CHAPTER 15

SHARE BASED PAYMENTS (IFRS-2)

OBJECTIVE

The objective of this IFRS is to provide accounting treatment for an entity when it involved in share based payment transactions. This IFRS primarily requires the share based payments to be recognized in profit and loss account.

SCOPE

An entity shall apply this IFRS in accounting for all share-based transactions whether or not the goods and services received are identifiable or not, including: -

a) Equity settled share based payment transactions, in which the entity receives goods or services as consideration for equity instruments of the entity.

b) Cash settled share based payment transactions in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on entity's shares or other equity instruments of the entity, and

c) Through issuance of equity or payments of cash for goods or services received.

A share based payment may be settled by another group entity on behalf of an entity receiving or acquiring the goods or services.

Examples of arrangements that come under IFRS 2 are:

- Call options that give employees the right to purchase an entity's shares in exchange for their services;
- Share appreciation rights that entitle employees to payments calculated by reference to the market price of an entity's shares or the shares of another entity in the same group;
- In-kind capital contributions of property, plant or equipment in exchange for shares or other equity instruments;
- Share ownership schemes under which employees are entitled to receive an entity's shares in exchange for their services; and
- Payments for services made to external consultants that are calculated by reference to the entity's share price.

However, this IFRS will not be applicable in the following circumstances: -

a) A transaction with an employee or other party in his capacity as a holder of the equity instrument is not a share based payment transaction (Right issue).

b) A transaction involving assets other than non-financial assets. (IFRS-3)

c) Contracts for the purchase of goods that are within the scope of IAS 39, such as commodity contracts entered into for speculative purposes, i.e., other than to satisfy the reporting entity's expected purchase or usage requirements.

DEFINITIONS

Cash-settled share-based payment transaction

A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity.

Employees and others providing similar services

Individuals who render personal services to the entity and either (a) the individuals are regarded as employees for legal to or tax purposes, (b) the individuals work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes, or (c) the services rendered are similar to those rendered by employees. For example, the term encompasses all management personnel, i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors.

Equity instrument

A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities

Equity instrument granted

The right (conditional or unconditional) to an equity instrument of the entity conferred by the entity on another party, under a share-based payment arrangement

Equity-settled share-based payment transaction

A share-based payment transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options)

Grant date

The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counter-party have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counter-party the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained

Intrinsic value

The difference between the fair value of the shares to which the counter-party has the right to receive, and the price (if any) the counter-party is (or will be) required to pay for those shares. For example, a share option with an exercise price of $15, on a share with a fair value of $20, has an intrinsic value of $5.

Market conditions

A condition upon which the exercise price, vesting or exercise-ability of the an equity instrument depends that is related to the market price of the entity' equity instruments, such as attaining a specified share price or a specified amount of intrinsic value of a share option or achieving a specified target that is based on the market price of the entity's equity instruments relative to an index of market prices of equity instruments of other entities.

Measurement date

The date at which the fair value of the equity instruments granted is measured for the purposes of this IFRS. For transactions with employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counter-party renders service.

Reload feature

A feature that provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

Reload option

A new share option granted when a share is used to satisfy the exercise price of a previous share option.

Share-based payment arrangement

An agreement between the entity and another party (including an employee) to enter into a share-based payment transaction, which thereby entitles the other party to receive cash or other assets of the entity for amounts that are based on the price of the entity's shares or other equity instruments of the entity, or to receive equity instruments of the entity, provided the specified vesting conditions, if any, are met.

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 for amounts that are based on the price of the entity's share or other equity instruments of the entity

Share option

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

Vest

To become an entitlement. Under a share-based payment arrangement, a counter-party's right to receive cash, other assets or equity instruments of the entity vests upon satisfaction of any specified vesting conditions.

Vesting conditions

The 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 payment arrangement. Vesting conditions are either service or performance conditions. Service conditions is, which require the other party to complete a specified period of service and performance conditions which require specified period and performance targets to be met over a specified period. A performance condition might include a market condition. (Such as a specified increase in the entity's profit over a specified period of time)

Vesting period

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

RECOGNITION

EQUITY-SETTLED TRANSACTIONS

An example of an equity-settled transaction is the issuance of options to employees that give them the right to purchase the entity's shares at a discounted price in exchange for their services.

