Ind AS 19 (Employee Benefits)
&
Ind AS 102 (Share-based Payments)

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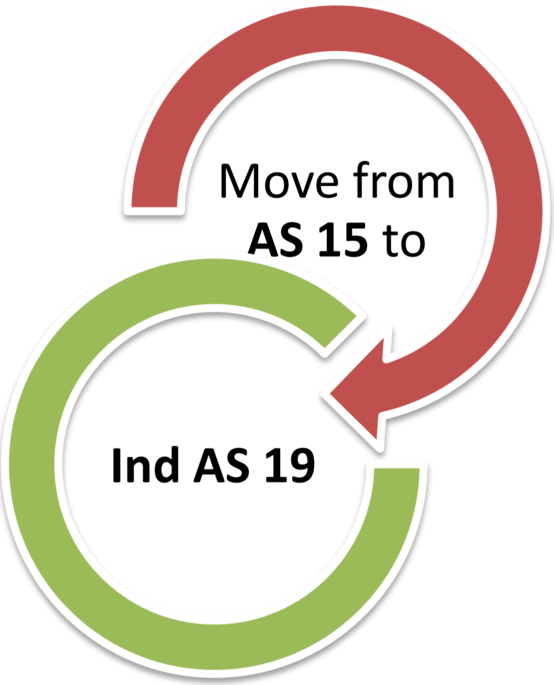
Session Objectives

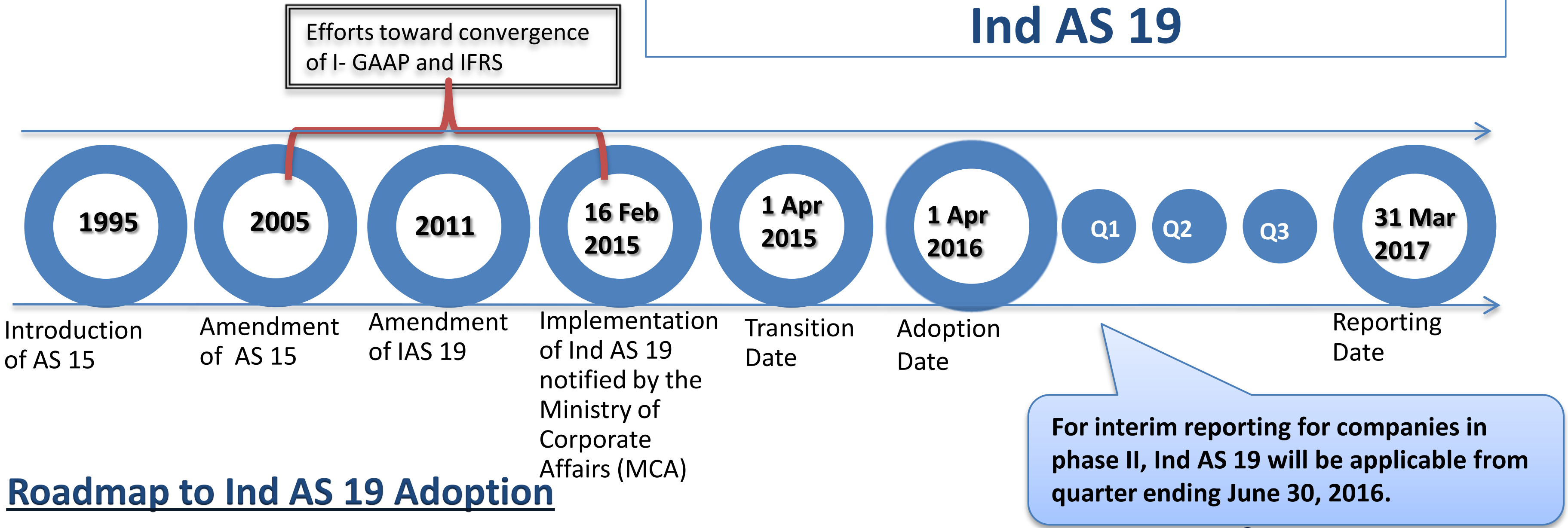


1. Understanding transition between AS 15 to Ind AS 19.
2. How different is Ind AS 19 from the existing AS 15?
3. To appreciate in principle, Ind AS 102
4. To understand the implementation guidance
5. To examine areas for specific attention on transition.

Today's discussion on Ind AS 19

- Transition timeline
- Ind AS 19's applicability
- Benefit Classification
- Post Employment Plans DB and DC
- Other Long Term Benefits
- Special Cases: Exempt PF and Long Service Awards
- Key Differences between Ind AS 19 and AS 15 (R)
- What should auditors check?

Transition timeline from AS 15 to Ind AS 19



Roadmap to Ind AS 19 Adoption

1 April 2015 — PHASE I	1 April 2016 — PHASE II	1 April 2017 — PHASE III
Voluntary adoption from FY 15-16 by any company (excluding Insurance companies, Banks and NBFCs as they are exempted from the application of this accounting standard).	Mandatory compliance from FY 16-17 for all entities with a net worth equal to or in excess of Rs 500 crore.	Mandatory compliance from FY 17-18 for the remaining listed entities and unlisted entities with a net worth between Rs 250 crore and Rs 500 crore.

Entity Applicability for Ind AS 19

There's a method to the madness of the employee benefits accounting standard!

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Applicability of Actuarial Valuation to Post Employment Defined Benefit & Other Long-term Plans AS 15(R)

Classification of Companies under AS15(R)

If Equity or Debt securities are listed or are in the process of being listed, or

In Insurance business, or

Turnover > than Rs 50 crores, or

Borrowings > than Rs 10 crores, or

Banks (incl. co-operative banks), or

Financial Institutions, or

Holding or subsidiary of any one of the above

Not a Small and Medium Sized Company (Non SMC)

Valuation by an Actuary; full disclosures

If any of the criteria does not apply, then company will be a

Small and Medium Sized Company (SMC)

Valuation by an Actuary; Limited disclosures

(AS 15 paras 50 to 123 except 120 (l) i.e. detailed disclosures are not applicable to SMC)

Projected Unit Credit Method

Need for an Actuary under Ind AS 19?

Need for an actuary?

Extracts from paragraphs 59 and 67 of Ind AS 19:

59. This Standard **encourages**, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations....

67. An entity shall use the projected unit credit method to determine the present value of its defined benefit obligations ....

Assumption Setting

Under paragraph 76, the demographic and financial assumptions (salary increase, expected inflation, claim rates under medical plans, withdrawal rate, etc) are those of the employer.

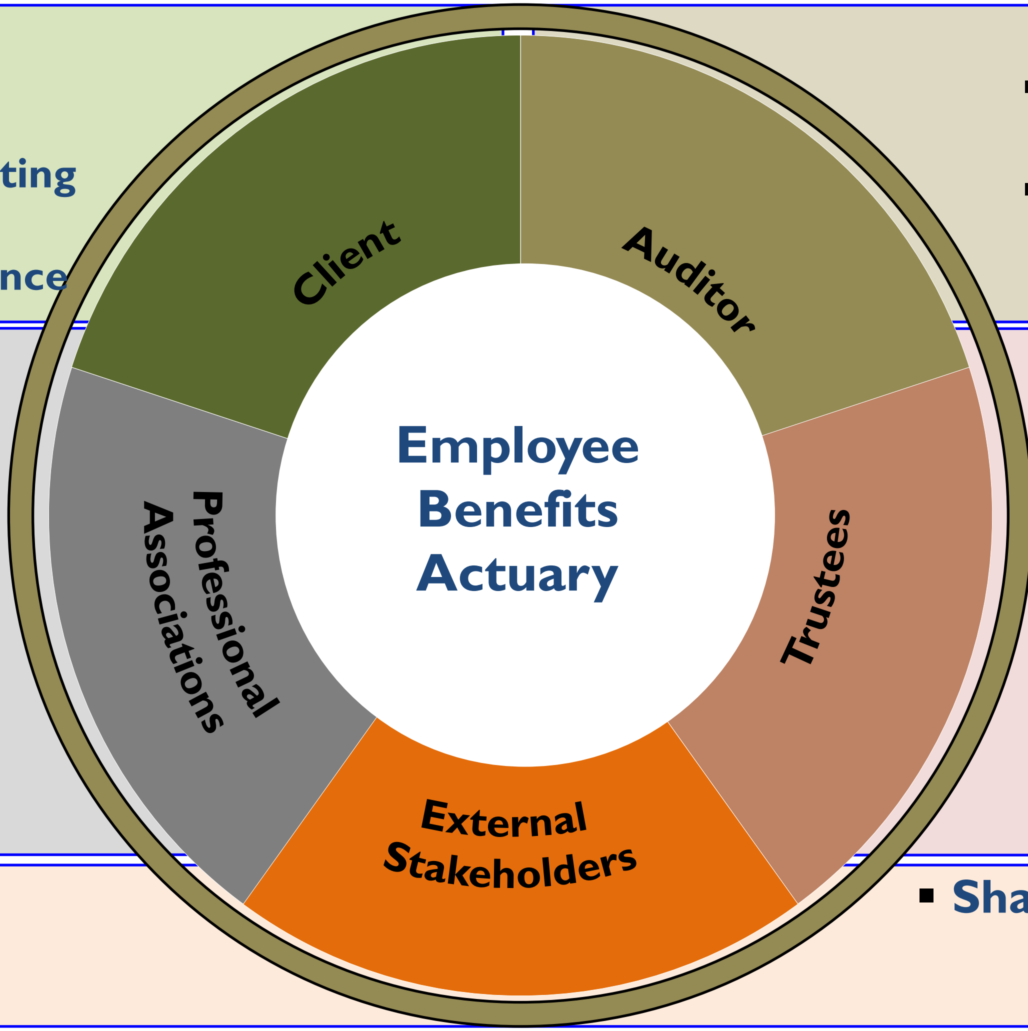
As these are vetted by the actuary (reference to APS 26 of the Institute of Actuaries of India).

