International Financial Reporting Standards:

Provisions, pensions and share based payments

The Ohio State University

Session 6

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Topical areas

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Provisions

Overview of key concepts — IAS 37

	Definition
Liability	▪ A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
Provision	▪ A liability of uncertain timing or amount
Contingent Liability	A contingent liability is: ▪ a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or ▪ a present obligation that arises from past events but is not recognized because: – it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or – the amount of the obligation cannot be measured with sufficient reliability.
Contingent Asset	▪ A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Overview of key concepts — IAS 37 (cont.)

	Definition
Constructive Obligation	▪ An obligation that derives from an entity's actions where: – by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and – as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Overview of key concepts — IAS 37 (cont.)

Concept	Discussion
Recognition	▪ A provision shall be recognized when: – an entity has a present obligation (legal or constructive) as a result of a past event; – it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and – a reliable estimate can be made of the amount of the obligation. ▪ An entity shall not recognize: – a contingent liability or – a contingent asset.

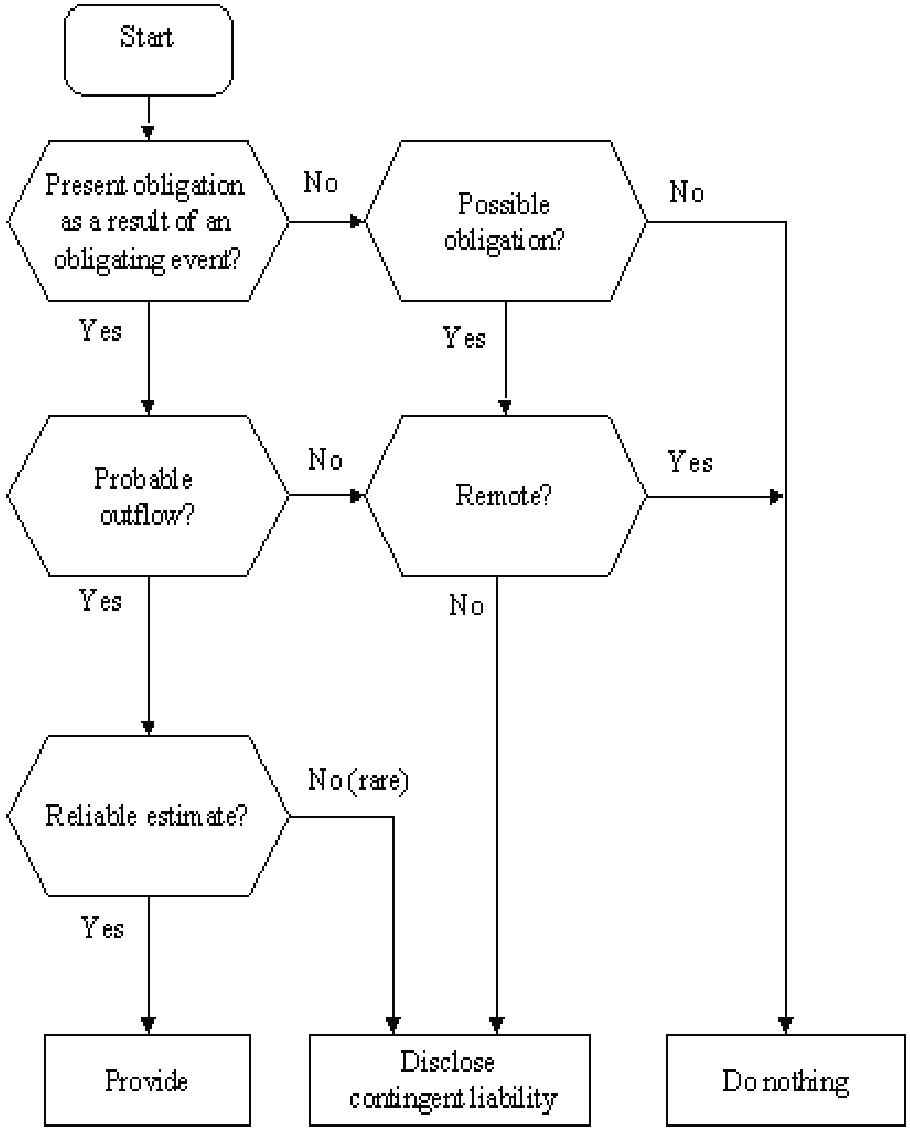
Overview of key concepts — IAS 37 (cont.)

