



## SLFRS 2 - Share- Based Payment

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## **SLFRS 2- Topics covered**

- 1. Introduction and overview**
- 2. Definitions**
- 3. Recognition**
- 4. Measurement**
- 5. Accounting for SBP Transactions**
- 6. Modifications & Cancellations**
- 7. Disclosure**
- 8. Potential Adoption Issues.**



# **1. Introduction & Overview**

## 1. Introduction & Overview

### Objective of the Standard

- To specify Financial Reporting by an entity when it undertakes a share- based payment transaction.
- It requires an entity to reflect in its profit or loss and financial position the effect of share-based payment transactions including expenses associated with share options granted to employees.

## 1. Introduction & Overview

### Effective Date & Transitional Provisions

- Annual periods beginning on or after 1 January 2012.
  - ❖ 31<sup>st</sup> December 2012 Financial Statements
  - ❖ 31<sup>st</sup> March 2013 Financial Statements.
- Earlier application is encouraged. If an entity applies for a period beginning before 1 January 2012, it shall disclose that fact.
- To be applied to equity –settled share based payment transactions granted after 1<sup>st</sup> January 2012 and not vested at the effective date of this SLFRS.



## 1. Introduction & Overview

### *Scope Includes-*

- **Transfer of equity instruments to employees for the supply of services**
  - ❖ **Employee Share Option Schemes( equity-settled SBP)**
  - ❖ **Payment made to employees with reference to the increase in Share Price ( Cash-settled SBP)**
  
- **Transfer of equity instruments to parties that have supplied goods or services other than employees**
  - ❖ **In-kind capital contributions of property, plant or equipment in exchange for shares or other equity instruments (equity- settled SBP)**
  - ❖ **Payment to External Consultant by issue of shares. (equity- settled SBP)**
  - ❖ **Transfer of equity to another group company( Parent) for supply of goods or services. (equity- settled SBP)**
  - ❖ **Payments for services made to external consultants that are calculated by reference to the entity's share price. (cash-settled SBP)**



## 1. Introduction & Overview

### *Scope Excludes-*

- **Shares received by an employee as a shareholder.**
  - ❖ **Bonus Issues, Rights Issues**
  
- **Shares received by a company in a business combination.**  
**(if employees are given shares in a business combination as employees for continued services is scoped in.)**
  
- **Contracts for the purchase of goods that are within the scope of LKAS 32/39.**

## 1. Introduction & Overview- Practice Question.

Which of the following fall within scope of SLFRS 2?

Employees of company A will receive 1,000 share options after a service period of 3 years with the company	
Holding Company A gives 100 shares each to the employees of its Subsidiary B	
The Directors will receive a cash bonus if EPS increase by X% in 2012.	
A Shareholder receive 100,000 shares in exchange of a land owned by him.	
A company settle an investment advisor his fees using a formula based on the increase in its share price.	

## 2. Definitions

## 2. Definitions

### Share –based payment transaction(SBP)

- **An agreement between an entity and another party ( including an employee) to enter into a share-based payment transaction.**
  
- **Settlement for the goods or services received will be through:**
  - ❖ **Issue of equity instruments (including shares and share options) (Equity –settled SBP)**
  - ❖ **Price based on price of entity's shares or other equity instruments (Cash-settled SBP)**

## 2. Definitions

### Types of Share –based payment transactions

<b>Equity-settled share based payment transaction:</b>	<b>Transaction in which entity exchange goods or services for its equity instruments (including shares or share options)</b>
<b>Cash- settled share based payment transaction</b>	<b>Transaction in which entity acquires goods or services by incurring a liability to transfer cash or other assets based on its share price</b>
<b>Cash or Equity settled share based payment transaction</b>	<b>Transactions in which the entity received goods or services and either the entity or the supplier has a choice of settlement in:</b> <ul style="list-style-type: none"> <li>–Equity Instruments</li> <li>–Cash or Other assets.</li> </ul>

## 2. Definition

### Share Options

- A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

### Grant Date:

- The date at which the entity and another party (including an employee) agree to a share based payment arrangement,
  - ❖ entity and the counterparty have a shared understanding of the terms and conditions of the arrangement.
  - ❖ At grant date the entity confers on the counterparty the right to cash , other assets or equity instruments of the entity provided the specified **vesting conditions**, if any are met.
  - ❖ If subject to approval ( Shareholders) grant date is the date of approval.

