IFRS-2
Share-based Payment

by

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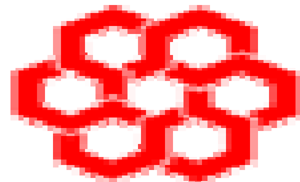

International
Accounting Standards
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Need for a standard

Share plans and share option plans have become a common feature of remuneration packages for directors, senior executives and other employees in many countries.

Share-based payment transaction arrangement

An agreement between the entity and an employee (or other party) to enter into a *share-based payment transaction* which entitles the employee to receive:

equity instruments (including shares) of the entity; or

cash (or other assets) for amounts based on the price of the entity's instruments,

Provided any specified *vesting* conditions are met.

Share-based payment transaction arrangement

Share-based payment transaction: A transaction 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 based on the price of the entity's equity instrument(s).

Types of transactions

The Standard identifies three types of share-based payment transactions:

- equity-settled share-based payment transactions;
- cash-settled share-based payment transactions; and

Equity-settled

The entity receives services as consideration for equity instruments of the entity (including shares or share options).

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Cash Settled

The entity acquires goods or services by incurring liabilities for amounts that are based on the price (or value) of the entity’s equity instrument's).

Scope exemption

- Issuance of shares to effect a business combination

  - *Distinguish between in exchange for control and those to employees of the acquiree*

- Share-based payments in scope of IAS-32 & 39 – *Contract to buy a non-financial items that can be settled net (excluding normal purchase and sale contracts)*

Recognition & Measurement

Equity-settled transactions

The fair value of the services received (and the corresponding increase in equity) is measured either:

- directly, at the fair value of the services received; or
- indirectly, by reference to the fair value of the equity instruments granted.

- Direct measurement is at the date the entity receives the services (or obtains the goods).

- Indirect measurement, as a surrogate, is at the grant date.

Equity-settled transactions- Employee Vs non-employee

- **Quiz** –X Ltd hires 20 people from Y Ltd for assistance in the book-keeping services for an IOP. X Ltd will pay a fixed monthly amount of Rs. 25000 per employee to Y Ltd. Y Ltd has no obligation on the performance of the hired people.

X Ltd awards share appreciation rights to its employees including the hired people. Proceeds from exercise of the rights will be paid net of employee income taxes

Grant Date

Defined as the date at which the entity and another party (including employees) agrees to share-based payment arrangement, being the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement.

at the grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments provided vesting conditions are met.

Grant Date

Why is grant date important ?

Date of measurement of fair value of options granted to employees

Without vesting condition

- When equity instruments granted vest immediately, employees (executives or other suppliers) are not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments.
- Unless there is evidence to the contrary, the entity presumes that services rendered by the employee have been received. So, on grant date the entity recognizes:
  - the services received in full; and
  - a corresponding increase in equity.

With vesting condition

- If the equity instruments granted do not vest until a specified period of service has been completed, it is presumed that the services to be rendered as consideration will be received over the future vesting period.
- Services must then be accounted for as they are rendered by the employee during the vesting period, with a corresponding increase in equity.

Expected vesting period

- The expected vesting period at grant date is estimated based on the most likely outcome of the performance condition.
- A performance condition may be a market condition (i.e. a condition upon which the exercise price, vesting or exercisability of an equity instrument is related to the market price of the entity's equity instruments).

Measurement of Share-based payment

Quiz –

X Ltd purchases 1000 computers in exchange for 5000 ordinary shares trading at Rs. 1000 each. The seller generally sells the computers for Rs. 5500 each.

what is the appropriate value at which the transaction should be recorded at and why?

Valuation Models

Black Scholes

Assumes exercise at one point

- Strengths
  - Wide acceptance
  - Easy to compute
- Weakness
  - Does not allow for variability
  - Cannot take account of market-based performance

Cash settled share-based payments

- Share based payment transactions that will be settled in cash or other assets
- Measured at the FV of the liability at each reporting date
- Changes in FV are recognized in profit or loss
- FV estimation should take into consideration expected forfeitures

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Deferred tax

- The tax expense within the profit or loss will be credited with the double entry to the recognition of the deferred tax asset.

