IFRS 2 Share-based Payments
IAS 28 Investments in Associates and Joint Ventures
IFRS 11 Joint Arrangements

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Share-based payments (IFRS 2)

IFRS 2
Learning objectives

- Purpose of IFRS 2
- How to recognize share-based payments
- Disclosures

IFRS 2
Purpose of the standard

Does company remunerate its top management by granting them own shares?

Do employees receive bonuses based on the increase of the company’s share price?

IFRS 2
Purpose of the standard

The objective of IFRS 2 is to prescribe the accounting treatment of payments made by an entity either

A) In the form of shares (including share options), or

B) In cash, where the amount of cash payable depends upon the company's share price

Every other benefit paid to employees is reported in line with the standard IAS 19 Employee Benefits.

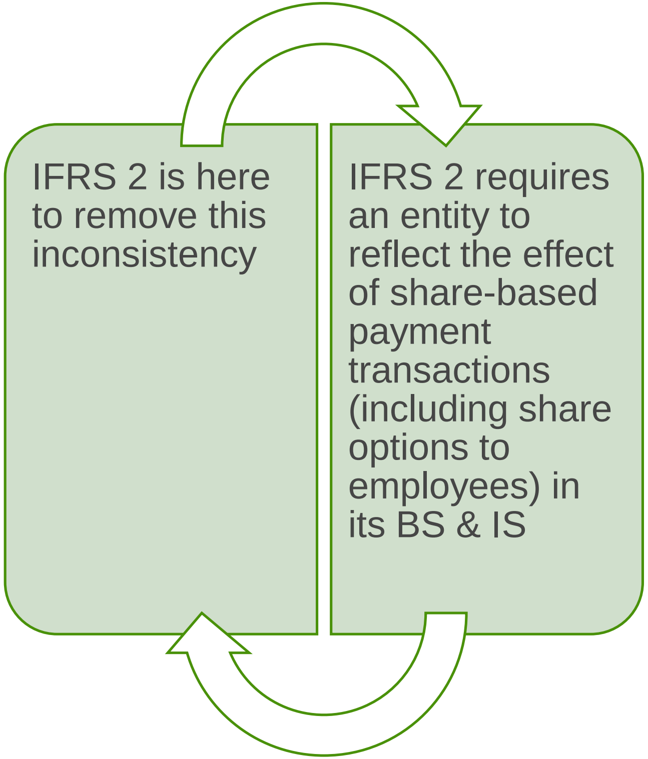
IFRS 2
Purpose of the standard

In the past, companies often did not reflect granting share options in their financial statements. Why?

- For very simple reason: the options had no intrinsic value, so there was nothing to record in the financial statements.

And what happens in such a case?

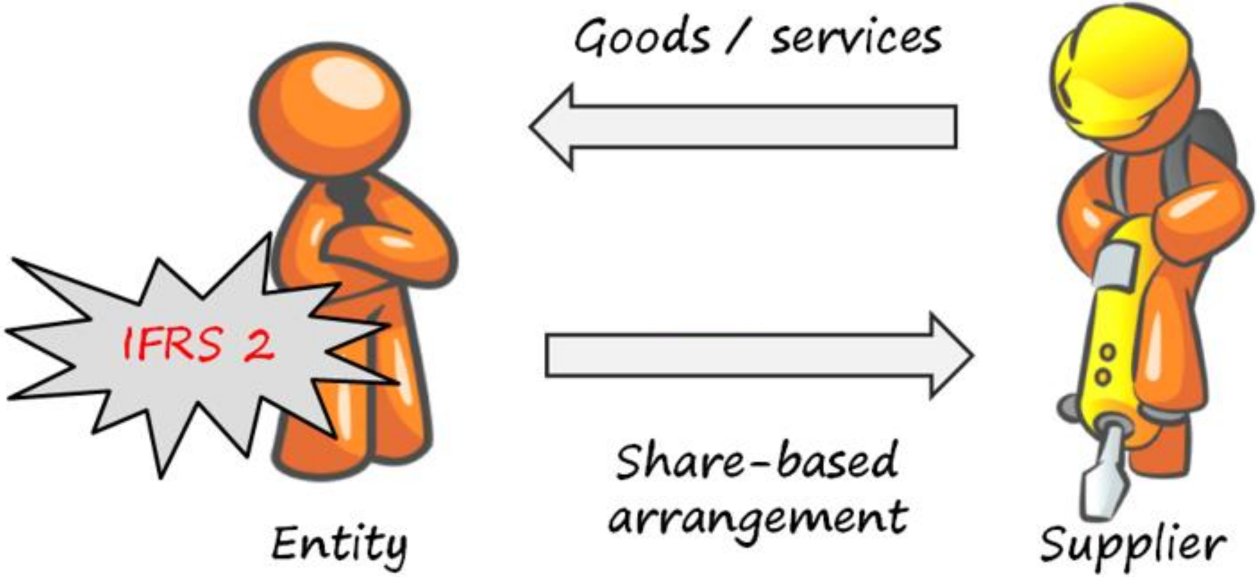
- If company paid its management by cash, the transaction was recorded as an expense. But if company paid its management by share options, nothing was recorded.