## 2. Definition

### Vesting Period

- The period during which all the specified **vesting conditions** of a share-based payment arrangement are to be satisfied.

### Vest

- To become an entitlement.
- Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments upon satisfaction of the **vesting conditions**.

## 2. Definition

### Vesting Conditions

- **The service and performance conditions that must be satisfied for the counter party to become entitled to receive cash, other assets or equity instruments of the entity under a share -based payment arrangement.**  
Performance conditions are market conditions or nonmarket conditions

### Non-vesting conditions

- **Conditions necessary in order to earn award, but do not ensure that the entity receives services:**
  - ❖ Non-compete agreement
  - ❖ Transfer restrictions
  - ❖ Paying option price

## 2. Definition

Vesting Condition	
<b>Service Conditions</b>	
Service conditions	a specified period of service.(x no of years)
<b>Performance Conditions- require a service condition and specified performance targets to be met</b>	
Non-market performance conditions	Condition upon which the exercise price, vesting, or exercisability of an equity instrument does <b>NOT</b> relate to the market price of the entity's equity instruments <ul style="list-style-type: none"> <li>✓ EPS rising by 30%</li> <li>✓ Opening 10 new shops</li> </ul>
Market Performance conditions	Condition upon which the exercise price, vesting, or exercisability of an equity instrument relates to the market price of the entity's equity instruments <ul style="list-style-type: none"> <li>○ Share price target</li> <li>○ Intrinsic value target</li> </ul>



## 3. Recognition

### 3. Recognition

- **Recognized when goods are obtained or services are received.**
- **The Credit Entry**
  - ❖ **Equity-settled SBP- corresponding increase in equity**
  - ❖ **Cash-settled SBP- Corresponding increase in Liability/ decrease in cash.**
- **The Debit Entry**
  - ❖ **Asset if the asset recognition is met- Land, Inventory**
  - ❖ **Expense – cost of employee services,**

### 3. Recognition

Equity Settled Vs Cash Settled Share Based Transactions

Equity Settled	Cash Settled
FV based on the goods or services received or <b>FV of Options at grant date.</b>	FV is ultimately the <b>cash paid</b>
FV measurement <b>only on grant date.</b> No subsequent adjustment for FV changes. ( Unless option modified)	Measure at FV <b>at each reporting date.</b>
Cost is spread during the vesting period	Cost is spread during the vesting period
Where award does not vest entire charge reversed.	Where award does not vest the entire charge reversed
Where award vests but is not exercised any charge previously made <b>cannot be reversed</b>	Where award vests but is not paid because 'out of the money', any charge previously made is reversed

### 3. Recognition

#### Equity or Cash Settled Share Based Payments

- If **employee** has choice:- Cash or Shares/ Share options
  - Split accounting (i.e., part cash-settled, part share-settled)
  - Emphasis on contractual obligation
  - Award seen as a compound instrument:
    - ✓ Debt component – employee's right to demand cash
    - ✓ Equity component – employee's right to demand equity
- If **employer** has choice:
  - Must account for as entirely share-settled or cash-settled
  - Emphasis on contractual obligation and past practice leading to constructive obligation

## 4. Measurement

### 4. Measurement

#### Direct method

- Fair value of goods or services received
  - Option Price = FV of Goods or Services Received.
- Examples:
- ❖ FV of Assets Received (Land/ Inventory/P&M)
  - ❖ FV of Architect Fees