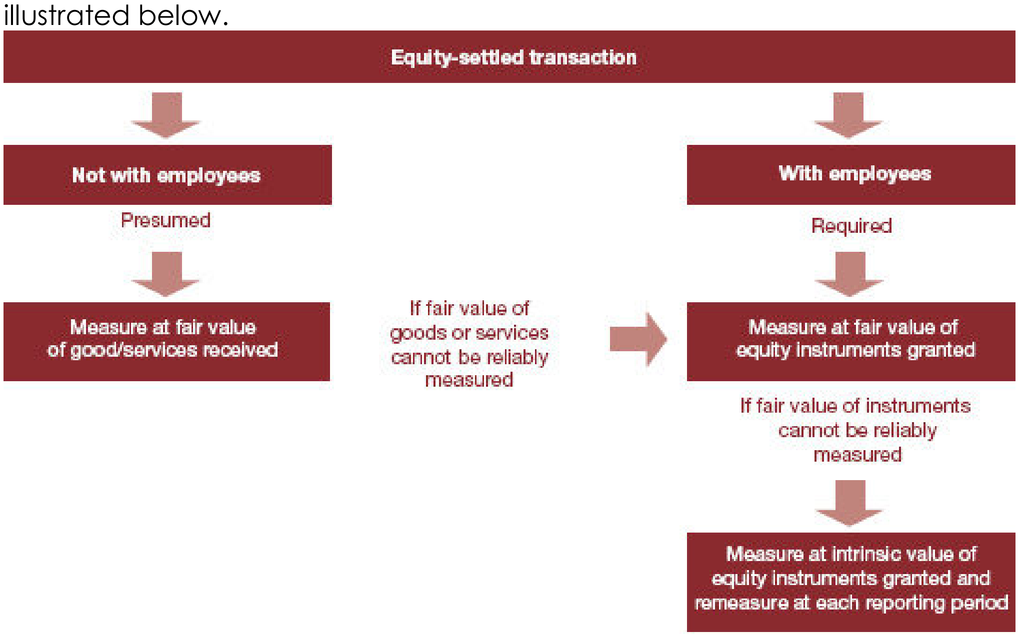
When should a charge be recognized?

- Goods or services acquired in a share-based payment transaction should be recognized when they are received. It will usually be a question of fact as to when this occurs, such as when goods are delivered. However, sometimes it is less obvious as to when the services are received.
- The vesting date is not normally relevant to the purchase of goods or services other than employee services. It is, however, relevant for employee services. Where equity instruments vest immediately, management should presume that they represent consideration for employee services already rendered, if there is no evidence to the contrary. Management should therefore recognize the employee services received in full on the date on which the options are granted.
- If the options do not vest until the employees or others providing similar services have completed a specified period of service, management should presume that services are to be rendered over that period, referred to as 'the vesting period'. IFRS 2 does not distinguish between vesting periods during which the employees have to satisfy specific performance conditions and vesting periods during which there are no particular requirements other than to remain in the entity's employment.

- An expense (or increase in assets if the criteria for asset recognition are met) arises out of a share-based payment transaction. The credit side of the entry will be a liability if the entity has an obligation to settle the transaction in cash. However, if there is no possibility of settling in cash, and the consideration for goods and services will therefore be achieved through the issuance of equity instruments, the credit entry is an increase in equity.

MEASUREMENT

IFRS 2 requires the fair value of the goods or services acquired by an entity to be determined and used as the value for an equity-settled share-based payment transaction. However, if the fair value of the goods or services cannot be measured reliably, the transactions should be measured indirectly by reference to the fair value of the equity instruments granted. In these circumstances, the fair value of the equity instruments granted represents a surrogate for the price of the goods and services. Shares and share options are often granted to employees as part of their remuneration package, in addition to salary and other employment benefits. IFRS 2 requires an entity to measure the fair value of the employee services received by reference to the fair value of the equity instruments granted. It presumes that remuneration components cannot be measured reliably. These requirements are illustrated below.



If the identifiable goods/services received seem to be less than fair value of equity instrument granted, the goods/ services should be measured at fair value. The difference between fair value of equity instrument granted and fair value of goods / services received will be assumed to be received in shape of un-identified goods/services.

Measurement date

The fair value of the equity instruments granted, as consideration should be measured at either:

- the grant date in the case of employee services; or
- the date on which goods are received or services are rendered, in all other cases.

Determining fair value of equity instruments

Fair value should be based on market prices, where available. Many shares and most share options are not traded on an active market, in which case management should consider valuation techniques. The objective is to derive an estimate of the price of the instrument at the relevant measurement date in an arm's length transaction between knowledgeable, willing parties. IFRS 2 does not specify which pricing models should be used. However, it describes the factors that should be taken into account when estimating fair value.

Share options are often valued using the Black-Scholes model, the Binomial model or the Monte- Carlo model.