IFRS 2
What is a share-based payment transaction?

- Share-based payment transaction is a transaction in which the entity:

Receives goods or services from the supplier (including employee) in a share-based payment arrangement; OR	incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.


Goods / services
IFRS 2
Share-based
arrangement
Entity
Supplier

IFRS 2
What is a share-based payment arrangement?

- Share-based payment arrangement is an agreement between the entity and another party (including an employee) whereby the other party receives:

Cash or other assets of the entity for amounts that are based on the price of equity instruments of the entity or another group entity.

This type of arrangement is cash-settled share-based payment transaction.

Alternatively, the other party can receive equity instruments of the entity or another group entity.

This type is called equity-settled share-based payment.

If there are some specified vesting conditions, these must be met before receiving any share-based payment.

IFRS 2
2 types of vesting conditions

SERVICE CONDITIONS

- they require the counterparty to complete a specified period or service;

PERFOMANCE CONDITIONS

- they require the counterparty to complete a specified period of services AND specified performance targets to be met.

IFRS 2
Recognition of Share-Based Payment transaction

IFRS 2
Recognition of Share-Based Payment transaction

EQUITY SETTLED

- Entity should measure the fair value of each equity instrument at the grant date.
- Once made, this measurement is fixed and is not adjusted to reflect any changes in share values during the vesting period

CASH SETTLED

- Entity should measure this liability at fair value at the grant date and then re-measure the fair value of the liability at each reporting date during the vesting period
- Any changes are recognised in P/L

IFRS 2
Case

- On 1.1.2018 a company which prepares its accounts to 31.12.2018 grant 5000 share opitons each to twelve of its senior employees.
  - Fair value of one share option is 9€ as of 1.1.2018
- The specified vesting date is 31.12.2020 and the grant is conditional upon the achievement of certain performance targets by that date. The estimations are as follows:
  - 31.12.2018: All employees will achieve their performance targets
  - 31.12.2019: Estimate has fallen to 11 employyes
  - 31.12.2020: Only 10 employees achieved their targets

How the following transactions should be treated in the company's accounts?

IFRS 2
Disclosures relating to share-based payments

- The nature and extent of any share-based payment arrangements that existed during the accounting period
- How the fair value of equity instruments granted during the period was determined
- The effect of share-based payment transactions on entity's financial statements

UPM Annual Report 2018

3. Employee rewards

3.1 Employee costs

EURm	2018	2017
Salaries and fees	936	965
Share-based payments	13	23
Pension and other post-employment benefits, defined benefit plans	29	57
Pension costs, defined contribution plans	105	107
Other indirect employee costs [1]	110	113
Total	1,194	1,265

[1] Other indirect employee expenses primarily include other statutory social expenses, excluding pension expenses.

3.3 Share-based payments

UPM offers rewards and recognition with an emphasis on high performance. All UPM's employees belong to a unified annual Short Term Incentive (STI) scheme. In addition, UPM has two long-term incentive plans: the Performance Share Plan (PSP) for senior executives and the Deferred Bonus Plan (DBP) for other key employees.

§ ***Accounting policies***

The group's long-term share incentive plans are recognised as equity-settled or cash-settled share-based payment transactions depending on the settlement. The group classifies the transactions with net settlement features for tax obligations as equity-settled in its entirety. Shares are valued using the market rate on the grant date. The settlement is a combination of shares and cash. The group may obtain the necessary shares by using its treasury shares or may purchase shares from the market. PSP and DBP share deliveries are executed by using already existing shares and the plans, therefore, have no dilutive effect.

Associates and joint arrangements (IAS 28 & IFRS 11)

Overview

- If one company is able to exercise control over another company, the parent compnay must prepare consolidated financial statements in accordance with IFRS 10. However, in case control is not achieved

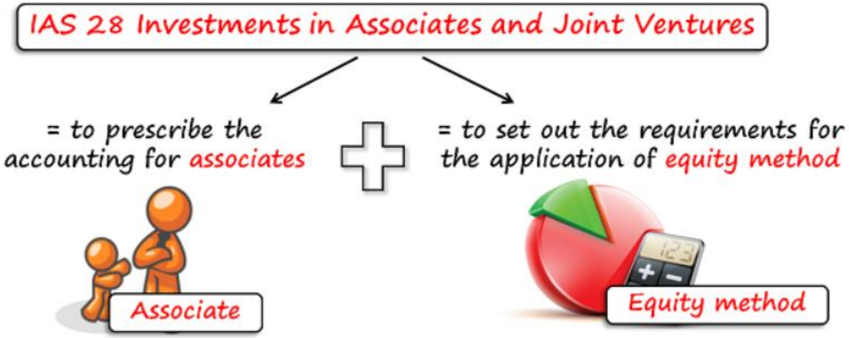
1. The investor company might own enough shares in the investee company to be able to exercise significant influence over its activities.
   - Investee company is known as an ”associate” and the investment is accounted for in accordance with IAS 28
2. The investor company together with other investors might be able to exercise joint control over the investee company
   - This type of arrangement is known as a ”joint arrangement” and the required accounting treatment is prescribed by either IFRS 11 or IAS 28