Concept	Discussion
Measurement	▪ Best Estimate – The provision shall be the best estimate of the expenditure required to settle the obligation at the end of the reporting period. ▪ Risks and Uncertainties – Shall be taken into account in arriving at the provision amount. ▪ Present Value – Where the effect of the time value of money is material, the amount of a provision shall be discounted to present value. – Discount rate shall be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.
Uncertain tax positions	▪ Under IAS 37 measurement is based on management's best estimate, weighted-average probability or a range of possible outcomes. No guidance is given on which method to use or how to determine the best estimate of the liability to be recognized.

Overview of key concepts — IAS 37 (cont.)

Concept	Discussion
Changes in provisions	▪ Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate.
Use of provisions	▪ Shall be used only for expenditures for which the provision was originally recognized.

Decision Tree – Recognition Criteria



Measurement of provisions

IFRS	U.S. GAAP
▪ When all possible outcomes are equally likely of occurrence, mid-point of the range is accrued	▪ ASC 450 (FIN 14) requires that when all possible outcomes are equally likely of occurrence, **low end** of the range be accrued
▪ Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability ▪ If the obligation involves a large population of items, the liability is estimated by weighing all possible outcomes by their associated probabilities (i.e., the probability-weighted **expected value** is used)	▪ ASC 450 (SFAS 5 and FIN 14) requires accrual for the most likely amount
▪ IFRS requires discounting when the effect of the time value of money is material	▪ Generally provisions are not measured at a discounted amount under ASC 450 (FAS 5), since the timing/amount is uncertain

Measurement — Example

Facts

- An entity faces a single legal claim, with a 40 percent likelihood of success with no cost, and a 60 percent likelihood of failure with a cost of $1 million.

Analysis

- Where the provision relates to a single event, paragraph 40 of IAS 37 indicates that the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes.
- In this example, there are only two possible outcomes and it is more likely that the cost of $1 million will result, and therefore, a provision of $1 million should be recognized.

Measurement — Example (cont.)

Facts

- Utility company generates electricity. The EPA has brought litigation against Utility company alleging violations of the Clean Air Act. Utility company expects the lawsuit to be settled in the range of $1 million to $4 million and no one outcome is more likely than the other.

Analysis

- Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used. In this case the mid-point is $ 2.5 million.

Restructuring provisions

- Must determine whether a constructive obligation exists
  - Must have a detailed formal plan identifying certain items, or
  - Entity has raised a valid expectation.
- Board decision itself does not give rise to a constructive obligation
  - Must have either implemented the plan or announced the major feature of the plan.
- Similar to EITF 94-3

Overview of accounting differences

	IFRS	U.S. GAAP
Restructuring provision	A restructuring liability is recognized if a detailed formal plan is announced or implementation of such a plan has started.	A restructuring liability is recognized when the transaction or event occurs that leaves little or no discretion to avoid the future transfer or use of assets to settle the liability. An exit or disposal plan, by itself, does not give rise to a liability.

Provisions and contingent liabilities

	Recognition	Disclosure
There is a present obligation that probably requires an outflow of resources	A provision is recognized	Disclosures are required for the provision
There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources	No provision is recognized	Disclosures are required for the contingent liability
There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote	No provision is recognized	No disclosure is required

Contingent assets

	Recognition	Disclosure
The inflow of economic benefits is virtually certain	The asset is not contingent and is recognized	
The inflow of economic benefits is probable, but not virtually certain	No asset is recognized	Disclosures are required
The inflow is not probable	No asset is recognized	No disclosure is required

Application of IAS 37

Concept	Discussion
Future operating losses	No provision is recognized
Onerous contracts	The present obligation under the contract is recognized and measures as a provision
Restructuring	A constructive obligation to restructure arises only when an entity: (a) has a detailed formal plan for the restructuring identifying at least: (i) the business or part of a business concerned; (ii) the principal locations affected; (iii) the location, function, and approximate number of employees who will be compensated for terminating their services; (iv) the expenditures that will be undertaken; and (v) when the plan will be implemented; and (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both: ▪ necessarily entailed by the restructuring; and ▪ not associated with the ongoing activities of the entity

