Share based payment transactions with cash alternatives.

As mentioned in class, there are two kinds of SBP transactions with cash alternatives as follows:

1. The counterparty (employee) has the choice between equity or cash at vesting date OR
2. The entity has the choice.

A. Counterparty has the choice

When the counterparty has the choice, the instrument granted to the employee is viewed as a compound financial instrument with the fair value of the equity alternative representing the "value of the total services, i.e the value of the compound financial instrument at grant date. To the extent that the value of the share alternative exceeds the value of the cash alternative (at grant date), the residual is referred to as the equity component (treated in accordance with equity settled transactions).

It is a compound financial instrument because the entity does not have an unconditional right to avoid paying cash, but to the extent that the liability component has been accounted for, any excess or residual must be regarded as the equity component (right to receive equity).

The accounting for the SBP transaction upto vesting date is quite simple. The "equity component is accounted for in accordance with "equity-settled transactions" and the liability component is accounted for in accordance with "cash-settled transaction".

The challenge arises at the vesting date, once the employee has made the choice of either equity or cash.

1. If the employee chooses cash, then you should make sure that the liability is remeasured to its latest fair value, and then just reverse it upon the payment of the cash.
    a. Does this make sense?
    b. What happens to the equity component? Nothing, because the objective of the standard is to account for the services received, not the equity issued. This follows the same principle as a normal equity-settled transaction where the services are rendered, but the equity is not issued because a market condition has not been met. We do not reverse out the transaction because the services, in effect, were received for "free".
2. If the employee chooses the equity component, then you need to reverse the liability, because it won't be settled in cash. Why do you reverse it against equity? The value of the liability represents the cost of the services received, whereas the equity component accounted for was merely measured as the "residual of the FV at grant date". Hence, if the employee chooses equity, it stands to reason that the services received were for the issue of equity and the liability should be reversed against equity.

B. **Entity has the choice**

Again, accounting for this upto vesting date is very simple. The basic question to ask is: Does the entity have a present obligation to settle in cash? If yes, then the entire instrument is regarded as cash settled, but if no present obligation exists, the entire instrument is regarded as equity-settled.

If the entity has accounted for the SBP transaction as equity –settled and then does settle in equity this is just treated using the normal principles of equity-settled transactions. Again, if the entity has accounted for the SBP transaction as cash –settled and then does settle in cash, this is just treated using the normal principles of cash-settled transactions.

The challenge here ONLY arises at the vesting date where the entity has accounted for the transaction as equity-settled, but then actually settles in cash, OR where the entity has accounted for the transaction as cash-settled, but then actually settles in equity.

1. Where the entity has accounted for the transaction as equity-settled, but then actually settles in cash:
    a. Reverse equity and instead show the liability that needs to be settled. This makes sense as the entity is settling in cash not equity.

2. Where the entity has accounted for the transaction as cash-settled, but then actually settles in equity.
    a. Reverse liability and instead show equity. This makes sense as the entity is settling in equity not in cash.

Sounds simple enough…so what's the problem?

Students are struggling with one concept here: The fact that the fair value of the equity instruments changes from grant date to vesting date, but we do not account for that change, i.e we do not re-measure equity because equity is a residual.

IFRS 2 para 43 (c) states that ***"if the entity elects the settlement alternative with the higher fair value, as at the date of settlement, the entity shall recognise an additional expense for the excess value given, ie the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable."***

Let us analyse this paragraph :

i. "***the entity elects the settlement alternative with the higher fair value, as at the date of settlement."***
   This is referring to the need to:
   1) determine the **fair value** of both settlement alternatives (equity and cash)
   2) at **settlement** date (The settlement date is normally the vesting date when either the equity instrument or the cash instrument is issued/given to the employee)

ii. "***the entity shall recognise an additional expense for the excess value given"***
After determining the fair value of the alternatives at vesting date, you will need to assess whether the settlement chosen by the entity has a higher fair value (at vesting date) than the settlement accounted for. If so, then in reality, the employees are being paid more for their services than originally accounted for. Consequently, an additional expense must be recognised for the additional value.

Finally, let us consider the following question:
Suppose an entity accounts for the SBP transaction as equity-settled, but then ACTUALLY settles in cash.

Can the value that we de-recognise for equity (when settling in cash) exceed the grant date fair value that was originally reported in equity?

YES. The grant date fair value of the equity is NEVER re-measured, because equity is a residual. However, in reality, the value of the equity instruments DOES change. So, even though the equity is originally shown at the grant date fair value, and this does not change, it nevertheless represents the equity instruments that will be issued upon vesting. Those equity instruments have a different fair value at vesting date than they had at grant date, even though they are the same instruments. Consequently, when equity is therefore de-recognised and a liability recognised, the maximum amount that can be de-recognised is the actual value of the equity, because this is what they are worth.

The only reason the equity now appears to be negative is not because of the de-recognition of equity at its "vesting date" fair value (or anything up to its vesting date fair value) but rather because we were not able to re-measure the equity instrument after grant date (due to the fact that equity is defined as a residual).

Now go through examples 13, 13a and 13b again……..