An actuarial valuation is usually a joint effort of employer and actuary.

Spectrum of Stakeholders

- Data
- Assumption Setting
- Terms of Reference

- Interactions
- Report usage



- Institute of Actuaries of India
- Institute of Chartered Accountants of India

- Advice on funding
- Asset Liability Management

- Tax authorities
- IRDA

- Shareholders

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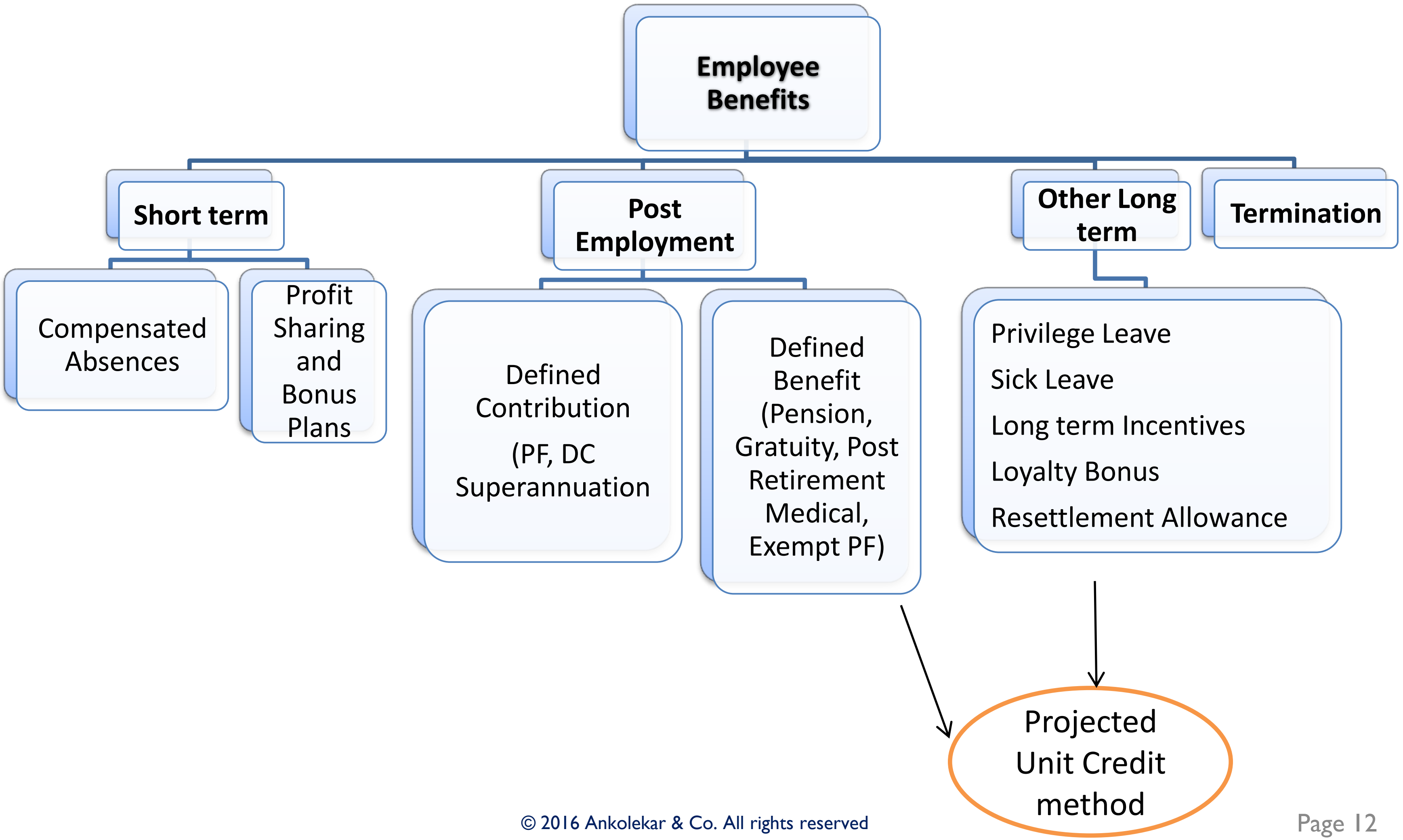
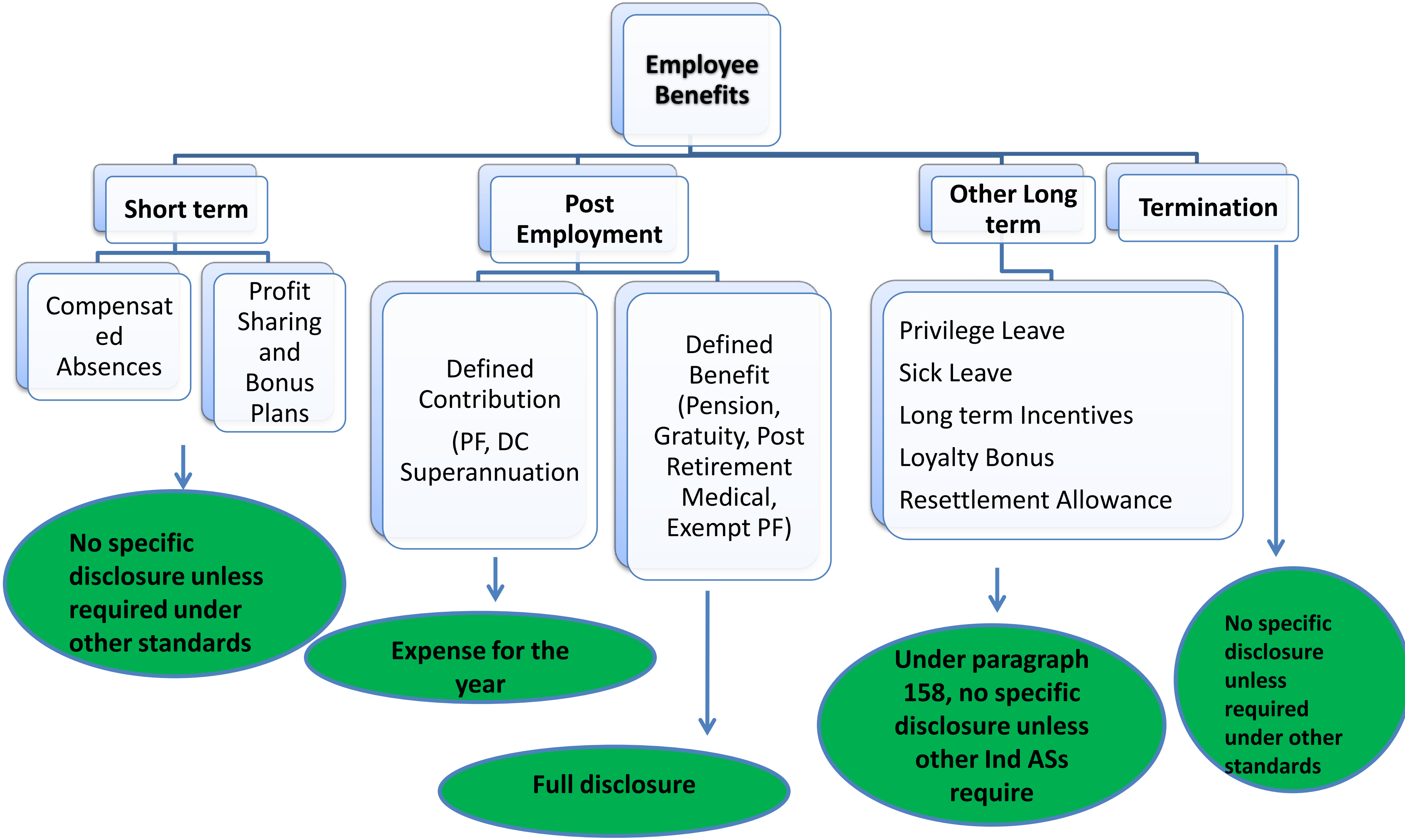
Employee Benefits under Ind AS 19



Employee Benefits under Ind AS 19- Disclosures



Short Term Employee Benefits

Measurement

- Employee benefits which are expected to be settled wholly before 12 months after the end of the annual reporting period of the employee rendering the related service.

Recognition

- As a liability (accrued expense) after deducting any amount already paid
- As an expense

Disclosure

- No specific disclosures unless required by other accounting standards

Short Term Employee Benefits- When should they be recognized?