Associates and joint arrangements
Learning objectives

- Define terms “associate” and “significant influence” in accordance with IAS 28
- Equity method accounting
- Define terms ”joint arrangement” and ”joint control” in accordance with IFRS 11
- Distinguish between a joint operation and a joint venture and the related accounting

IAS 28
Purpose of the standard

To prescribe the accounting for investments in associates, and	To set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.



IAS 28

Associates and significant influence

ASSOCIATE

- *“an entity over which the investor has significant influence”*

SIGNIFCANT INFLUENCE

- *“the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies”*

IAS 28

What is significant influence and how to detect it?

The standard suggests at least 20% of a company's voting power, i.e. normally owning at least 20% of that company's ordinary shares.

IAS 28
What is significant influence and how to detect it?

The standard suggests at least 20% of a company's voting power, i.e. normally owning at least 20% of that company's ordinary shares.

BUT!

It's not the rule of thumb and often, the truth is different.

Sometimes, when an investor holds more than 20% of the voting power (but less than 50), it can still control the investee.

CarProd
40%
TyreCorp
60% (max. 1% each)

IAS 28
Signifcant influence

- Indicators of significant influence
  a) Material transactions between investor & investee
  b) Board representation
  c) Provision of essential techinal information
  d) Participation in policy making process; and
  e) Interchange of management personal

An investor company loses significant influence over an investee company when it loses the power to participate in the investee’s financial and operating policies. This generally occurs when the investor no longer holds at least 20% of the investee’s voting power.

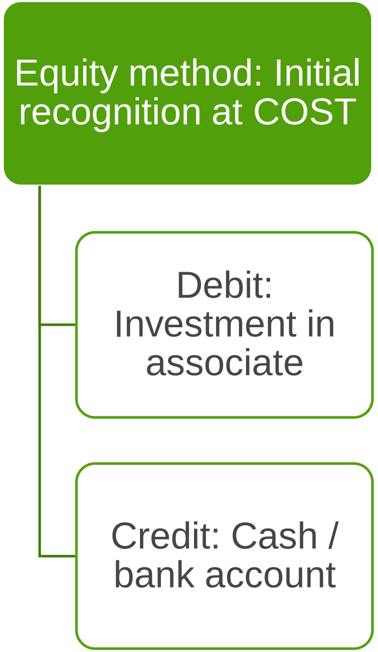
IAS 28

Apply the equity method

Once the investor acquires significant influence, or joint control of a joint venture, then it must apply equity method.

The basic principles of equity method
On initial recognition

1. The investment in an associate or joint venture is recognized at cost. The journal entry is:
   - Debit investments in the statement of financial position,
   - Credit cash (bank account, or whatever applies).
2. If there’s a difference between cost and investor’s share on investee’s net fair value of identifiable assets and liabilities, then it depends, whether this difference is positive or negative:
   - When the difference is positive (cost is higher than the share on net assets), then there’s a goodwill and you don’t recognize it separately. It is included in the cost of an investment and NOT amortized.
   - When the difference is negative (cost is lower than the share on net assets), then it’s recognized as an income in profit or loss in the period when the investment is acquired.



The basic principles of equity method
Subsequently, after the initial recognition

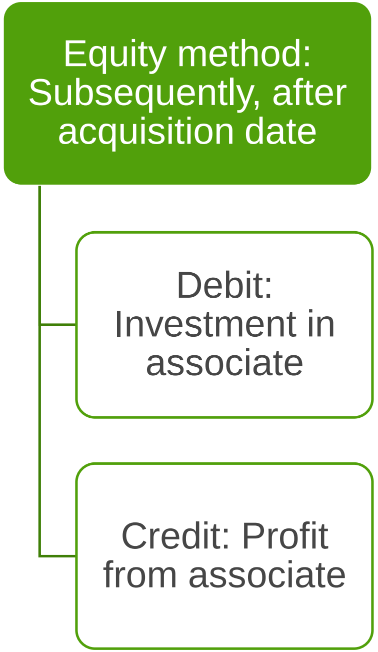
1. The carrying amount of the investment is **increased or decreased** by the investor’s share on investee’s net profit or loss after the acquisition date. The journal entry is:

   – Debit Investment in the statement of financial position, and

   – Credit Income from associate in profit or loss.