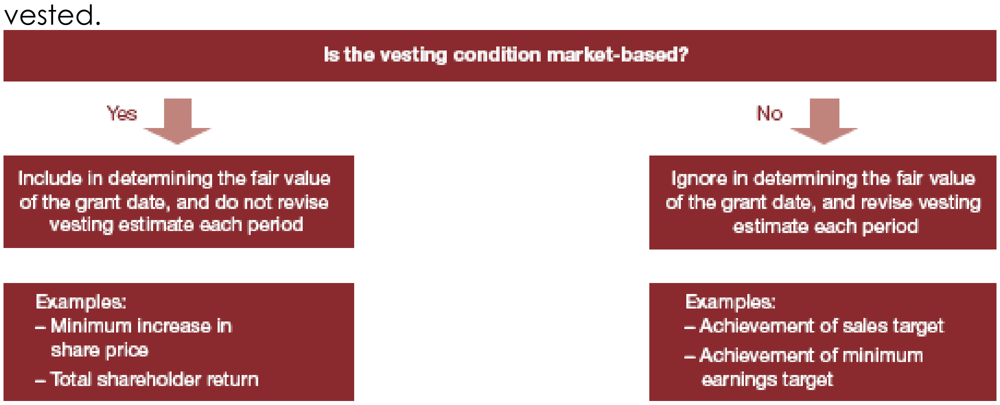
In the absence of a reliable measure of fair value, IFRS 2 requires an entity to measure the equity instruments granted at their intrinsic value – that is, the difference between the fair value of the shares and amount that the counterparty is required to pay for them. <u>**The intrinsic value should then be re-measured at each reporting date until the equity instruments are settled.**</u>

Vesting conditions

Many employee share option arrangements contain conditions that must be met before an employee becomes entitled to shares or options (vesting conditions). There may be performance conditions that must be satisfied. For example, the number of options to which employees are entitled under a bonus arrangement may depend on a certain increase in profit or growth in the company's share price.

The treatment of vesting conditions varies depending on whether or not any of the conditions relate to the market price of the entity's equity instruments. Such conditions, defined by IFRS 2 as 'market conditions', are taken into account when determining the fair value of the equity instruments granted; they are ignored for the purposes of estimating the number of equity instruments that will vest.

<u>For conditions other than market conditions, the goods or services recorded during the vesting period are based on the best available estimate of the number of equity instruments expected to vest</u>. The estimate is revised when subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates; it is revised finally to the actual number of instruments that vested.



Post-vesting date accounting

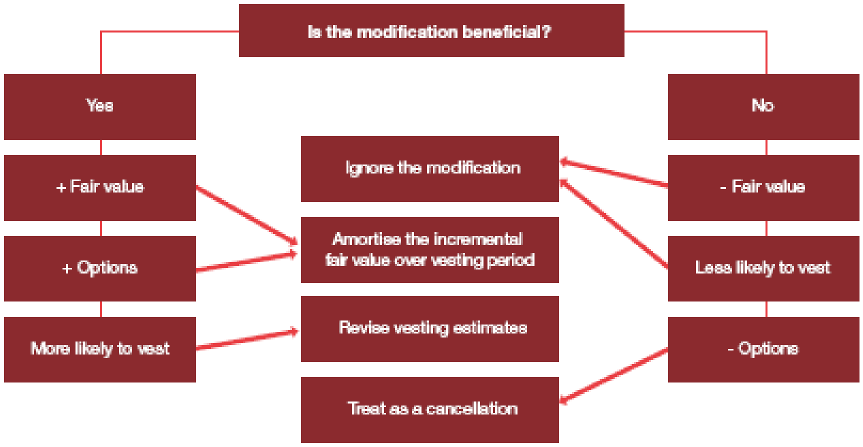
No adjustments (other than reclassification within equity) are made after the vesting date. For example, in the case of share options, no adjustments are made even if the options are not exercised.

Treatment Reload Option

The reload option will be taken as new option and will not be considered while assigning fair value at the date of original grant date of share base payments.

Modifications

Modifications should be viewed as incremental instruments in their own right. The standard requires an entity to ignore a modification if it does not increase the total fair value of the share-based payment arrangement or is not otherwise beneficial to the employee or service provider. However, reductions in the number of options granted are treated as cancellations. The diagram below illustrates the thought-process.



If a modification increases the fair value of the equity instruments granted (for example, by reducing the exercise price of share options), the incremental fair value should be added to the amount being recognized for the services received. If a modification increases the number of equity instruments granted, the fair value of these additional instruments is added to the amount recognized. In each case, this will be in addition to any amount recognized in respect of the original instrument, which should continue to be recognized over the remainder of the original vesting period unless there is a failure to satisfy the original non-market vesting conditions.
If a modification occurs during the vesting period, the incremental fair value should be recognized over the period from the modification date until the date on which the modified equity instruments vest. If the modification occurs after the vesting date, the incremental fair value should be recognized immediately, or over the revised vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to the modified instruments.
If a modification provides some other benefit to employees, this should be taken into account in estimating the number of equity instruments that are expected to vest. For example, a vesting condition might be eliminated.

Cancellations

An entity may cancel and replace a grant of equity instruments. In this case, the incremental fair value is the difference between the fair value of the replacement instruments and the fair value of the original instruments. The replacement is treated as a modification.

Early settlements

An entity may cancel or early settle an award without replacement. On early settlement, the entity should recognize immediately the balance that would have been charged over the remaining period.
Any payment made to employees in connection with the cancellation of a grant of an equity instrument should be deducted from equity, except where the payment exceeds the fair value of the equity instrument at that date. In this case, the excess is recognized as an expense.