#### Indirect method

- Fair value of equity instruments granted
  - ❖ Services received from employees measured using FV of the share option or equity instruments granted to services,

## 4. Measurement

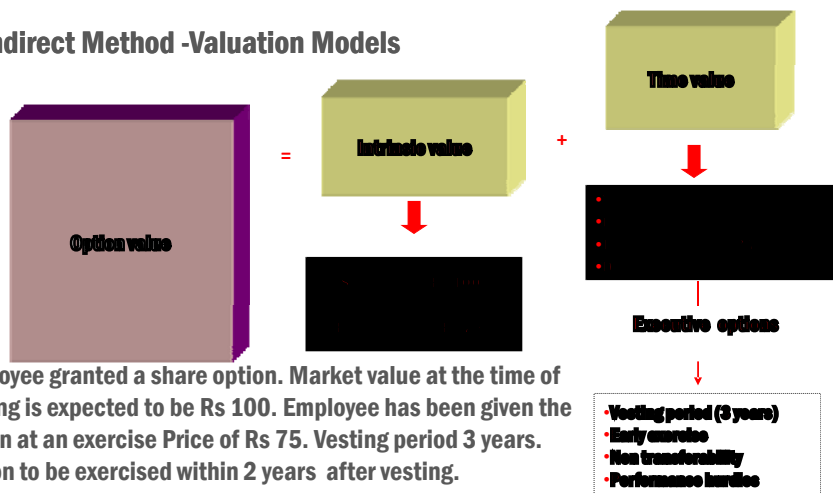
### Fair value of equity instruments

- At grant date, account for all the terms and conditions of grant:
  - ❖ Shares granted – market price or estimated market price
  - ❖ Options granted – market price of traded options with similar terms and conditions
  - ❖ If no similar traded options exist (this is usually the case)
    - ❖ FV then must be determined by using an option-pricing model.
- Expense based on the fair value at grant date



## 4. Measurement

### Indirect Method -Valuation Models



Employee granted a share option. Market value at the time of vesting is expected to be Rs 100. Employee has been given the option at an exercise Price of Rs 75. Vesting period 3 years. Option to be exercised within 2 years after vesting.

## 4. Measurement

### Option-pricing models

- **SLFRS 2 does not specify a preferred option-pricing model to be used.**
- **However, any model used requires the following inputs as a minimum:**
  - ❖ **Exercise price of the option**
  - ❖ **Life of the option**
  - ❖ **Current price of underlying shares**
  - ❖ **Expected volatility of share price**
  - ❖ **Dividends expected on shares**
  - ❖ **Risk-free interest rate for life of option**

## 4. Measurement

### Effects of different inputs on valuation

Increase	FV increase	FV decrease
Expected Price		
Expected life		✓
Price of shares	✓	
Expected volatility	✓	
Expected dividend yield	✓	✓
Risk-free interest rate	✓	

## 4. Measurement

Choosing the right valuation model is important

Features of Plan	Binomial model	Black-Scholes model
Market-based performance condition	✓	
Non-market-based performance condition	✓	✓
Varying valuation variables over vesting period	✓	
Combination of market-based and non-market-based performance conditions.	✓	

Where the market-based performance conditions specify, for example, a target share price relative to an index of market prices then simulation techniques such as Monte Carlo analysis will need to be applied in conjunction with the Binomial model.

## 4. Measurement

If the fair value of the equity Instrument cannot be measured reliably.

