SLFRS 2 – Share-Based Payments

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Agenda

- Definitions
- The 2 basic types
- Scope, classification, conditions
- Equity-settled SBP with employees
- Cash-settled SBP with employees
- Other issues

Definition: SBP arrangement

An agreement between the entity and another party that entitles the other party to receive:

Cash / other assets based on the value of equity instruments of the entity or another group entity

or

Equity instruments of the entity or another group entity

Definition: SBP transaction

A transaction in which the entity:

Receives goods / services from a supplier / employee in a SBP arrangement

or

Incurs obligation to settle transaction with supplier / employee when another group entity receives the goods / services

Common types of SBP transactions

Share option

Share granted

Employee share purchase plan (ESPP)

Share appreciation right (SAR)

2 basic types of SBP arrangement

Equity settled

Entity receives goods / services as consideration for entity's or another group entity's <u>equity instruments</u>

Cash settled

Entity receives goods / services by incurring liability to transfer <u>cash</u> / other assets to supplier for amounts based on entity's or another group entity's share price

Employees vs non-employees

Employees

Non-employees

Different accounting

In the scope of IFRS 2

Grants to employees, and others providing similar services

Grants to non-employees, e.g. consultants, suppliers

Employee share purchase plan (ESPP)

Certain SBPs settled by a group entity or an external shareholder of the same group

Outside the scope of IFRS 2

Equity instruments issued as consideration in a business combination

Commodity contracts that can be settled in cash or in other financial instruments and are accounted as financial instruments (not for own use)

A question for you: Classification (1)

- On 1 January Year 1 Company A grants employees 100 options with a 3-year service condition and a L$ 10 strike price
- On 31 December Year 4 the share price is L$ 20
- Employees have the option to either:
  - Pay L$ 1,000 and receive 100 shares worth L$ 2,000
  - Receive 50 shares for no consideration by forfeiting all 100 options

Should Company A classify this SBP arrangement as equity settled or cash settled?

A question for you: Classification (2)

- On 1 January Company A agrees that employees still employed by Company A in 3 years will receive a cash payment
- Payment is excess of share price over L$ 10 multiplied by 1,000
- For example, if the share price is L$ 15 in 3 years, employees receive L$ 5,000

Should Company A classify this SBP arrangement as equity settled or cash settled?

Conditions (1)

Does condition determine whether entity receives the services that entitle the counterparty to the SBP?

yes → Vesting condition

no → Non-vesting condition

Vesting condition → Does the condition require *only* a specified period of service to be completed?

yes → Service condition

no → Performance condition

Conditions (2)

Performance condition

Is condition related to market price of entity's equity instruments?

yes → Market performance condition

no → Non-market performance condition

A question for you: Conditions (1)

- On 1 January Company A grants a share option to an employee
- The option can be exercised any time within the next 5 years

Has Company A granted an option with service conditions and/or performance conditions?

A question for you: Conditions (2)

- On 1 January Company A grants a share option to an employee
- Employee must remain an employee of Company A for
  2 years before they can exercise the option

Has Company A granted an option with service conditions and/or performance conditions?

A question for you: Conditions (3)

- On 1 January Year 1 Company A grants a share option to an employee
- Employee must remain an employee of Company A for 2 years and Company A's share price must exceed L$ 120 at 31 December Year 2 before they can exercise the option
- Share option is exercisable for 5 years after 31 December Year 2 even if not still employed by Company A

Has Company A granted an option with service conditions and/or performance conditions?