CASH-SETTLED TRANSACTIONS

Cash-settled share-based payment transactions are where goods or services are paid for at amounts that are based on the price (or value) of the entity's shares or other equity instruments (such as share options). An example of a cash-settled transaction is share appreciation rights issued to employees. These entitle employees to cash payments equal to the increase in the share price of a specified number of the entity's shares.

The principles that apply to cash-settled share-based payment transactions are:

- Goods or services should be recognized as they are received by the entity;
- Goods or services acquired should be measured at the fair value of the liability incurred; and
- Vesting conditions should be taken into account when estimating the number of rights to payment that will vest.

The fair value of the liability incurred in respect of a cash-settled transaction is re-measured at each reporting date until the date of settlement.

Changes that affect the fair value of the awards, as well as those that affect the number of awards expected to vest, will be updated at each reporting date as part of the re-measurement process and used to determine the amount to be recognized.

The payment for settlement of a cash-settled share-based transaction may occur after the services are rendered. In those situations, the liability is still measured at fair value at each reporting date.

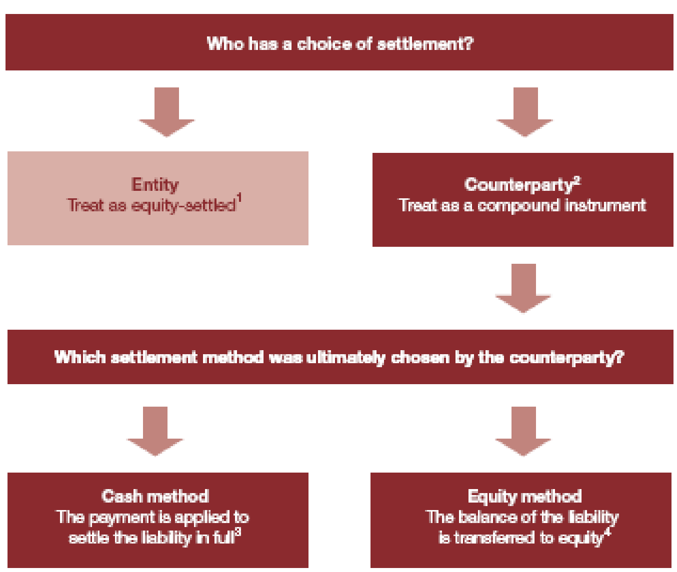
Any changes in the fair value of the liability are recognized immediately in the income statement.

ARRANGEMENTS WITH SETTLEMENT ALTERNATIVES

Some share-based payment transactions give either the entity or the counter-party the choice as to whether to settle in cash or equity instruments. For example, an employee may have a right to choose between a payment equal to market price of 100 shares or 150 shares subject to not selling them for at least one year.

IFRS 2 requires an entity to account for such a transaction as cash-settled if, and to the extent that, it has incurred a liability to settle in cash. The accounting depends on which party has the choice of settlement method.

Counterparty chooses the settlement method



If the counter-party chooses the settlement method, the entity is considered to have issued a compound financial instrument. This means that it has issued an instrument with a debt component (where the counter-party has a right to demand cash) and an equity component (where the counter-party has a right to demand settlement in equity instruments).

IFRS 2 requires a different method than that required by IAS 32 to determine the value of the constituent parts of a compound instrument. The liability is measured at fair value.

For transactions in which the fair value of goods or services is measured directly, the fair value of the equity component is measured as the difference between the fair value of the goods or services received and the fair value of the debt component.

Equity component = **Fair value of the goods or services** less **Fair value of the debt component**

For other transactions in which the fair value of goods or services (including employee services) is measured indirectly by reference to the fair value of the instruments granted, the fair value of the compound instrument as a whole should be estimated. The debt and equity components should be valued separately, taking into account the fact that the counter-party must forfeit its right to receive cash in order to receive the equity instrument.

Equity component = **Fair value of equity alternative, based on fair value of instruments granted** less **Fair value of the debt component**

Transactions are often structured in such a way that the fair value of each settlement alternative is the same. The fair value of the equity component will therefore be nil. However, where the fair value of the equity component is greater than nil, the components need to be split. The debt component should be accounted for as a cash-settled share-based payment transaction, the equity component will be accounted for as an equity-settled share-based payment transaction.

At the date of settlement, the liability in respect of the debt component should be re-measured at fair value. The method of settlement chosen by the counter-party will then determine the final accounting.