Accumulating Compensated Absences *e.g. privilege leave which can be accumulated for 1 year only*	**When services rendered increase an employee's entitlement to future compensated absences**
Non-accumulating compensated absences *e.g. maternity and paternity leave*	**When absences occur**
Profit-sharing and bonus plans	**When a present obligation to make such payment arises as a result of past events e.g. annual incentive, MD's commission.**

Expected cost of **accumulating compensated absences -** additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Termination Benefits

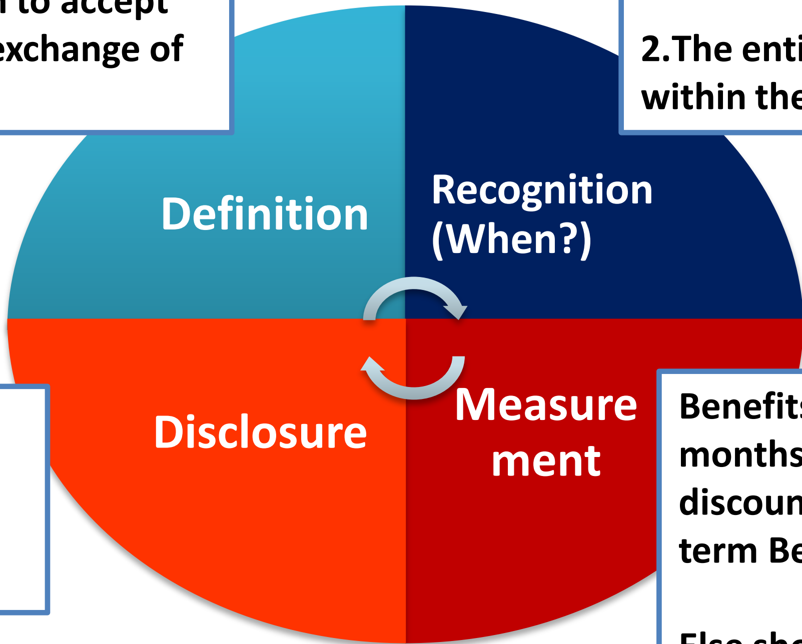
I. Employer's decision to terminate with no conditions on future service being provided; or

II. An employee's decision to accept an offer of benefits in exchange of the termination

Recognize it as a liability and an expense at the earlier of the following dates:

1.The entity can't withdraw the offer for those benefits

2.The entity recognizes restructuring costs within the scope of Ind AS 37



No specific disclosure unless other Ind ASs require.

Benefits that are expected to be settled 12 months after B/S date should be discounted using the logic of other Long-term Benefits

Else should be recognized using requirement of Short-term Benefits

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Post Employment Benefits

Post Employment Benefits include:

a. Retirement Benefits e.g. Gratuity and Pension

b. Other Benefits e.g. Post employment medical care

Defined Contribution Plans	Defined Benefit Plans
1. Obligation is limited to the **amount contributed** to the fund 2. Risk (Actuarial and Investment) fall on the employee E.g. Superannuation, Provident Fund	1. Obligation is to provide **agreed benefits** to the employees 2. Risk (Actuarial and Investment) falls on the enterprise E.g. Pension, Gratuity, Post employment Medical Benefits, Exempt PF

Calculation of the DBO is the first step in Actuarial Valuation!

Post-employment Benefits: Defined Benefit Plans

Defined Benefit Obligation (DBO) at Balance Sheet date − **Fair Value of Plan Assets** = **Net Defined Benefit Liability (Asset)**

What is DBO?	DBO is the Present Value (PV) of the obligation of the company towards its employees for their services rendered over a period of time
How is DBO calculated?	An enterprise should use the Projected Unit Credit (PUC) Method to determine the PV of its DBO and the related current service cost and, where applicable, past service cost (paragraph 67, Ind AS 19).
What is the PUC Method?	The PUC Method sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (paragraph 68, Ind AS 19).
Examples	Post retirement benefits viz. Pension, Gratuity, Medical Benefits

Actuarial Assumptions

Actuarial assumptions should be **unbiased** and **mutually compatible** and are an enterprise's **best estimates**.

Financial Assumptions	Demographic Assumptions
Discount rate	Mortality
Salary escalation	Attrition/ withdrawal
Medical cost Inflation	Disability

1) Discount rate

market yields on government bonds (within India) paragraph 83, Ind AS 19

Yields on high quality corporate bonds (For subsidiaries outside India)

2) To track appropriate YTM → Weighted expected remaining lifetime of employees

3) Financial assumption should be based on market expectations **at the balance sheet date** for the period over which the obligations are to be settled (paragraph 80, Ind AS 19)

An example of y-o-y DBO

Benefit is ½ month's salary for every yr served. Vesting period is 5 yr. Normal retirement age is 60 yr. Assumption of zero withdrawal or death.

Yr	Age	Yr served	Salary rise rate	Discount rate	Salary p.m.	Discontinuance liability	Actuarial liability
0	50 yr	5	10% pa	10% pa	100,000	250,000	250,000
1	51 yr	6	10% pa	10% pa	110,000	330,000	330,000

Assumption of yr 0 was continued in yr 1. Experience in yr 1 is as per assumption. In short, we had no deviation either in actual experience or assumptions.

No actuarial gain/ loss arises.

Reconciliation of DBO reads:

Opening DBO	**250,000**
Service cost (110,000 x½x(1.1/1.1)^9)	55,000
Interest cost (250,000 x 10%)	25,000
Closing DBO	**330,000**

A modified example of y-o-y DBO

Benefit is ½ month's salary for every yr served. Vesting period is 5 yr. Normal retirement age is 60 yr. Assumption of zero withdrawal or death.

250,000 x (1.1/1.11)^10

Yr	Age	Yr served	Salary rise rate	Discount rate	Salary p.m.	Discontinuance liability	Actuarial liability
0	50 yr	5	10% pa	11% pa	100,000	250,000	228,370
1	51 yr	6	10% pa	9% pa	110,000	330,000	358,269

330,000 x (1.1/ 1.09)^9

Assumption of yr 0 was changed in yr 1.

Experience in yr 1 is as per assumption.

In short, we had a deviation only due to change of assumption.

Actuarial gain/ loss arises.

Reconciliation of DBO reads:

Opening DBO	**228,370**
Service cost (110,000 x ½ x (1.1 ÷1.09)^9)	59,712
Interest cost (228,370 x 11%)	25,121
Actuarial loss	45,066
Closing DBO	**358,269**

DBO Reconciliation
between two valuation dates

a) Current Service cost
b) Interest cost
c) Past Service cost
d) Settlement
e) (Curtailment)
f) Acquisition/ (Divestiture)
g) Transfer in/ (Transfer out)
h) Actuarial (gains)/losses or Re-measurements

Closing DBO and Opening DBO needs to be reconciled through these movements!

In a **Settlement and Curtailment**, a loss/ (gain) will arise if the net discount rate {discount rate minus salary escalation rate} is positive/ (negative) and the liability was transferred at discontinuance value

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Other Long-term Benefits (contd.)

Privilege Leave

Long term Incentives

Loyalty Bonus

Resettlement Allowance

Sick Leave

ESOP/ ESPS are not 'Other Long-term Benefits' (separately covered under Ind AS 102/ ICAI GN 18)

Measurement

Other long term benefits need to be actuarially valued using the PUC method as shown in paragraph 67

Recognition

Recognize as net defined benefit liability (asset) in the balance sheet; in case of net defined benefit asset it is recognized at the lower of:

a. Surplus in the plan, and
b. Asset ceiling calculated using the discount rate

Disclosure

No specific disclosure otherwise unless other Ind ASs require

Nothing routed through OCI!

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Exempt Provident Funds – Defined Benefit Pension Plans

Minimum Yield required	ICAI ASB has provided a guidance that an 'in-house' or 'exempt' provident fund should credit a yield at least equal to or better than that declared by the EPFO.
Any shortfall becomes obligation	This creates an obligation on the part of the trustees and in turn the sponsoring employer to provide for the shortfall in yield i.e. between the yield to be declared and that achieved.
How to account for the obligation?	The present value of such guarantee is the liability to be provided by the sponsoring employer.

Modelling Methods

- Deterministic
- Option Pricing
- Stochastic

Exempt Provident Funds – Defined Benefit Pension Plans … contd.

1. Guidance to actuaries follows the Institute of Actuaries of India's APS 29
2. The present value of such guarantee can be calculated on a deterministic or a stochastic basis.
3. So a need to understand emerging liabilities from trends in future interest rates vis-à-vis underlying assets of the provident fund.
4. The guarantee is the equivalent of an 'Interest Rate Floor' and can be calculated using Black's model.
5. Ind AS 19 is a 'fair value' standard, so assets to be measured on MTM basis.

Long term Incentives

Cash based, not shares

Deferred Compensation (part of Other Long Term EB)

Appropriate assumption e.g. escalation, attrition

Projected Unit Credit Method

Recognize P&L charge over the vesting period

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What has changed under Ind AS 19?

1. Recognition of Actuarial Gains and Losses

Under AS 15, immediate recognition in P&L

Under Ind AS 19, Immediate recognition in Other Comprehensive income (OCI).