   – Or vice versa when an associate made loss.

When an associate or joint venture make losses and these losses exceed the carrying amount of the investment, investor cannot bring down the carrying amount of the investment below zero. Investor simply stops bringing in further losses.

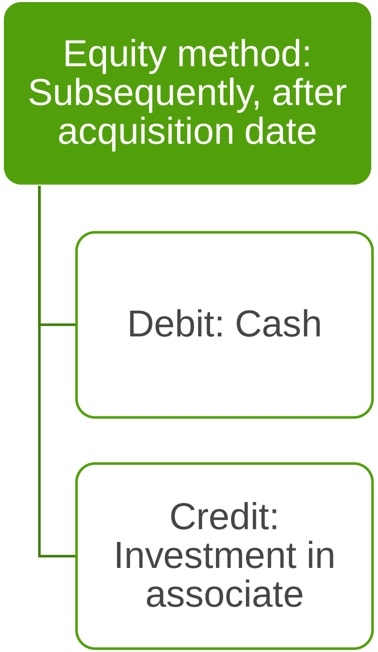


The basic principles of equity method
Subsequently, after the initial recognition

2. When an investee **distributes some dividends** to the investor, then such a distribution decreases the carrying amount of the investment. The journal entry is:

   – Debit Cash, and

   – Credit Investment in the statement of financial position.



Equity method
Case

- Company A is the parent of a group companies. On 1 January 2018, Company A acquired 25% of the ordinary share capital of Company B at a cost of 100TEUR. This was precisely equal to 25% of the fair value of the identifiable net assets of Company B. During the year to 31 December 2018, Company B

a) Made profit of 42TEUR

b) Paid dividend of 27TEUR

Explain how these transactions should be reflected on the consolidated financial statements of Company A for the year 31 December 2018

Equity method
Upstream and downstream transactions

- IAS 28 requires gains and losses resulting from ‘upstream’ (sales by associate/JV to investor) and ‘downstream’ (sales by investor to associate/JV) transactions involving assets to be recognised only to the extent of unrelated investors’ interests.

- The investor’s share in the investee’s gains or losses resulting from these transactions is eliminated.

Upstream and downstream transactions
Case

- Entity A holds 20% interest in Entity B and exercises significant influence over it. During year 20X0, Entity A sold an item of inventory to Entity B for $1m. This inventory was carried at cost in A's books at $0.7m. During year 20X1, Entity B sold this inventory to its client for $1.5 million.

How the following transactions should be treated in the companies accounts?

IFRS 11
Joint arrangement

- A ”joint arrangement” exists if two or more parties exercise joint control over an entity

A JOINT ARRANGEMENT

- *“an arrangement of which two or more parties have joint control”*

JOINT CONTROL

- *“the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant decisions about the relevant activities require the unanimous consent of the parties sharing control”*

IFRS 11
Classify your joint arrangement

- There are 2 types of joint arrangements:

Joint operations

Joint ventures

IFRS 11
Joint ventures

JOINT VENTURE

- In a joint venture, the parties having joint control have **rights to the net assets** of the arrangement.
- E.g. the parties might establish a separate business entity over which the parties have joint control and which has its own liabilities and assets
- In this case the assets and liabilities would below to the separate entity and not to parties themselves
- Structured as a ”separate vehicle”

Interests in joint ventures are accounted for using the equity method of accounting and are initially recognised at cost.

IFRS 11
Joint operations

JOINT OPERATIONS

- The parties that have joint control of the arrangement (joint operators) have rights to particular assets, and obligations for particular liabilities, relating to the arrangement
  - E.g. the parties could agree to manufacture a product together each party being responsible for a specific task using its owns assets and incurring its own liabilities
- Agreement would specify how revenue and expenses should be shared between them
- Not structured as a ”separate vehicle”

IFRS 11
Accounting for joint operations

IFRS 11 requires a joint operator to recognise and measure its share of the assets and liabilities (and recognise the related revenues and expenses) in accordance with IFRS Standards applicable to the particular assets, liabilities, revenues and expenses.

There is no need to prepare financial statements for the joint operation itself

IFRS 12
Disclosure of Interest in Other Entities

- Entities shall disclose the significant judgments and assumptions it has made in determining the nature of its interest in other entities (e.g. significant influence or joint control) and type of any joint arrangement to which it is a party
- The entity should also disclose information which enable the users of its financial statements to evaluate:

a) The nature, extent and financial effects of its interests in associates and its interest in joint arrangements

b) The nature of (and changes in) any risks associated with its interest in associates and joint arrangements

NEXT TIME 10.5.2019

- Financial instruments and hedging (IFRS 7 & IFRS 9)
- Agriculture (IAS 41)