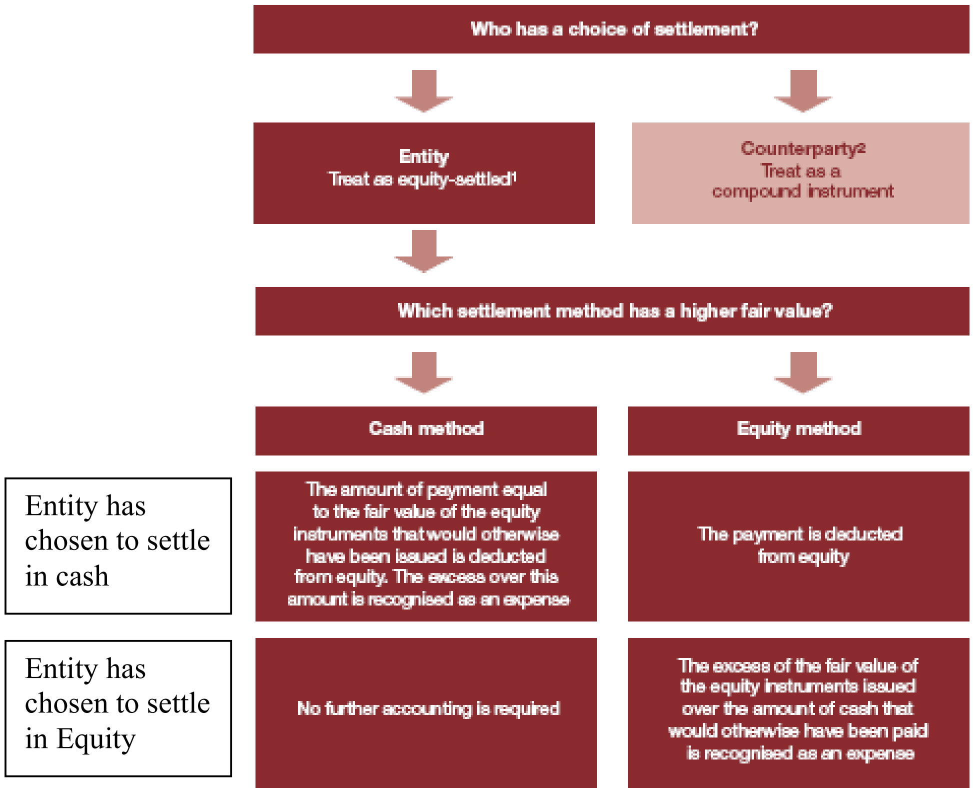
Entity chooses the settlement method

If the entity chooses the settlement method, it should determine whether it has created in substance an obligation to settle in cash. This is the case if, for example:

- The choice of settlement in equity instruments has no commercial substance;
- The entity has a past practice or stated policy of settling in cash; or
- The equity instruments to be issued are redeemable, either mandatorily or at the counter-party's option.

The entity should account for the transaction as a cash-settled share-based payment transaction, to the extent that it has incurred a liability.

If the transaction is accounted for as equity-settled, the accounting on settlement depends on which settlement alternative has the greater fair value, as shown in the diagram below.



SHARE BASED PAYMENT TRANSACTIONS AMONG GROUP COMPANIES

1. For share-based payment transactions among group entities, in its separate or individual financial statements, the entity receiving the goods or services shall measure the goods or services received as either an equity-settled or a cash-settled share-based payment transaction by assessing:
   (a) the nature of the awards granted, and
   (b) its own rights and obligations.
2. The amount recognized by the entity receiving the goods or services may differ from the amount recognized by the consolidated group or by another group entity settling the share-based payment transaction.
3. The entity receiving the goods or services shall measure the goods or services received as an equity-settled share-based payment transaction when:
   (a) the awards granted are its own equity instruments, or
   (b) the entity has no obligation to settle the share-based payment transaction.
4. The entity shall subsequently re-measure such an equity-settled share-based payment transaction only for changes in non-market vesting conditions in accordance. In all other circumstances, the entity receiving the goods or services shall measure the goods or services received as a cash-settled share-based payment transaction.
5. The entity settling a share-based payment transaction when another entity in the group receives the goods or services shall recognize the transaction as an equity-settled share-based payment transaction only if it is settled in the entity's own equity instruments. Otherwise, the transaction shall be recognized as a cash-settled share-based payment transaction.
6. Some group transactions involve repayment arrangements that require one group entity to pay another group entity for the provision of the share-based payments to the suppliers of goods or services. In such cases, the entity that

receives the goods or services shall account for the share-based payment transaction in accordance with paragraph 5 regardless of intra-group repayment arrangements.

DEFERRED TAX IMPLICATIONS

Tax deductions in some jurisdictions are available for share-based payment transactions. However, the amount of the deduction in the case of equity-settled transactions does not often correspond to the amount charged to the income statement in accordance with IFRS 2. For example, a tax deduction in connection with an employee share option scheme may be available at the time the options are exercised, measured on the basis of the options' intrinsic value (the difference between market price and exercise price) at that date.

IAS 12 provides guidance where an item has a tax base (the amount the tax authorities will permit as a deduction in future periods in respect of goods or services consumed to date), but the item is not recognized as an asset or liability in the entity's balance sheet. In the above example, employee services are expensed and their carrying amount is therefore nil, but an estimate of the value of the tax base at the end of each reporting period is determined by multiplying the options' intrinsic value at year-end by the proportion of the vesting period that has elapsed.