Corridor approach is not recognised.

Lesser volatility in the P&L due to actuarial gain/ loss from

i. Impact of changes in assumptions and;

ii. Experience being different from assumptions

being routed through OCI

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What has changed under Ind AS 19? ...contd.

2. Financing Cost: Expected Return On Assets (EROA) = Discount Rate

Under AS 15, the P&L includes the interest cost on plan liabilities and the actual return on Plan assets,

Where actual return= EROA + Actuarial Gain/(Loss)

EROA need not equal the discount rate

Under Ind AS 19, EROA = discount rate; net interest cost is calculated by multiplying the discount rate with the net defined benefit liability.

Thus, Interest Cost and EROA is replaced by "Interest Cost on net DBO."

This is part of "Finance Cost"

1. **Asset return greater or lesser than the discount rate will be recognised as actuarial gain/ loss in OCI.**
2. **Categorization of excess/ lower asset returns to OCI means that investing in more volatile assets would not affect P&L immediately.**

What has changed under Ind AS 19? ...contd.

3. Impact of change in Asset Ceiling

Under AS 15, the P&L includes the impact from applying the asset ceiling

Under Ind AS 19, the impact from applying the asset ceiling would be routed through OCI

Lesser P&L volatility as a result of routing of asset ceiling impact through the OCI

What has changed under Ind AS 19? ...Contd.

4. Past Service Cost

Under AS 15, Past Service Cost recognized in the P&L **over the period of vesting.**

Under Ind AS 19, Past Service Cost is recognized **immediately** in the P&L.

P&L will be more volatile. However, the event is likely to be a one-off, e.g. scaling up the benefit formula or enhancing the benefit ceiling.

AS 15 v. Ind AS 19: Recognition and Measurement Differences

	Recognition		Measurement
	AS 15 (R)	Ind AS 19	Differences between AS 15 (R) and Ind AS 19
Past Service Cost	P&L, to the extent vested	P&L irrespective of vesting	No change
Asset Ceiling Charge	P&L	OCI	No change
Actuarial gains and losses - liabilities	P&L	OCI	No change
Actuarial gains and losses - assets	P&L	OCI	The company sets the "expected rate of return on assets" assumption in AS 15 (R). Expected rate of return equals the discount rate at start of year in Ind AS 19.

What has changed under Ind AS 19? ...contd.

5. Additional Disclosures

Under AS 15, such disclosures are currently not required

Under Ind AS 19, disclosures are needed for:

a) Asset Liability Matching Strategies
b) Sensitivity Analysis of significant actuarial assumptions.
c) Information of Future Cash Flows which includes description of funding arrangements, maturity profile of DBO.
d) Entity has to recognize a net position in the BS, hence current liability should also be calculated net of assets available in terms of funded plans.

1. **Increase in transparency and a superior evaluation of ALM risks.**
2. **Depiction of the criticality of each valuation assumption and its ultimate impact on the obligation.**
3. **Enable stakeholders to understand the composition of assets, including whether self- managed or insurer-managed.**
4. **The weighted average duration will indicate the maturity of the plan which could be used to gauge the consistency with the ALM strategy.**

What has changed under Ind AS 19? ...contd.

8. Experience analysis

Under AS 15, five years' comparative tables for experience analysis for both liabilities and assets are disclosed.

Under Ind AS 19, the breakdown of actuarial gains/ losses by:

a) assumption change, and
b) experience

needs to be disclosed for the current and the previous year only.

Experience analysis provides insights to assumption setting.

Management, auditors and actuaries would need to rely on past reports to refine the assumption setting process.

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Actuarial Gains and Losses

Actuarial gains and losses (paragraph 128) may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of plan assets.

Causes are:

(a) unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits or medical costs;

(b) the effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits or medical costs;

(c) the effect of changes in the discount rate; and

(a) is an Experience Gain/ Loss

(b), (c) are Assumption Change Gains/ Losses

Are assumptions ok?

1. **Consistent actuarial losses** due to experience are a pointer toward **sub-optimal assumption setting.**
2. How different is annuitant mortality assumption than in-service mortality assumption?
3. Assumption setting, particularly for salary escalation and withdrawal – need to understand how experience gains and losses feed into assumption setting.
4. Large actuarial gains and losses, say beyond 10% of DBO

Disclosure for short term provision

As per MCA Notification SO 447(E) dated 28 Feb 2011, general instructions to prepare Balance Sheet state that short term provisions for Employee Benefits under Schedule III to the Companies Act, 2013 need to be disclosed.

Unfunded Plans

→ Expected PV of 1 year DBO

Funded Plans

→ Max [EPV of 1 year DBO *less* Fair Value of Trust Assets, 0]

Where to Disclose?

Reconciliation of Defined Benefit Obligation

	2012
Present value of DBO at start of the period	
Current Service Cost	
Interest Cost	
Actuarial Gain/Loss	
Present value of DBO at end of the period	
Of which, Short term Liability at end of the period	??

Net Liability/ (Asset) recognised in the Balance Sheet

	2012
Present value of DBO at start of the period	
Fair Value of Plan Assets	
Net Liability/ (Assets)	
Less: Unrecognised Past Service Cost	
Net Liability/(Assets) recognised in the B/S	
Of which, Short term Liability	??

Managing the transition efficiently

For companies to whom Ind AS applies from FY 2016-17

- **No voluntary adoption as that would imply drawing out disclosures as per Ind AS 19 for March 2015 as well**
- **Recommended practise: Receive both formats viz. AS 15 and Ind AS 19 for the March 2016 valuation**
- **Use the AS 15 numbers for accounting and retain the Ind AS 19 numbers for next year's disclosures**

Important Aspects

1. In post employment DBO plans like gratuity and pension, liabilities arising for employee transfers in/ acquisition or being ceded due to employee transfers out/ divestiture would reflect in DBO reconciliation

2. Direct payments by employers and part settlements from the funds are 'benefits paid.' Provide right information to actuary.

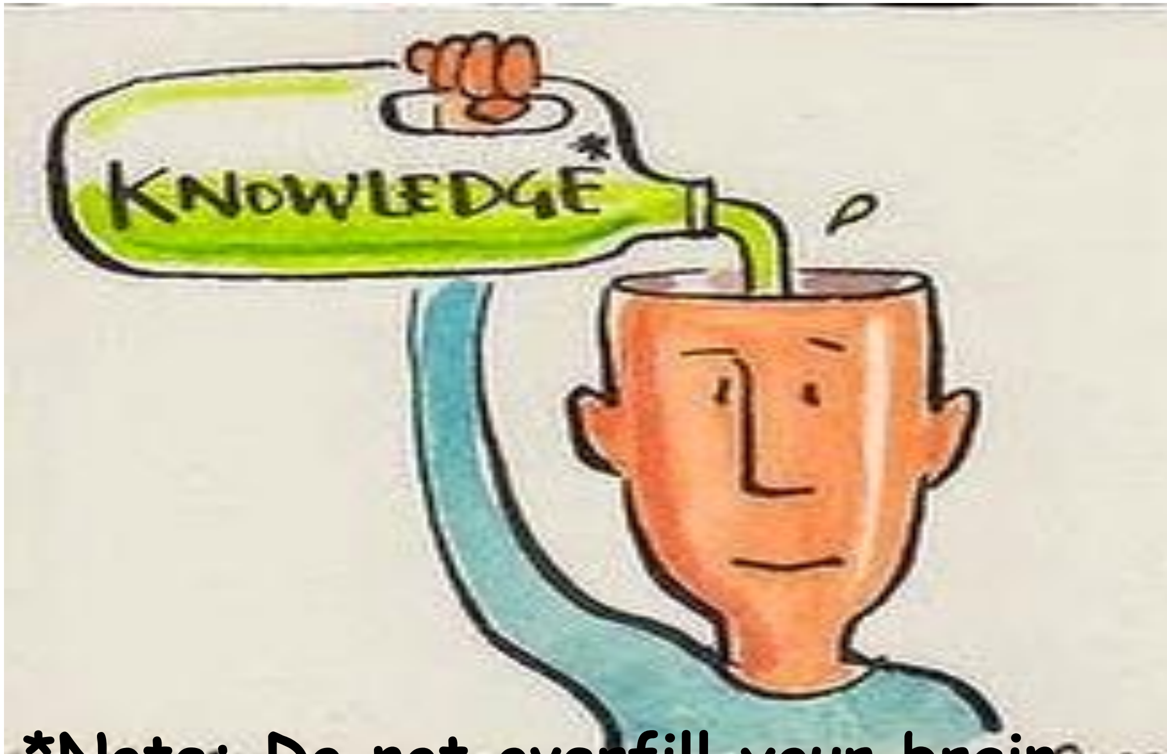
3. Expenses of the fund (e.g. administration charges) are 'employer expense.'

Look Differently

4. Pension scheme valuation – is DBO correctly defined and modeled?
   - Joint life annuities
   - Inflation assumption for index-linked pensions

5. Post employment medical benefits
   - Calculating the burn i.e. annual medical cost
   - Medical inflation, usually higher than pension indexation
   - Is enough experience and trend of the scheme considered

Any questions before starting with Ind AS 102?