- The amount that can be credited within profit or loss is set as a maximum, being the cumulative share option expense × tax rate. Any additional benefit will be credited through other comprehensive income.

Disclosure

- Nature and extent of schemes in place
- How fair value was determined
- Effect of expenses arising

Example 1- Length of service

100 options each that vest if employed in 3 years.

Fair value per option = Rs. 15.

Total grant date value?

Adjust expense for actual vested shares since there is non- market vesting condition.

750,000 (= 200 x 100 x15)

Rs. 250,000 each year

Cont. . .

Example 1- Length of service

If 80% are expected to vest (and does vest):

Year 1 - Rs. 200,000 = [250,000 x 80%]

Year 2 - Rs. 200,000 = [500,000 x 80% -200,000]

Year 3 – Rs. 200,000 = [750,000 x 80% - 400,000]

Rs. 600,000 total expense over three years

[50,000 options x 80%] x Rs. 15

Cont…

Example 1- Length of service

IF

At the end of Year 1: expected 85% of options vest;

At the end of Year 2 : expected 88% of options vest;

At the end of Year 3: 44,300 shares (or 88.6%) actually vest.

Year 1 - Rs. 212,500 = [250,000 x 85%]

Year 2 - Rs. 227,500 = [500,000 x 88% -212,500]

Year 3 – Rs. 224,500 = [750,000 x 88.6% - 440,000]

Total expense = Rs. 664,500 [Rs. 15 x 44,300]

Example 1- Length of service

All employees resign during period 3 without receiving options (or another non-market vesting condition is not met)

Year 1 - Rs. 200,000 = [250,000 x 80%]

Year 2 - Rs. 200,000 = [500,000 x 80% -200,000]

minus

Year 3 – Rs. 400,000 = [500,000 x 80%]

Rs. 0 total expenses reduced to zero – because no options vest

Example 2- Non-market performance conditions

100 options each at 01.01.2005

Fair value per options = Rs. 25

500 employees

Vesting condition

Average net profit for next 3 years increase > 10%

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Example 2- Non-market performance conditions

2005

- Net profit increased by 17% and 20 employees left
- Expect profit will continue and further 20 employees will leave during 2006

$$[500-20-20] \times 100 \times 25 \times 1/3 = 383,333$$

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Example 2- Non-market performance conditions

2006

- Net profit increased by 10% and 25 employees left
- Expect net profit will increase 8% in 2007 (average for each year more than 10%) and further 10 employees will leave

[500-20-25-10] x 100 x 25 x 2/3 = 383,333

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Example 2- Non-market performance conditions

2007

- Net profit increased by 8.5%, results in an average increase of more than 10%
- 450 employees received 100 shares

Year 2005 - Rs. 383,333

Year 2006 – Rs. 358,334

Year 2007 – Rs. 383,333*

*[450x100x25] – [383,333+358,334]

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Example 3 - Market performance conditions

100 options each that vest if employed in 3 years, however, the share option cannot be exercised unless the share price increases by 20% at the end of 2007.

Fair value per option (after taking into account the market performance conditions) Rs. 25

10 Directors

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Example 3 - Market performance conditions

If the company expect s the directors to complete the 3 years service and the directors do so.

In year 2006, it is assessed that the probability of an increase in the share price of 20% by the end of 2007 is remote

2005 - Rs. 8,333 = [10x100] x 25x1/3

2006 - Rs. 8,333 = [(10x100) x 25x2/3] –8,333

2007 - Rs.8,334 = [(10x100)X25] –8,333-8,333

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Example 3 - Market performance conditions

- The possibility that the share price target might not be achieved is taken into account when estimating the fair value at grant date

THANK YOU

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