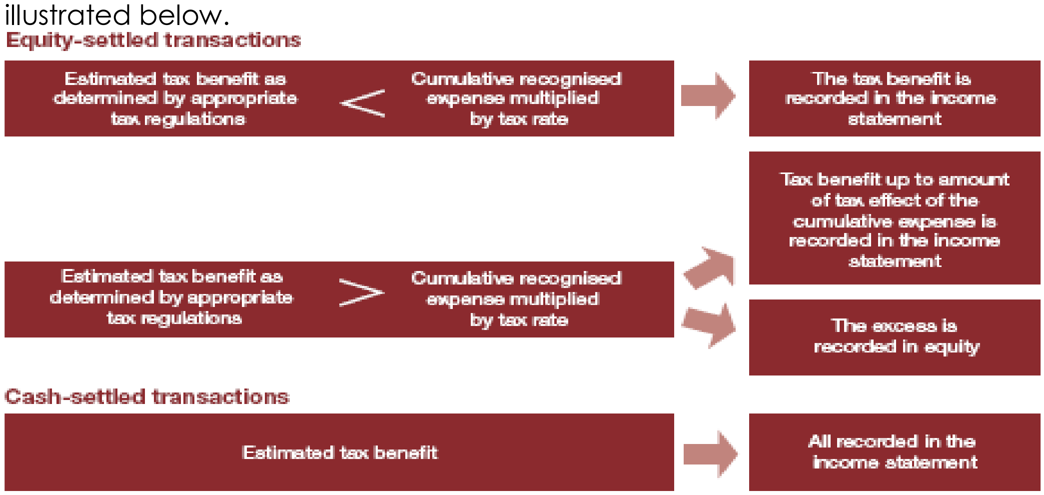
The difference between the tax base of the employee services received to date (the amount the tax authorities will permit as a deduction in future periods in respect of those services) and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset, if the entity has sufficient future taxable profits against which the deferred tax asset can be utilized.

Measurement of the deferred tax asset

The deferred tax asset should be measured at each reporting date based on an estimate of the future tax deduction. The calculation of the future tax deduction depends on the specific tax jurisdiction; it is often based on the intrinsic value of options that are actually exercised. When this is the case, in order to estimate the future tax deductions, management should multiply the intrinsic value determined at the balance sheet date by the number of options expected ultimately to vest. The determined amount of the future tax deduction is spread over the vesting period. The estimate of the tax deduction should be based on the current share price if the deduction is based on the intrinsic value.

Recognition of the tax benefit

The expected future tax benefit should be allocated between the income statement and equity. The excess of the total tax benefit over the tax effect of the related cumulative remuneration expense is recognized in equity. The accounting is illustrated below.



DISCLOSURES

IFRS 2 requires extensive disclosure under three main headings:

- Information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period;
- Information that enables users of the financial statements to understand how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined; and
- Information that enables users of the financial statements to understand the effect of expenses arising from share-based payment transactions on the entity's profit or loss for the period.

Approach to solve Examination Questions

A four-step approach has been taken in the analysis of the IFRS 2 transactions:

- Step A: Obtain the key data needed to perform the calculations;
- Step B: Make an initial estimate of the total amounts to be recorded;
- Step C: Determine the expense for each year and the corresponding journal entries; and
- Step D: Determine tax adjustments.

PRACTICE QUESTIONS

Question # 1 Share options granted to key executives

Wayne Holdings grants 100 share options to each of its 10 key executives at 1 January 2005, with the following conditions: (1) they must complete three years of service, and (2) there must be an 18% increase in share price by the end of 2007. Wayne Holdings estimates that its 10 executives will complete the three-year service period. The fair value of one option at grant date is $5. The market condition of an 18% increase in the share price has been included in the fair value of $5. The exercise price of each option is $3. The options have a contractual life of 10 years, and Wayne Holdings has estimated their value using a Monte-Carlo model.

At grant date, Wayne Holdings expected that none of the key executives would leave the company during the vesting period. No employees left Wayne Holdings during 2005, but two employees unexpectedly left the company during 2006. Wayne Holdings therefore revised its total compensation expense down to $4,000 (8 x $500). The increase in share price exceeded the increase in the share price threshold by the end of 2007. As a result, eight employees vested their options at the end of 2007. These options are exercised on 5 January 2008, and Wayne Holdings issues shares with a par value of $1 to its employees.

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to an equity-settled share-based payment transaction involving share options is based on the difference between the share price and the exercise price of an option at exercise date, which represents the intrinsic value for tax purposes.

The share prices were as under: -

	1-1-05	**31-12-05**	**31-12-06**	**31-12-07**	**5-1-08**
Share price	**7**	**9**	**15**	**22**	**23**

Required: -

a) Determine the expense for each year and pass appropriate Journal entries; and

b) Record deferred tax implication in each year and pass necessary journal entries assuming tax rate of 40%.