*Note: Do not overfill your brain
Allow the knowledge to soak up before topping up!

Discussion List for Ind AS 102

- Applicability and Structure
- Overview and Scope
- Measurement
- Recognition
- Challenges

Ind AS 102 Share Based Payments

Entity Applicability

MCA Notification dated Feb 16, 2015

FY 2016-17

Listed and unlisted companies (and subsidiaries) both with net worth > Rs 500 crores

FY 2017-18

All listed companies and unlisted companies (and subsidiaries) with net worth > Rs 250 crores

First-time Adoption - Ind AS 101

As per Paragraph D2:

Option status	**Applicability**
Options already vested or already settled	Encouraged, but not required to apply Ind AS 102
Terms of issue modified for options not yet vested	Not required to apply Ind AS 102 paragraphs 26-29 if the modification occurred before transition date. i.e. **if unexpired options granted earlier are modified after transition date,** applying Ind AS 102 would be necessary

Structure of Ind AS 102

- Paragraphs 1 to 52
- Appendix A: Defined terms
- Appendix B: Application guidance
- Appendix 1: Comparison with IFRS 2
- Implementation guidance

  (accompanies, but not a part of IndAS102)

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- Challenges

Ind AS 102 Share Based Payments

Overview of Ind AS 102

Scope	Applies to **all share-based payment** transactions
Types of share-based payments	**Equity settled, cash settled, or choice** between equity and cash settlement
Recognition of cost	Recognized **over vesting period**; can further be expensed or capitalized
First measured on	**Grant date** for employees **Date goods or services are received** for others
How to measure	**Fair value** basis e.g., valuation techniques for ESOP, SAR, shares or payment derived from share prices

Ind AS 102's Scope

All share-based payment transactions even if entity can't identify specifically some or all services received, including

- Equity settled share-based payment transactions
- Cash settled share-based payment transactions
- As per terms of arrangement of receiving goods or services, the entity or supplier can settle transaction in cash or equity shares

Examples

1. Share options
2. Share based payments with cash alternatives
3. Share appreciation rights
4. Restricted shares

Ind AS 102's Scope .. Contd.

Ind AS 102 covers share-based payment arrangements, not merely share-based payment transactions

> A share-based payment arrangement is "an agreement between the entity (or another group entity as defined in Ind AS 110 or any shareholder of any group entity) and another party (includes an employee) that entitles the other party to receive …."

Ind AS 102 thus applies to share-based payment transaction <u>settled by another group entity</u>

A Classification exercise

Choose from:

1. Share options →A
2. Share based payments with cash alternatives →D
3. Share appreciation rights →B
4. Restricted shares →C

A. Employees receive 100 shares after 3 years	B. Employees receive the difference between current market price and price prevailing at the end of 3 years of 100 shares	C. Employees receive 100 shares after 3 years, however shares have a lock-in of 2 more years	D. Employees can elect to receive 100 shares after 3 years, or its cash equivalent

Valuation technique to use

Choose from:

1. Option Valuation at grant date only →A
2. Compound financial instrument – value equity and debt separately →D
3. Option Valuation at each B/S date →B
4. Fair Value of restricted shares i.e. after allowing for opportunity lost → C

A. Employees receive 100 shares after 3 years	B. Employees receive the difference between current market price and price prevailing at the end of 3 years of 100 shares	C. Employees receive 100 shares after 3 years, however shares have a lock-in of 2 more years	D. Employees can elect to receive 100 shares after 3 years, or its cash equivalent

Excluded from scope of Ind AS 102

i. Transactions based on the holder's capacity as an equity owner (Para 4 of Ind AS 102)
ii. Instruments issued as consideration in a business combination (Para 5 of Ind AS 102)
iii. Awards in which the goods or services are within the scope of Ind AS 32, Financial Instruments: Presentation or Ind AS 109, Financial Instruments (Para 6 of Ind AS 102)
iv. Amount paid is not based on market price of entity's shares (definition of Share-based Payment Arrangement, Appendix A)

Definition of an 'Option'

A Call (Put) Option is a right, but not an obligation, to buy (sell) an underlying security at a particular time and at a predetermined Strike Price.

The time could be at the end of the life of the option i.e. European or at any time during the life of the option i.e. American.

Binomial/ Lattice and Black Scholes Formulae – A comparison

Black Scholes Model	Binomial/ Lattice Model
Black-Scholes-Merton formula uses static assumptions and is not the best method to estimate the fair value of ESOPs	A lattice model can explicitly use dynamic assumptions regarding the term structure of volatility, dividend yields, and interest rates.
Black-Scholes-Merton formula cannot handle the additional complexity of a market based performance condition .	The lattice model, that takes into account employee exercise patterns based on the dynamics of an entity's share price may result in a better estimate of fair value.

The longer the term of the option and the higher the dividend yield, the larger the amount by which the binomial lattice model value may differ from the Black-Scholes-Merton value.

Key Parameters for Option Valuation

Whilst Ind AS 102 on Share-based Payments does not obligate any particular method, the option-pricing model used must take into account a minimum of six inputs, viz.

1. **Current price of the underlying share**
2. **Exercise price**
3. **Expected volatility of the price of the underlying share**
4. **Expected dividends on the underlying share**
5. **Risk-free interest rate for the expected term**
6. **Expected term of the option, taking into account both the contractual term of the option and the expected effects of employees' exercise and post-vesting behavior**

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Ind AS 102 Share Based Payments

Grant Date

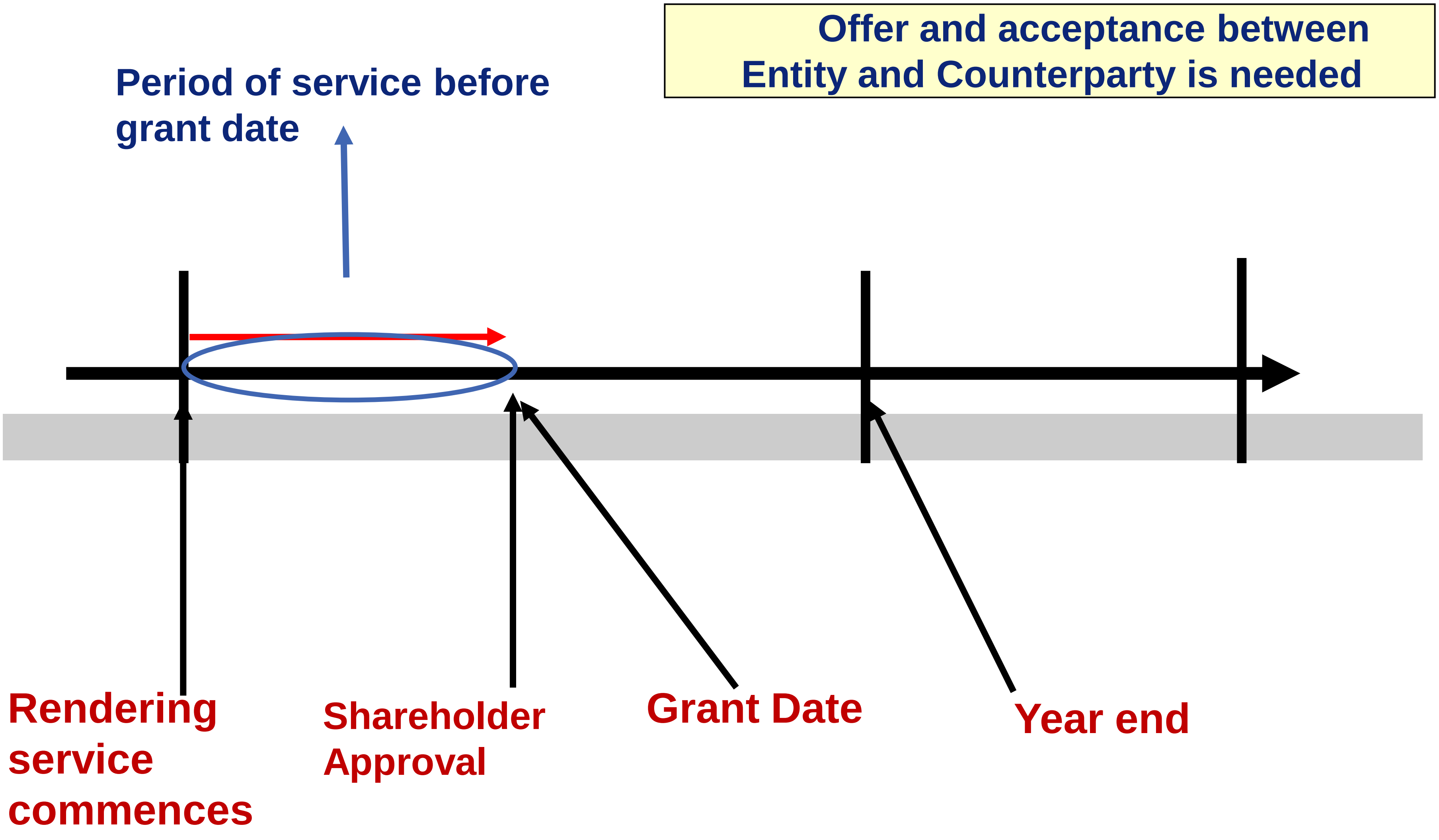
<u>IG1, IG2 and IG3</u>

The date at which:

1. The entity and employee (or other party providing similar services) agree+ to a share-based payment arrangement
2. A shared understanding of the terms and conditions of the arrangement exists
3. 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
4. Approval is obtained (if subject to an approval process)

+Agree connotes both an offer and acceptance of the offer

Grant date Illustration



Source: K G Pasupathi, 2014 (ICAI website)

Vesting Conditions

Conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets, or equity instruments of the entity under a share-based arrangement (Appendix A — amended)

Vesting conditions include:

- Service Conditions — Which require the other party to complete a specified period of service
- Performance Conditions — Which require specified performance target to be met.