Non-vesting conditions

Conditions that neither entity nor counterparty can choose to meet

Examples:
- ♦ Inflation not > 5%
- ♦ Gold price must increase > 3%

Conditions that counterparty can choose to meet

Examples:
- ♦ Holding shares over holding period
- ♦ Paying monthly contributions to share purchase plan

Conditions that entity can choose to meet

Example:
- ♦ Continuation of plan by entity

Impact of conditions

Service condition

Non-market performance condition

Not considered in estimating fair value of individual instrument, but are considered in estimating number of instruments expected to vest

Non-vesting condition

Market condition

Are considered in estimating fair value of individual instrument (inputs to valuation model)

Conditions impact timing of expense recognition and measurement

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Timeline of a share option award

Vesting period. Period during which all specified vesting conditions are to be satisfied

Year 1 | Year 2 | Year 3 → Time

Grant date
Date at which entity and counterparty have shared understanding of terms and conditions of arrangement

Vesting date
Date that vesting conditions for entitlement satisfied

Exercise date
Date that awards exercised

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General measurement principles

Equity settled

Goods / services measured directly based on their fair value

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Goods / services measured indirectly based on fair value of equity instrument

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Goods / services measured at intrinsic value of equity instrument

Cash settled

£$

Goods / services measured at grant date fair value of liability. Liability is remeasured

** If not reliably measurable (rare)

Equity-settled general recognition principles

Debit

- Recognise goods / services received when goods obtained / services received
- When goods / services do not qualify for recognition as assets, expense is recognised

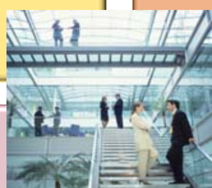
- Corresponding increase in equity recognised

Credit

Determining the grant date fair value

Measure employee services indirectly, based on fair value of equity instruments granted

Fair value of equity instruments measured at market price for instruments with similar terms and conditions (rare)



Measured at grant date

If no market exists, fair value is estimated by applying a valuation (e.g. option pricing) model

Calculating total expected charge

Total number of options × Grant date fair value of one option × Percentage expected to vest

=

Total value at grant date

Management assumptions can affect the result significantly

Fact
Assumption

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Accounting for conditions

Grant date fair value of options × Percentage expected to vest

♦ Market conditions
♦ Non-vesting conditions

Do not true up during vesting period or on vesting date

♦ Service conditions
♦ Non-market performance conditions

True up estimates during vesting period and on vesting date

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Measurement illustration: (1) Performance conditions

- On 1 January Year 1 Company A grants employees 100 options with a 3-year service condition and a target share price of L$ 10 at the vesting date (market condition)
- Assumptions:
  - All employees remain in service over vesting period
  - Grant date fair value of each option is L$ 3.5 excluding market condition, and L$ 3 including market condition
  - Best estimate is that market condition will be met

What compensation cost does Company A recognise over the vesting period?

Measurement illustration: (2) Performance conditions

- **Market conditions** accounted for in calculation of grant date fair value
- Estimated discount for market condition is L$ 0.50
- Therefore grant date fair value = L$ 3.00 (3.50 - 0.50)
- Total compensation cost = L$ 300 (3 x 100)

	Expense
Year 1	L$ 100
Year 2	L$ 100
Year 3	L$ 100

Measurement illustration: (3) Performance conditions

- At the end of Year 2 Company A estimates that the market condition will not be met (i.e. share price target of L$ 10 will not be reached at vesting date)
- All service conditions expected to be met
- Employee service cost of L$ 300 recognised even if market condition not met (as long as services provided)

	Expense
Year 1	L$ 100
Year 2	L$ 100
Year 3	L$ 100

Measurement illustration: (4) Performance conditions

- On 1 January Year 1 Company A grants employees 100 options with a 3-year service condition and revenue target of L$ 100,000 per employee at the vesting date (non-market condition)
- Assumptions:
  - All employees remain in service over vesting period
  - Grant date fair value of each option is L$ 3.5
  - Non-market performance condition expect to be met by all employees

What compensation cost does Company A recognise over the vesting period?