Question 2 Performance conditions – an increase in earnings

Wayne Holdings grants 100 shares to each of its 500 management-level employees at 1 January 2005, conditional upon the employees remaining in Wayne Holdings'

employment during the vesting period. The shares will vest at the end of year one if the company's earnings increase by more than 10%; at the end of year two if the company's earnings increase by more than 15 % over the two-year period; and at the end of year three if the entity's earnings increase by more than 36% over the three-year period. The fair value of one share at grant date is $7.
Wayne Holding's earnings have increased by 8% by the end of 2005, and 30 employees have left. The company expects that earnings will continue to increase at a similar rate in 2006 and therefore expects that the shares will vest at the end of 2006. Wayne Holdings also expects that an additional 30 employees will leave in 2006, and that 440 employees will receive their shares at the end 2006.
By the end of 2006, Wayne Holdings' earnings in fact increase by 12% and the shares do not therefore vest. Additionally, only 28 employees leave during 2006, rather than 30 originally estimated by Wayne Holdings. Wayne Holdings believes that an additional 25 employees will leave in 2007 and earnings will increase so that the performance target will be achieved in 2007.
By the end of 2007, only 23 employees have left, compared with Wayne Holdings' original estimation of 25, and the performance target has been met.
The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to this equity-settled share-based payment transaction is based on the share price at the vesting date. The share prices were as under: -

	31-12-05	31-12-06	31-12-07
Share price	**9**	**15**	**22**

Required: -

a) Determine the expense for each year and pass appropriate Journal entries; and

b) Record deferred tax implication in each year and pass necessary journal entries assuming tax rate of 40%.

Question 3 Share options – re-pricing

Wayne Holdings granted 100 share options to each of its 600 management-level employees at 1 January 2002, conditional upon the employees remaining employed by Wayne Holdings over a five-year period. The share price at grant date was $20. The exercise price is $25.
Wayne Holdings decides to re-price the options at 2 January 2005, at an exercise price of $10. At the re-pricing date, Wayne Holdings estimates that the fair value of the original award (before taking into account the re-pricing) is $1.50, and the fair value of the re-priced award is $3.
The incremental value is therefore $1.50. The re-priced options will vest at the end of 2006. Wayne Holdings has 500 employees left at the date of re-pricing and estimates that 440 employees will receive their share options at the end 2006. It estimates that 30 employees will leave in 2005, and that another 30 will leave in 2006. The actual number of leavers was 30 for 2005, and 28 for 2006.
Compensation expense under the old arrangement (from 2002 through 2006):
Wayne Holdings is not required to apply IFRS 2 to the original grant, as the instruments were granted prior to 7 November 2002. However, it is required to apply IFRS 2 to the modification, as the re-pricing occurred after 1 January 2005.
Compensation expense for the incremental value arising from the re-priced award (from 2005 through 2006):
The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to this equity-settled share-based payment transaction involving share options is based on the difference between the share price and the exercise price of an option at exercise date, which represents the intrinsic value for tax purposes.

The share prices were as under: -

	31-12-05	31-12-06
Share price	**15**	**22**

Required: -

a) Determine the expense for each year and pass appropriate Journal entries; and

b) Record deferred tax implication in each year and pass necessary journal entries assuming tax rate of 40%.

Question 4 Share appreciation rights

Wayne Holdings granted 10 share appreciation rights (SARs) to each member of a group of 40 management employees on 1 January 2004. The SARs provide the employees, at the date the rights are exercised, the right to receive cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31 December 2005. They can be exercised during 2006 and 2007. The entity estimates that at grant date, the fair value of each SAR granted is $11, and 10% of the employees will leave evenly during the two-year period. The fair values and intrinsic values are shown below. In 2006, six employees exercise the SARs at 31 December 2006; the remaining 30 employees exercise the SARs in 2007.

Date	Fair value	Intrinsic value
31 December 2004	€12	€10
31 December 2005	€8	€7
31 December 2006	€13	€10
31 December 2007	€12	€12

Intrinsic value equals fair value at the end of the life of a SAR because there is no time value.

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to cash settled share-based payment transaction involving SARs is based on the intrinsic value for tax purposes.

Required: -

a) Determine the expense for each year and pass appropriate Journal entries; and

b) Record deferred tax implication in each year and pass necessary journal entries

Question 5 Transactions with settlement alternatives

At 1 January 2005, Wayne Holdings grants its CEO the right to choose either 1,000 phantom shares (i.e., the right to receive a cash payment equal to the value of 1,000 shares) or 1,500 shares. The grant is conditional upon the completion of two years of service. If the CEO chooses the share alternative, he must keep the shares for a period of five years. The share price is as follows:

Date	Fair value
1 January 2005	€7
31 December 2005	€9
31 December 2006	€15
31 December 2007	€22

After taking into account the effects of the post-vesting transfer restrictions, the entity estimates that the grant date fair value of the share alternative is $6.50 per share.

The CEO exercises his cash option at the end of 2006.

The tax legislation applicable to Wayne Holdings provides that the tax deduction relating to an arrangement with settlement alternatives is based on the share price at the date of settlement for the phantom shares.

