example 2

Managing director share appreciation rights

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 2012</td>
<td><strong>Dr</strong> Employee benefit expense (10 000 x 12)</td>
<td>120 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share based payment liability</td>
<td>120 000</td>
</tr>
<tr>
<td>30 June 2013</td>
<td><strong>Dr</strong> Employee benefit expense (10 000 x [12.50-12])</td>
<td>5 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share based payment liability</td>
<td>5 000</td>
</tr>
<tr>
<td>30 June 2014</td>
<td><strong>Dr</strong> Employee benefit expense (10 000 x [12.90-12.50])</td>
<td>4 000</td>
</tr>
<tr>
<td></td>
<td><strong>Cr</strong> Share based payment liability</td>
<td>4 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Liability on balance sheet</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Liability on balance sheet</strong></td>
<td></td>
</tr>
<tr>
<td>1 July 2012</td>
<td></td>
<td>120 000</td>
</tr>
<tr>
<td>30 June 2013</td>
<td></td>
<td>125 000</td>
</tr>
<tr>
<td>30 June 2014</td>
<td></td>
<td>129 000</td>
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</tbody>
</table>

IFRS 2
PwC
Example 2

Managing director share appreciation rights (continued)

<table>
<thead>
<tr>
<th>30 June 2015</th>
<th>Liability on balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dr</strong> Employee benefit expense (10 000 x [13.80 – 12.90])</td>
<td>9 000</td>
</tr>
<tr>
<td><strong>Cr</strong> Share based payment liability</td>
<td>9 000</td>
</tr>
<tr>
<td><strong>Dr</strong> Share based payment liability</td>
<td>138 000</td>
</tr>
<tr>
<td><strong>Cr</strong> Cash</td>
<td>138 000</td>
</tr>
</tbody>
</table>

Settlement of liability
Questions?