Measurement illustration: (5) Performance conditions

- Non-market conditions accounted for in calculating number of options expected to vest
- Grant date fair value = L$ 3.50
- Therefore total compensation cost = L$ 350 (3.50 x 100)

	Expected compensation cost (total)	Accumulated attribution*	Expensed in prior periods	Expense in current year
Year 1	L$ 350	L$ 117	0	117
Year 2	L$ 350	L$ 233	-117	116

* (350 / 3) x (number of periods lapsed)

Measurement illustration: (6) Performance conditions

- At the end of Year 2 Company A estimates that only 50% of employees will meet the non-market condition
- All service conditions are expected to be met
- This is also the actual outcome

	Expected compensation cost (total)	Accumulated attribution	Expensed in prior periods	Expense in current year
Year 1	350	117*	0	117
Year 2	~~350~~ 175	117**	-117	0
Year 3	175	175**	-117	58
Total				175

** (350 / 3) x (number of periods lapsed)

** (175 / 3) x (number of periods lapsed)

Measurement illustration: (7) Performance conditions

- A change in the expectation of whether or not a performance condition will be met:
  - is ignored for market conditions (accounted for through valuation model)
  - but recognised for non-market conditions

Expense:	Market condition	Non-market condition
Year 1	100	117
Year 2	100	0
Year 3	100	58
Total	300	175

General measurement principles

Equity settled

Non-employees

Goods / services measured directly based on their fair value

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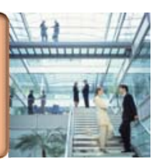
Employees



Goods / services measured indirectly based on fair value of equity instrument

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Goods / services measured at intrinsic value of equity instrument

Cash settled

£$

Goods / services measured at grant date fair value of liability. Liability is remeasured

** If not reliably measurable (rare)

Cash-settled general recognition principles

Debit

- **Recognise goods / services received when goods obtained or services received**
- **When the goods / services do not qualify for recognition as assets, expense is recognised**

Credit

- **Corresponding liability recognised for obligation to pay cash / other assets**
- **Liability remeasured to fair value at each reporting date (profit or loss)**

Requirement to remeasure overrides no true-up for market conditions

Calculating total expected charge

Total number of SARs × Fair value of one SAR × Percentage expected to vest

= Total value at grant date

Accounting policy choice:

- **Account by analogy to equity-settled arrangements (above)**
- **All conditions taken into account in estimating FV of one SAR**

Fact
Assumption

SAR = share appreciation right

Measurement illustration: (1) Cash-settled transaction

- On 1 January Year 1 Company A grants employees
  100 SARs with a 3-year service condition and target share price of L$ 10 at vesting date (market condition)
- Assumptions:
  - Transaction will be settled in cash not shares
  - Employees remain in service over vesting period
  - Grant date fair value of each SAR is L$ 3 (including market condition)
  - Best estimate is that market condition will be met

L$

Measurement illustration: (2) Cash-settled transaction

- Assumptions (continued):
  - Subsequent estimates of fair value of each SAR:

	Fair value	Intrinsic value
End Year 1	4.00	1.50
End Year 2	4.25	3.00
End Year 3	4.50	4.25
Settlement date	4.00	4.00

  - All service conditions fulfilled and vested SARs settled on 31 December Year 4

What compensation cost does Company A recognise at each reporting date over the vesting period?

What does Company A record at settlement date?

L$

Measurement illustration:
(3) Cash-settled transaction

	Original grant date fair value	Remeasure-ment	Current year total	Cumulative
Year 1	100	33	133	133
Year 2	100	50	150	283
Year 3 Vesting date	100	67	167	450
Year 4 Settlement	0	-50	-50	-50
Total	300	100	400	400

Grant date: (100 x 3.00) / 3 = 100 per year

Year 1: ((100 x (4.00 - 3.00)) / 3 = 33 per year

Year 2: (((100 x (4.25 - 3.00)) * 2/3) - 33 = 50 per year

Year 3: ((100 x (4.50 - 3.00)) * 3/3) - 83 = 67 per year

Year 4: (100 x 4.00 = 400 - 450 = -50