Market Vesting Condition

Does the condition upon which the exercise price, vesting, or exercisability of an equity instrument depends or <u>is related to the market price of the entity's equity instruments,</u> such as

a) attaining a specified share price or
b) specified amount of intrinsic value of a share option, or
c) achieving a specified target that is based on the market price of the entity's equity instruments related to an index of market prices of equity instruments of other entities?

No → **Non-market Condition**

Shall be taken into account by adjusting the number of equity instruments included in measurement (paragraph 19)

Yes → **Market Condition**

Shall be taken into account when estimating the fair value of equity instruments granted (paragraph 21)

Non-market Vesting Condition

Does the condition determine whether the entity receives the services that entitles the counterparty to the share-based payment?

No

Non-vesting Condition (condition to be satisfied for Entitlement)

Shall be taken into account when estimating the fair value of equity instruments granted (paragraph 21A)

Yes

Does the condition only require a specified period of service to be completed

Yes

Service condition

No

Performance condition

Vesting Conditions *Other than Market Conditions*

- Vesting conditions other than market conditions are not considered in estimating the fair value (paragraph 19 of Ind AS 102).

- Taken into account by adjusting the number of equity instruments included in the calculation so compensation is recognized for only those that vest.

Non-vesting Conditions

- Taken into account when estimating the fair value of the instruments granted (paragraph 21A).
- Conditions which need to be satisfied for the counterparty to become entitled to the equity instrument.
- Conditions that do not have an implicit or explicit service requirement.
- If failure to meet a non-vesting condition is in either party’s control if the condition is not met, it would be treated as a cancellation.

Measurement of Equity-settled SBPT to Employees

In practice, it is not possible to measure fair value of services rendered by employees (and others providing similar services)

Paragraphs 11 & 12 of Ind AS 102:

1. Measure at fair value of equity instruments granted
2. Fair value measured at grant date
3. Credit recognized in equity

Measurement of Equity settled SBPT to parties other than Employees

A rebuttable presumption exists that fair value of goods or services received from parties other than employees can be reliably estimated.

Paragraph 13 of Ind AS 102:

1. Measure at fair value of the goods or services received.
2. Fair value measured at date of receipt of goods or services.
3. Only if fair value of goods or services cannot be measured reliably would fair value of equity instruments granted be used for measurement (rarely done, i.e. when the entity rebuts the presumption).

Treatment of vesting conditions

Equity-settled		Cash-settled
Non-market based vesting conditions	Market based vesting conditions	All vesting conditions
↓	↓	↓
Fair value **excludes** these vesting conditions	Fair value **includes** these vesting conditions	Fair value **includes** all vesting conditions
↓	↓	↓
"True-up"	No "True-up"	"True-up"

Source: K G Pasupathi, 2014 (ICAI website)

Discussion List for Ind AS 102

- Applicability and Structure
- Overview and Scope
- Measurement
- Recognition
- **Challenges**

Ind AS 102 Share Based Payments

Recognition Principles: Equity-settled and Cash-settled SBPT

Equity Settled SBPT

- Recognize the goods or services when received under SBPT (i.e. periodic cost from grant date to vesting date)
- When goods or services do not qualify for recognition as assets, recognize as expenses
- No re-measurement, unless modification before vesting date increases fair value
- Adjustment for other vesting conditions (e.g. service and performance conditions) to be done at each reporting period

Cash Settled SBPT

- Recognize the goods or services when received under SBPT (i.e. periodic cost from grant date to vesting date)
- When goods or services do not qualify for recognition as assets, recognize as expenses
- Re-measurement of fair value at each reporting date
- Adjustment for other vesting conditions (e.g. service and performance conditions) to be done at each reporting period

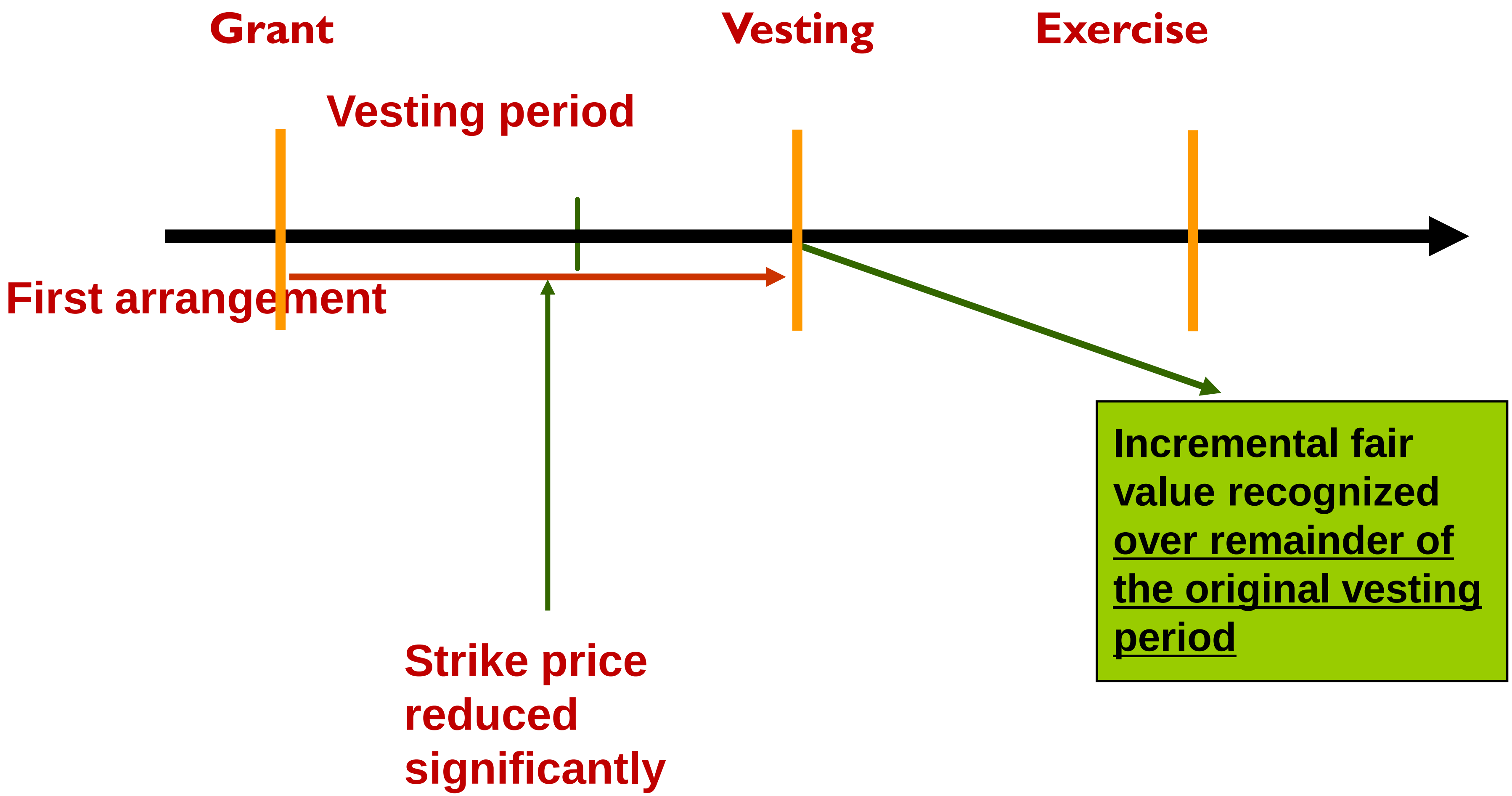
Modification to grant terms and conditions

+ Fair value can increase by reducing exercise price or reducing vesting period or both