Overview of key potential differences

Item	U.S. GAAP	IFRS
Recognition threshold	• When the loss is “probable” i.e. reasonably possible (generally higher than the “more likely than not” threshold under IFRS)	• When the loss is “more likely than not” (generally > 50% likelihood)
Measurement of provisions	• The amount most likely to occur	• Based on the best estimate (may or may not be the outcome with highest probability)
Discounting of provisions	• Acceptable only if the timing of payment is fixed or readily determinable	• Required when time value of money is material
Timing of restructuring provisions	• Examine each type of cost individually to determine whether to accrue	• Emphasis on recognition of the cost of the exit plan as a whole

Pensions

Objectives and Scope of IAS 19

- Objectives and Underlying Principle
  - Recognize liability when employee has rendered service in exchange for employee benefits.
  - Recognize as expense when entity consumes the economic benefit arising from the services provided by employees, rather than when paid/payable.
- Scope
  - Applicable for accounting for all employee benefits unless addressed by other standards (e.g., IFRS 2 – Share-Based Payment).

IAS 19 (Revised 2011)

- In June, 2011, the IASB issued IAS 19 (Revised 2011), changing the accounting for certain employee benefits.
- Effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.
- The objective of this limited scope project was to improve the financial reporting of employee benefits by:
  - Requiring changes in the defined benefit obligation and plan assets to be reported in a more understandable way
  - Eliminating some recognition and presentation options, thus improving comparability
  - Clarifying requirements that have resulted in diverse practices
  - Enhancing disclosure about the risks arising from defined benefit plans
- The focus of the course content will be on IAS 19 as it is currently stated, however, we highlighted items that IAS 19 (Revised 2011) has impacted.

Short-Term Employee Benefits

- Short-term employee benefits include the following amounts, if due to be settled within 12 months after the end of the period*:
  - Wages, salaries, and social security contributions
  - Short-term compensated absences such as paid annual leave and paid sick leave
  - Profit sharing and bonuses
  - Nonmonetary benefits for current employees, e.g., housing, medical care, cars, and free or subsidized goods or services for current employees
- Measured on an undiscounted basis
- These topics are in scope of IAS 19 but there are no substantive differences from U.S. GAAP.

- *Amended by IAS 19 (Revised 2011) to include only those benefits “expected to be settled wholly” within 12 months after the end of the annual period in which the employee services are provided.