**Option Price = Intrinsic Value**

- **Intrinsic Value = Market Price/ FV - Exercise Price**
- **Change in intrinsic value to be adjusted to P&L until the share options are exercised, forfeited or lapse.**



## **4. Measurement**

### **Valuation implications**

- **Share-based payment transactions are rarely, if ever, “plain vanilla.”**
- **Mathematics can be complicated.**
- **The answer is only as good as inputs.**
- **Expectations are very difficult to incorporate.**



## **5. Accounting for SBP Transactions**

## 5. Accounting for SBP Transactions

### Equity- settled share based payments

Type of Vesting Condition	Accounting
<b>Service Condition</b> > Award vests if the employee stays with the company for 2 years.	<ul style="list-style-type: none"> <li>❖ Cumulative expense= awards vesting X grant date fair value</li> <li>❖ During vesting period, use best estimate of final outcome</li> <li>❖ Award vesting in installments - each instalment treated as separate option grant</li> </ul>
<b>Non Market Performance Condition</b> > Award vests if employee stays for 2 years and if the company achieve and EPS of 25%	<ul style="list-style-type: none"> <li>❖ Cumulative expense= awards vesting X grant date fair value</li> <li>❖ During vesting period, use best estimate of final outcome</li> <li>❖ Award vesting in installments - each instalment treated as separate option grant</li> </ul>
<b>Market Performance Condition</b> > Award vests if company reaches a market price of Rs 100 per share in 3 years.	<ul style="list-style-type: none"> <li>❖ Cumulative expense= awards vesting <u>as if the market condition did not exist</u> X grant date fair value</li> <li>❖ Considered when estimating grant date's fair value of award</li> <li>❖ In 3 years all employees who received the option will be entitled irrespective of the share reaching Rs 100 per share.</li> <li>❖ Expense recognised even if market condition not met. Reverse only for forfeitures.</li> </ul>

## 5. Accounting for SBP Transactions

### Equity- settled share based payments

Type of Vesting Condition	Accounting
<b>Non Vesting Conditions</b> > If <u>either</u> issuer or counterparty can choose whether to meet the non-vesting condition and the condition is not met: > The award will vest if the company or employee do not start competing businesses.	<ul style="list-style-type: none"> <li>❖ Cumulative expense= awards vesting <u>as if the non-vesting condition did not exist</u> X grant date fair value</li> <li>❖ Considered when estimating grant date's fair value of award</li> <li>❖ During vesting period, use best estimate of final outcome</li> <li>❖ Award treated as cancellation if non-vesting condition not met.</li> </ul>
<b>Non Vesting Conditions</b> > If <u>neither</u> issuer or counterparty can choose whether to meet the non-vesting condition and the condition is not met: > The share option cannot be transferred or cancelled.	<ul style="list-style-type: none"> <li>❖ Cumulative expense= awards vesting <u>as if the non -vesting condition did not exist</u> X grant date fair value</li> <li>❖ Considered when estimating grant date's fair value of award</li> <li>❖ Continue to recognize expense during vesting period unless other nonmarket vesting conditions are not met</li> </ul>



## **5. Accounting for SBP Transactions**

### **Cash- settled share based payments**

<b>Type of Vesting Condition</b>	<b>Accounting</b>
An employee is entitled to a future cash payment based on the increase in the entity's share price from a specified level during a specified period	<ul style="list-style-type: none"> <li>❖ Measured at fair value during the reporting period</li> <li>❖ BUT the liability – and therefore the expense – is remeasured upon settlement to equal the amount of cash paid out</li> <li>❖ Expense reversed is no cash is paid .</li> </ul>

## **5. Accounting for SBP Transactions**

### **Cash or equity- settled share based payments**

- **Awards that can be settled in shares or cash**
  - ❖ **If employee has choice:**
    - **Split accounting (for instance, part cash-settled and part equity-settled)**
    - **Emphasis on contractual obligation**
- **Award seen as a compound instrument:**
  - ❖ **Debt component – employee's right to demand cash**
  - ❖ **Equity component – employee's right to demand equity**

## 5. Accounting for SBP Transactions

### Cash or equity- settled share based payments

#### ➤ Awards that can be settled in equity or cash

##### ❖ If employer has choice:

- Must account for as entirely equity-settled or cash-settled
- Emphasis on contractual obligation and past practice leading to constructive obligation



## 5. Equity Settled SBP- Practice questions.

In January 2012 an entity grants 10,000 share options to 10 senior executives at an exercise price of Rs 25. The award will vest if the Executive remain in service for 3 years (**Service Condition**) and if the Share price increases from Rs. 50 to above Rs.65 at end of Year 3

(**Market based performance condition**) Fair value of options (**Option Price**) at grant date is estimated to be Rs. 24 per option.