Modification

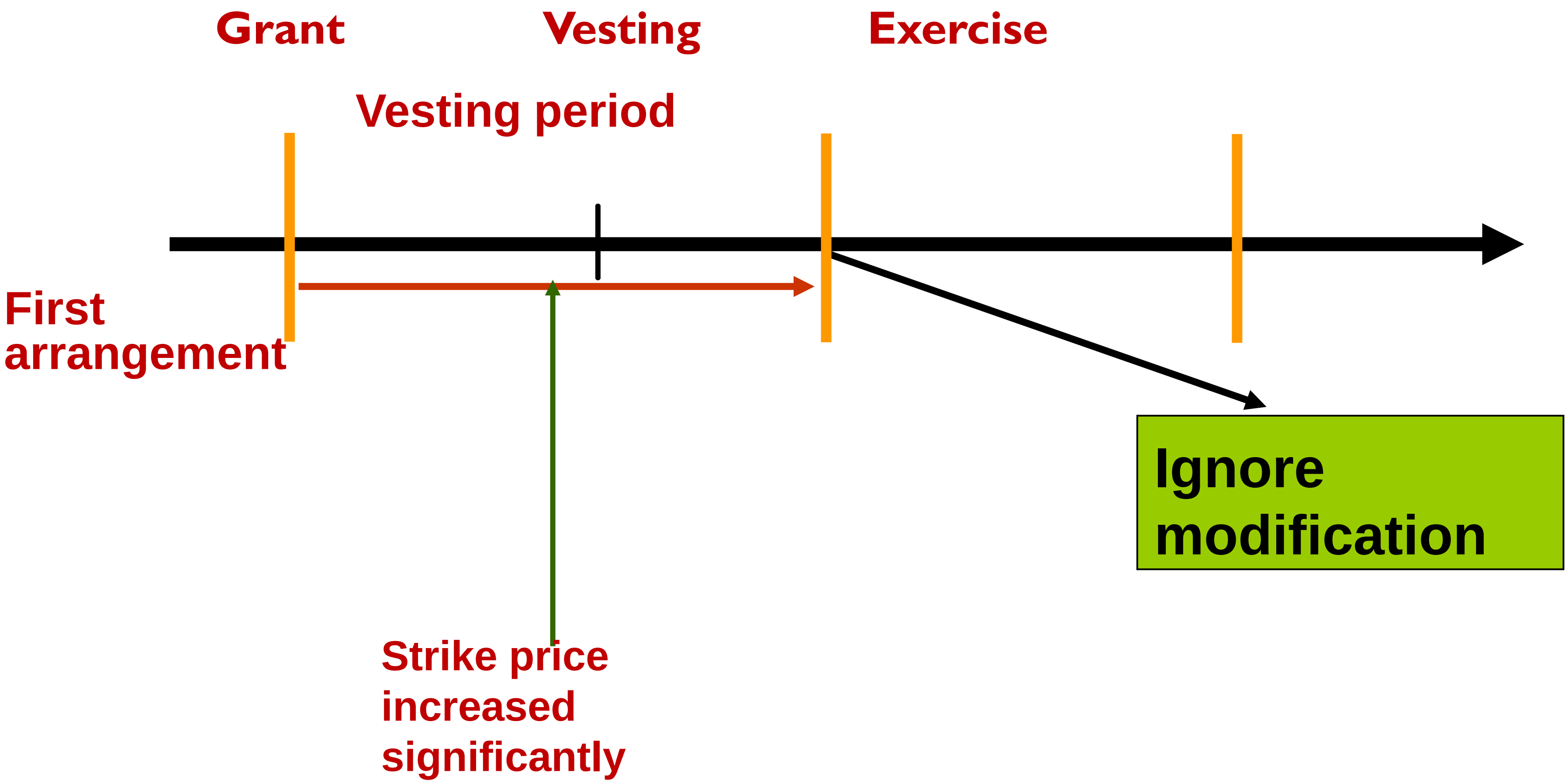
- Equity-Settled (Fair Value Change)
  - If Increases Fair Value+ recognize additional cost for incremental fair value (measured at date of modification) over remaining vesting period
  - Do nothing if decreases Fair Value i.e. continue to recognize original cost
- Equity-Settled (Cancellation or Settlement)
  - Treat as acceleration of vesting and recognize immediately
- Cash-Settled
  - Re-measure at each reporting period anyway

Modifications – Repricing/replacement



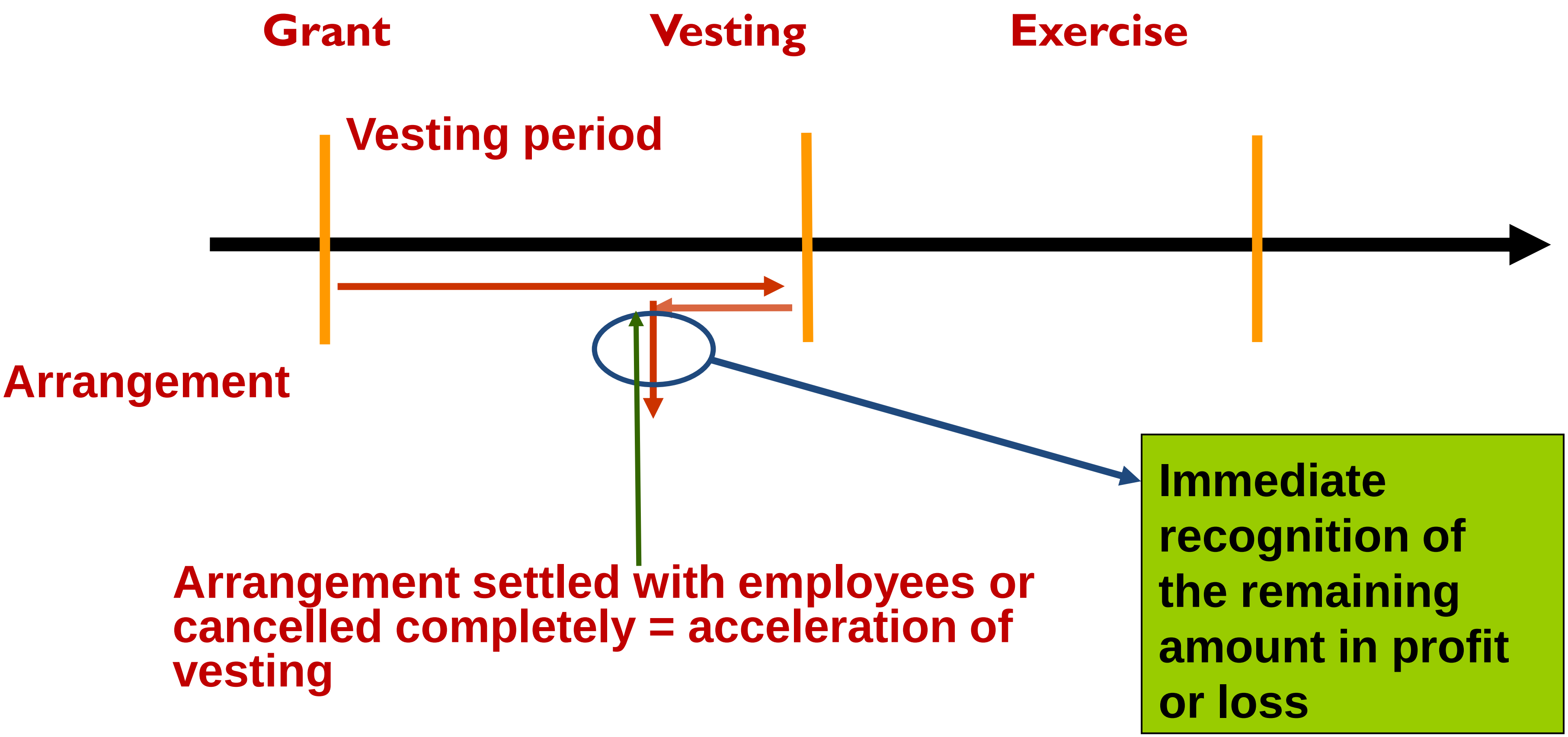
Source: K G Pasupathi, 2014 (ICAI website)

Modifications – Repricing/ Replacement



Source: K G Pasupathi, 2014 (ICAI website)

Modifications – Settlement/ Cancellation



Source: K G Pasupathi, 2014 (ICAI website)

Forfeiture and Lapses of Equity-Settled Instruments

Before Vesting Date

- Reverse amount earlier recognized (paragraph 23)

After Vesting Date

- Cannot subsequently reverse amount earlier recognized (paragraph 23)

Scheme of entries for recognition

Equity Settled

On grant and onward

Dr. Expense

Cr. ESOP o/s

(account fair value at grant date over period of vesting, reference paragraph 10)

Similar entry over future years

On vesting

Dr. ESOP o/s

Dr. Bank (cash recd)

Cr. Share Capital (face value)

Cr. Share Premium (Bal. Fig.)