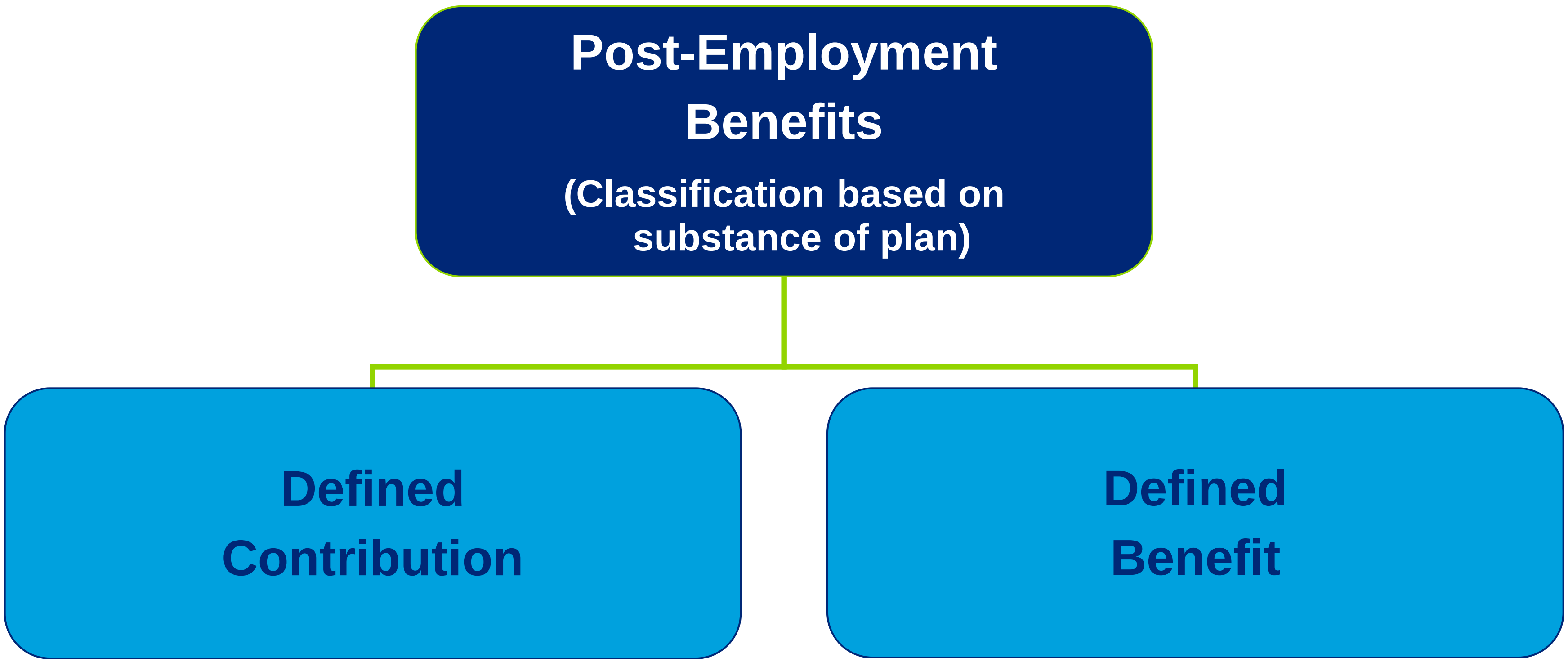
Other Long-Term Employee Benefits

- Employee benefits (excluding post-employment and termination benefits) that are **not due to be settled within 12 months** after the end of the period of related service*
- Examples of other long-term employee benefits include:
  - Long service or sabbatical leave
  - Jubilee benefits
  - Long-term disability
  - Profit sharing/bonuses
  - Deferred compensation
- Accounting treatment
  - Amount to be recognized as liability shall be the net of the following amounts:
    - Present value of the benefit obligation at the balance sheet date
    - Fair value of plan assets out of which obligations are to be settled directly
  - Gains/losses and prior service costs are recognized immediately in profit or loss

- *Amended by IAS 19 (Revised 2011) to include only those benefits that are NOT short-term benefits, post-employment benefits, or termination benefits. (i.e., benefits other than post-employment and termination benefits that are not "expected to be settled wholly" within 12 months after the end of the annual period in which the employee services are provided)

Post-Employment Benefits

– Employee benefits (other than termination benefits) payable after completion of employment



Termination Benefits

- Termination benefits are employee benefits payable as a result of:
  - Termination of employee’s employment.
  - Voluntary redundancy by employee.
- Termination benefits include:
  - Lump-sum payments,
  - Enhanced post-employment benefits, and
  - Salary paid until end of specified notice period if the employee renders no further service.
- Recognize as a liability and expense when entity is demonstrably committed to either:
  - Terminate employment of an employee or group of employees before normal retirement date, or
  - Provide termination benefits due to an offer made to encourage voluntary redundancy.

IAS 19 (Revised 2011) requires recognition of termination benefits at the earlier of when the entity can no longer withdraw the offer and when it recognizes any related restructuring costs.

Multi-Employer Plan – DIFFERENCES

IFRS	U.S. GAAP
• Accounted for as a defined benefit plan if, in substance, a defined benefit plan and the necessary information is available	• Accounted for as a defined contribution plan

Use of Calculated Market-Related Value of Assets – DIFFERENCES

IFRS	U.S. GAAP
• Cost calculated must be based upon the Fair Value of Plan Assets.	• Expected Return on Assets and Actuarial Gain/Loss Amortization may utilize a calculated “Market-Related Value of Assets” which smoothes the impact of asset gains/losses over up to five years.

IAS 19 (Revised 2011) affects the determination of return on plan assets. The revisions use a net interest approach (assuming asset return at the discount rate) thus eliminating the expected return calculation.