#### Application:

- The market based performance condition is considered in determining the option price.
- The expense recognised based on achieving the Service Conditions.
- Expense reversed for any Executive that does not meet the service condition.
- Expense cannot be reversed for all employees who achieve the vesting-service condition ( 3 year stay)
- If share price target is not met, the above expense cannot be reversed. However, the company will not issue shares to employees at the exercise price.

### 5. Equity Settled SBP- Practice questions, Cont.

1. Calculation of charge ( all Executives remain for 3 years/ SP target met / all take up the option at the end of 3 years)

year	Calculation of annual charge	Annual Charge Dr- P&L Cr. Equity ( reserve)	Cumulative charge (Reserve Balance)
1	(10,000 options x Rs 24) 1/3	80,000	80,000
2	(10,000 options x Rs 24) 2/3- 80,000	80,000	160,000
3	(10,000 options x Rs 24) -160,000	80,000	240,000

Recognition of Shares issue on Exercise of Option by Executives

Cash Dr (Rs.25 x 10,000)	250,000	
Stated Capital Cr (Rs 25 x 10,000)		250,000

The SBP expense for the shares issued could be transferred from the reserve to stated capital at the point of issue of share.

### 5. Equity Settled SBP- Practice questions, Cont.

2. In year 2 the co expects 2 Executives to leave and by year 3 only 6 remain. The share price target is not met by the end of year 3.

year	Calculation of annual charge	Annual Charge Dr- P&L Cr. Equity ( reserve)	Cumulative charge (Reserve Balance)
1	(10 employees x 1000 options x Rs 24) 1/3	80,000	80,000
2	(8 employees x 1000 options x Rs 24) 2/3- 80,000	48,000	128,000
3	(6 employees x 1000 options x Rs 24) - 128,000	16,000	144,000

As the market based performance condition is not met the company will not issue shares to employees at Rs 25 Exercise Price. Therefore no increase in Stated Capital.

Company cannot reverse the Rs 144 K for the employees that met the service condition.  
The Reserve will continue to be shown under equity

### 5.Cash Settled SBP-Practice questions

A Plc grants 100 cash settled Share Appreciation Rights (SARs) to each of its 450 employees.

Grant is conditional on the employees working for A Plc for the next 3 years.

Year	No of employees expected to vest	FV of SARs
1	300	10
2	310	12
3	360 ( actually qualify)	14

### 5.Cash Settled SBP-Practice questions Contd.

Year	Calculation	Y/E Liability	Annual Charge Dr- P&L Cr- Liability
1	$(300 * 100 * 10 * 1/3)$	100,000	100,000
2	$(310 * 100 * 12 * 2/3)$	248,000	148,000
3	$(360 * 100 * 14 * 3/3)$	504,000	256,000

**If by the end of the period award is paid**

**Dr. Liability                      504,000**  
**Cr Cash                              504,000**

**If by the end of the period award is not paid charge reversed.**

**Dr. Liability                      504,000**  
**Cr P&L                              504,000**

## 6. Modification & Cancellation

### 6. Modifications and cancellations

#### ➤ Modification

- Continue to recognize at least amount that would have been recognized under original share-based payment transaction
  - ❖ Even if fair value of modified share-based payment transaction is lower
- If fair value of modified share-based payment transaction is higher, treat the difference (less any cash paid) as if it were a new share-based payment transaction
  - ❖ Requires second fair value exercise for original share-based payment transaction

*Example : Company issued a share options at Rs 10.00 in 2012 ( Option price Rs 5)which will vest in 2015. In 2013 the share price is Rs 12.00 and hence the company decide to lower the Exercise price to Rs 7.00 ( Option price Rs 4)*