Cash Settled

On grant and onward

Dr. Expense

Cr. Liability

(account fair value at measurement date over period of vesting)

Similar entry for MTM adjustment of fair value at future measurement dates (reference paragraphs 30-33)

On vesting

Dr. Liability

Cr. Bank

For actual payout

SBPT with cash alternative to Counterparty

A compound financial instrument comprises a debt and an equity component

If counterparty is a supplier

- Calculate the fair value of debt
- Fair value of equity = Fair value of goods/ service received – Fair value of debt

If counterparty is an employee

- Calculate the fair value of debt as fair value of cash settled SAR
- Usually fair value of the equity component is Zero

SBPT with cash alternative to Entity

Entity has to determine if the present obligation is to settle in cash or equity

Cash

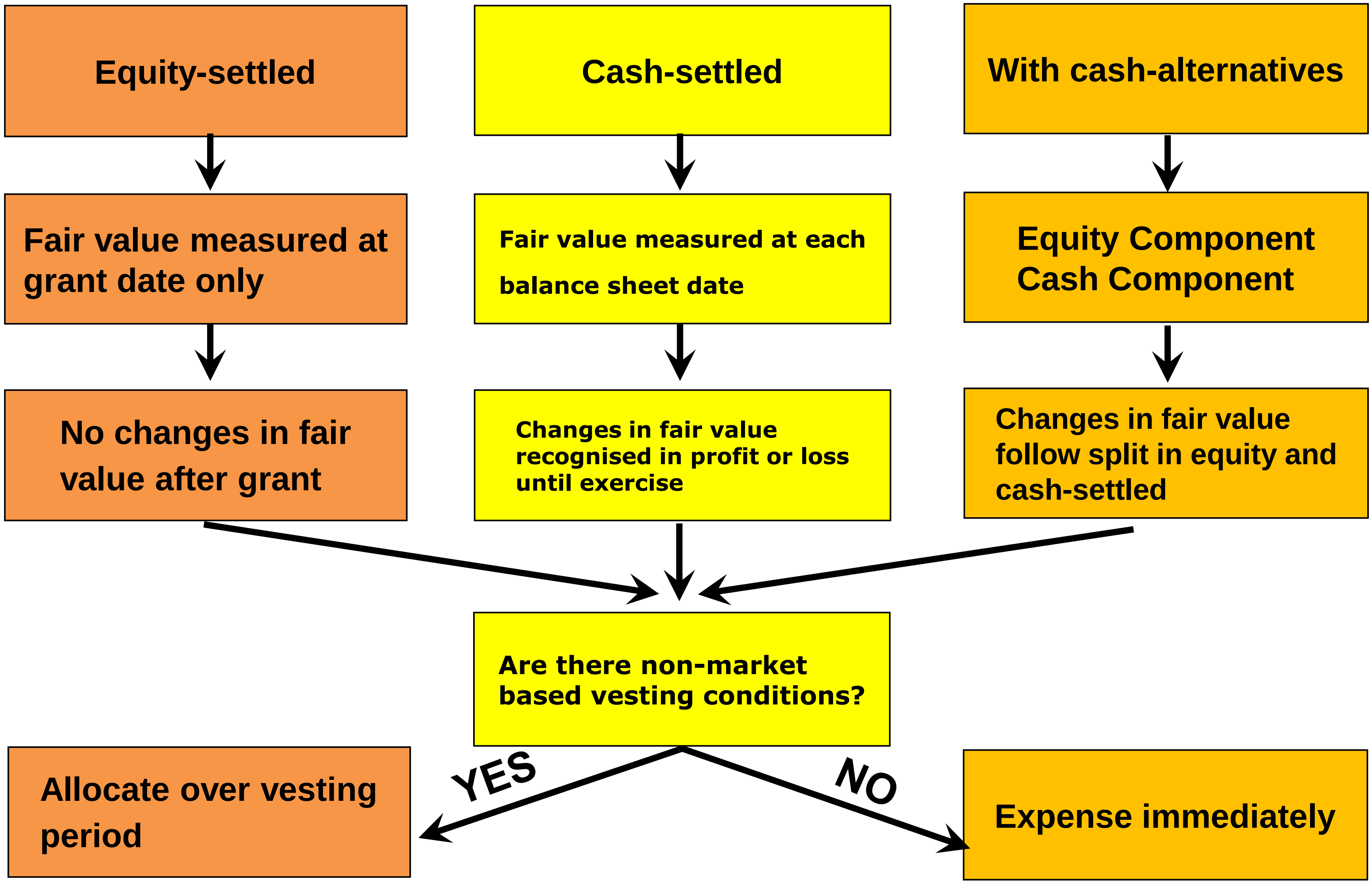
- If settlement choice in equity has no commercial substance (unlisted)
- If entity usually settles in cash when counterparty insists
- Account as per cash-settled SBPT

Equity

- For listed company, the settlement choice in equity has commercial substance
- Account as per equity-settled SBPT
- If final settlement is in cash (i.e. not equity) cash payment will be accounted as repurchase of equity interest

On final settlement, the entity needs to account for the cost of settlement alternative, if higher in value than earlier accounted.

Recognition Snapshot



Source: K G Pasupathi, 2014 (ICAI website)

Equity-settled SBPT of group entities

In the books of entity receiving goods or services

Treat as Equity-Settled if

a) awards are own equity instruments or

b) entity has no obligation to settle the SBPT

In the books of entity settling SBPT when another entity receives goods or services

Treat as Equity-settled only if settled in entity's own equity instruments

Scheme of accounting entries
Equity-settled for group entities

In the books of entity receiving goods or services

Dr. Employee Expense

Cr. Parent Co.

(ongoing over period to vesting)

In the books of entity settling SBPT when another entity receives goods or services

Dr. Group Company

Cr. ESOP o/s

(ongoing over period to vesting)

<u>On close out</u>

Dr. ESOP o/s

Dr. Bank

Cr. S/Capital

Cr. S/ Premium (Bal Fig.)

Scheme of accounting entries
Cash-settled for group entities

In the books of entity receiving goods or services

Dr. Employee Expense

Cr. Liability

(ongoing with MTM over period to vesting)

On close out

Dr. Liability

Cr. Parent Company

In the books of entity settling SBPT when another entity receives goods or services

No entry over period to vesting

<u>On close out</u>

Dr. Group Company

Cr. S/Capital

Cr. S/ Premium (Bal Fig.)

Deferred Taxation on SBPT expenses

- The amount of tax deduction might differ from the amount of the expense recognized in the financial statements.

- Evaluate the timing difference between charge of expenses and timing of deduction

- Deferred tax asset is re-measured at each reporting date.

Discussion List for Ind AS 102

- Applicability and Structure
- Overview and Scope
- Measurement
- Recognition
- Challenges

Ind AS 102 Share Based Payments

Comprehension Challenges

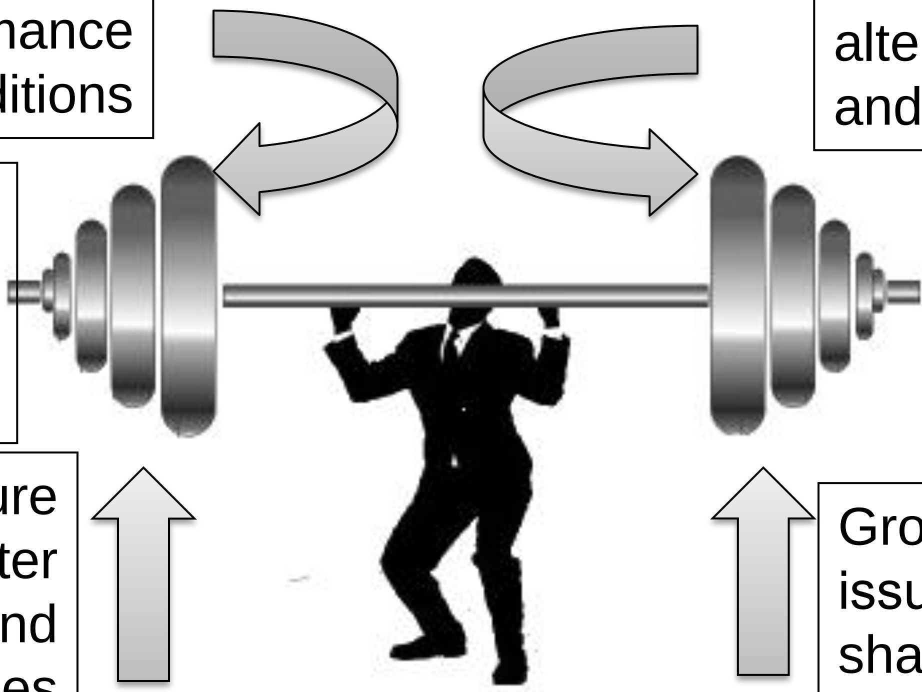
The unwieldy forces of weight

<u>Range of Instruments</u>: SAR, Cash based on Share Price, Restricted Shares, Normal Shares, Equity-and Cash-settled Options, Restricted Options, Reload Options

Parameters of service and performance conditions

SBPT with cash alternatives to entity and counterparty

Right fair value model esp. restriction, differential rights



Modifications, incl. cancellation and settlement

Forfeiture (before and after vesting) and lapses

Group entity issuing parent's shares

<u>Understanding the AS with its appendices and implementation guidance</u>

Approach Checklist

Nature of Share-based Payment

- Who's issuing (subsidiary, group company, parent)
- Whose shares
- Equity or cash-settled Options, SAR, Shares, With Cash Alternatives
- Grant date, Time to Vesting

Fair Value of Instruments

- Model Parameters, particularly 'best estimate' expectations
- Using the right model
- Restriction complexities
- Compound Instruments

Non-market Vesting Parameters and Non-Vesting Parameters

- Withdrawal rate parameter
- Performance parameters
- Appropriate calculation to amortize on graded vesting basis
- Entity or counterparty exercising the non-vesting parameters

During the year: Modification, Cancellation, Settlement

- Increase or decrease in fair value on modification, account for increase
- Cancellation due to forfeiture before vesting to account
- Settlement to account as acceleration of costs

Q & A

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