Recognition of Actuarial Gains and Losses – DIFFERENCES

IFRS	U.S. GAAP
• Immediately in OCI with no recycling in profit or loss*, or • Apply deferral through corridor*, or • Other faster, systematic method*	• Adjustment to OCI with recycling through profit or loss • Recycling using corridor method or other faster, systematic method

*** IAS 19 (Revised 2011) requires immediate recognition in OCI without any recycling to profit or loss.**

Recognition of Prior Service Costs – DIFFERENCES

IFRS	U.S. GAAP
• Recognized over vesting period, or immediately if fully vested • Not recognized in balance sheet to the extent not yet amortized*	• Recognized immediately in OCI • Amortized to profit or loss over the remaining service period or life expectancy • Vesting is ignored

Under IAS 19 (Revised 2011), all past service costs are recognized immediately in P&L regardless of whether the benefits are vested. Immediate recognition will eliminate the balance sheet difference between IFRS and U.S. GAAP.

Recognition of Gains/Losses on Curtailment of a Benefit Plan – DIFFERENCES

IFRS	U.S. GAAP
• Recognized when the entity is demonstrably committed and a curtailment has been announced	• Recognition timing differs depending upon whether impact of a curtailment is a gain/loss • If a loss, recognized when it is probable that a curtailment will occur and the effects are reasonably estimable • If a gain, recognized when the curtailment occurs

Curtailments and Settlements (Measurement)

- A settlement and a curtailment occur together if the plan is terminated where the obligation is settled and the plan ceases to exist.
- Recognize gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs.

IFRS	U.S. GAAP
• Curtailment or settlement charge/credit based upon the change in DBO, any change in plan assets, and pro rata amount of unrecognized items	• Curtailment charge/credit generally based upon the increase or decrease in the DBO in excess of unamortized actuarial gain or loss, respectively, and a portion of unamortized past service cost (detailed rules) • Settlement charge/credit based on the change in the DBO, change in plan assets, and a pro rata portion of unamortized actuarial gain/loss (detailed rules)

Termination Benefits – DIFFERENCES

IFRS	U.S. GAAP
• No distinction between special and other benefits; recognized when the employer is demonstrably committed to pay	• Distinction between type of benefits which can be recognized under different circumstances based on the type of benefits

Share based payments

Overview of key concepts — IFRS 2

Definitions of	Discussion
Share-based payment transaction	▪ A transaction in which the entity: – receives goods or services as consideration for equity instruments (including shares or share options) of the entity (**EQUITY SETTLED),** or – acquires goods or services by incurring liabilities for amounts that are based on the price of the entity's shares or other equity instruments of the entity **(CASH SETTLED).**
Equity instrument	▪ A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
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.

Overview of key concepts — IFRS 2 (cont.)

Definitions of	Discussion
Grant date	The date at which the entity and another party (including an employee) agree to a SBP arrangement.
Vesting conditions	The conditions that must be satisfied for the counterparty to become entitled to receive cash, other assets or equity instruments of the entity, under a SBP arrangement.
Vesting period	The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.
Market condition	A condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price of the entity's equity instruments.
Measurement date	The date at which the fair value of the equity instruments granted is measured.
Fair value	The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