## 6. Modifications and cancellations, Contd.

### ➤ Cancellation

- Accounted for as an acceleration of vesting
- Immediately expense unrecognized amount that would have been recognized during the remainder of the vesting period
- Amendment to SLFRS 2 introduces changes
  - ❖ Cancellation by employee as well as employer
  - ❖ Retrospective application

*Example : Company issued a share options at Rs 10.00 in 2012 ( Option price Rs 5)which will vest in 2015. In 2013 the share price is Rs 23.00 ( 2012 Rs 17) and hence the company decide to cancel the existing plan and issue a new plan at an Exercise price to Rs 15.00 ( Option price Rs 7 )*

## 6. Modifications and cancellations, Contd.

### ➤ Cancellation – replacement awards

- If entity does not designate new award as replacement:
  - Treat as a new award
  - Expense total fair value of new award during vesting period of new award
- If entity does designate new award as replacement, then either:
  - Immediately expense cancelled award and spread incremental value of new grant during new vesting period
  - Use modification accounting

## 7. Disclosures

### 7. Disclosures

- Information that enables users to understand the nature and extent of SBP arrangements that existed during the period
- Information that enables users to understand how the FV of goods or services received ,or the FV of the equity instruments granted ,during the perior was determined.
- The effect of the SBP transactions on the entity's profit or loss for the period and on its financial position.

## 8. Potential Adoption Issues

## 8. Potential Adoption Issues

### 1. The implementation of the standard will require careful planning, data collection and the use of valuation models

- **Initial impact study** - to evaluate the impact on the financial statements and review the design, data sources and collection processes for share-based payment arrangements;
- **Planning phase** - to assess the training needs, decide valuation processes and identify roles and responsibilities;
- **Preparation phase** - focusing on the collection of data, the selection of the assumptions and the valuations; and
- **Implementation phase** - resulting in the actual accounting entries and disclosures, and the development of plans for communicating with investors and analysts





## **8. Potential Adoption Issues**

### **2. Availability of the required expertise to value Share Options**

- Use of the allowed alternative –intrinsic value could result in higher expenses being charged to the income statement.
- Use of a wrong model could result in an incorrect value being charged to the income statement.
- Some of the data used for the valuation models might not be available- risk free rate, market performance conditions.



## **8. Potential Adoption Issues**

### **3. Understand Impact of vesting conditions.**

- ▶ Identifying the existence of non-vesting and vesting conditions in a share-based payment transaction, correctly classify the vesting conditions as either service conditions or as market or other performance conditions, and determining the appropriate accounting treatment
- ▶ If service or non-market performance conditions are met, the SBP expense cannot be reversed for equity settled SBP transactions.
- ▶ Amending an award can result in acceleration of expense being charged.
- ▶ Wording of vesting conditions could result in unexpected accounting implications.- e.g. Several Vesting conditions given where reaching of one could result in options being granted.



## **8. Potential Adoption Issues**

4. Modifications. Cancellations could have significant impact to income statements.

**Modifications -viewed as incremental instruments in their own right.  
(Continue to recognise at least amount that would have been booked under original award even if fair value of modified award is lower.)**

**Cancellations- Accounted for as an acceleration of vesting  
Immediately expense unrecognised amount that would have been recognised over the remainder of the vesting period**



## **8. Potential Adoption Issues**

### **5. Potential Tax Impact.**

- **Tax Impact to the employee will be recognized only when the share options are exercised by the employees. Will this be at the FV determined by the Company?**
- **Will the P&L expense be a deductible expense to the company ( even when the share option is not exercised?)**
- **Whether an allowed deduction equals recognized expenses?**
- **If company can deduct, will this be at the time of expensing or when the employee exercise the option? ( Deferred Tax Impact? )**

## **Conclusion**

- **Questions?**
- **Rule Based Standard**
- **Very Prescriptive**
- **Need to watch out for accounting implications!**