Required: -

a) Determine the expense for each year and pass appropriate Journal entries; and

b) Record deferred tax implication in each year and pass necessary journal entries

Question 6 In-kind capital contributions

Wayne Holdings issued 100,000 shares in exchange for a capital contribution of an office building. The ownership of the building was transferred to Wayne Holdings on 15 January 2005 when the shares were issued. The fair value of the building on that date was $5,500,000.

The tax legislation applicable to Wayne Holdings provides that the tax deduction is equal to depreciation of the building charged for accounting purposes over its useful life of 10 years.

Question 7 Shares for services

Wayne Holdings is establishing a media business and has hired a marketing agency to provide consultancy services. The services will be settled by issuing 50,000 shares.

Period over which the service is provided is 1 January to 28 February 2005 and fair value of the service $400,000. Fair value of the service was determined based on bids submitted by other marketing agencies to provide the consulting services.

The tax legislation applicable to Wayne Holdings provides that there is no tax deduction for non-cash costs incurred in connection with consultancy services settled by issuing shares.

PAST PAPERS

Q-1 Rahman Limited (RL) is a listed company engaged in the manufacture of leather goods. Its financial year ends on June 30. In a meeting held on July 1, 2009 its Board of Directors acknowledged the outstanding performance of the company's Chief Operating Officer (COO) and in recognition thereof, decided to allow him either of the following options:

Option I Receive a cash payment equal to the current value of 64,000 shares of RL.

Option II Receive 80,000 shares of RL. However, the above offer was subject to certain conditions. These conditions and other relevant information are as follows:

i) The right is conditional upon completion of three years' service from the date the right was granted and the decision to select the option shall also be exercised on the completion of the said period.

ii) The share price of RL on July 1, 2009 is Rs. 125 per share. It is estimated that the share price at the end of year 2010, 2011 and 2012 will be Rs. 130, Rs. 138 and Rs. 150 respectively.

iii) If the COO chooses option II, he shall have to retain the shares for two years i.e. up to June 30, 2014 before being eligible to sell them. However, the fair value of the shares after taking into account the effects of the post vesting transfer restrictions is estimated at Rs. 110 per share.

iv) RL does not expect to pay any dividend during the next three years.

Required: Prepare the journal entries:

(a) to record the above transactions in the books of Rahman Limited for the year ending June 30, 2010, 2011 and 2012.

(b to record the settlement of right on June 30, 2012 under:

- Option I
- Option II.

Q-2 Engineering Works Limited (EWL) is in the process of finalizing its Financial Statements for the year ended June 30, 2010. The issue as detailed below is being deliberated upon by the CFO.

It is the policy of EWL to pay annual bonus of Rs. 10,000 each to all of its 600 workers, after two months of closure of the financial year. On June 1, 2010 the management announced a scheme whereby each worker was given the option to purchase 1,000 shares of EWL on a payment of Rs. 8 per share, in lieu of cash bonus for the year ended June 30, 2010. The face value of the company's shares is Rs. 10 each. The last date to exercise the option was fixed at July 31, 2010. Other related information is as follows:

- 60% employees exercised the option by June 30, 2010.
- By July 31, 2010 further 20% employees had accepted this option.
- The workers who exercise the option are required to retain the shares up to June 30, 2012 before being eligible to sell them.
- The shares were issued on September 1, 2010.
- The market price and fair value of the shares at various dates were as under:

		30-Jun-10	31-Jul-10	01-Sep-10
Market price	Rs.	32	37	42
Fair value per share (after taking effect of post vesting transfer transaction)	Rs.	30	34	40

Required: - Prepare journal entries for the above transactions and adjustments during the years June 30, 2010 and 2011.

Q-3 Quail Pakistan Limited (QPL), a listed company, is reviewing the following transactions which have not yet been accounted for in the financial statements for the year ended 30 June 2012:

(a) On 1 July 2011, QPL announced a bonus of Rs. 30 million to its employees if they achieved the annual budgeted targets by 30 June 2012. The bonus would be paid in the following manner:

- 25% of the bonus would be paid in cash on 31 December 2012 to all employees irrespective of whether they are still working for QPL or not.
- The balance 75% will be given in share options, to those employees who are in QPL's employment on 31 December 2012. The exercise date and number of options will be fixed by the management on the same day.

The budgeted targets were achieved. The management expects that 5% employees would leave between 30 June 2012 and 31 December 2012. (04)

(b) On 30 June 2012, a plant having a list price of Rs. 50 million was purchased. QPL has allowed the following options to the supplier, in respect of payment there against:

- To receive cash equivalent to price of 1.5 million shares of the company after 3 months; or
- To receive 1.7 million shares of the company after 6 months.

QPL estimates that price of its shares would be Rs. 35 per share after three months and Rs. 40 per share after six months. (05)

Required:

Discuss how the above share-based transactions should be accounted for in QPL's financial statements for the year ended 30 June 2012. Show necessary calculations. ***(Journal entries are not required)***