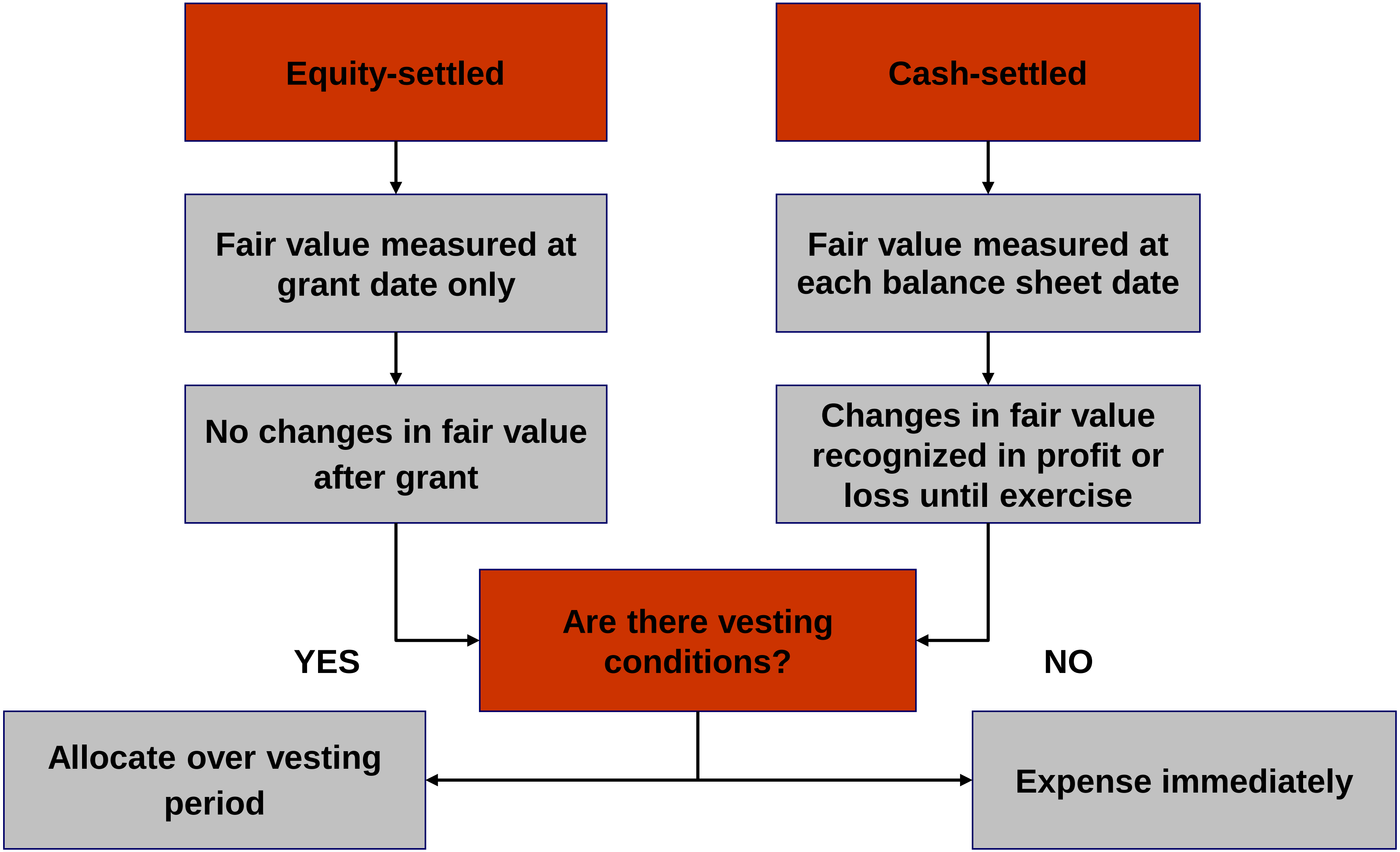
Main features of IFRS 2

Scope of the standard? →	**Applies to all share-based payment transactions**
Types of share-based payment transactions? →	**Equity-settled, cash-settled, or choice between equity- and cash-settlement**
Recognition of expense in profit or loss? →	**Yes — allocated over vesting period, if any**
Date of initial measurement? →	**Employees — Grant date** **Non-employees — Date goods or services received**
Measurement basis? →	**Fair value e.g. by applying valuation techniques for shares and share options**

Measurement

Key potential differences	IFRS	U.S. GAAP
Determine option value-based, separate valuations of tranches (multiple life method) or a single valuation (single life method) Only relates to share-based payments (SBPs) with graded vesting and service conditions	Multiple life	Accounting policy choice: single life or multiple life
Consider contingent features (e.g., clawback features) in option valuation	Yes	No

Overview of recognition criteria



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”

Expense for awards with graded vesting

- Assume company grants 1,000 options at a fair value of $10 per-share. The options vest over 4 years at 25% per year
- IFRS requires separate expense amortization for each tranche. Therefore, the fair value of each tranche (1,000 x $10 x ¼ = $2,500) is amortized from the grant date to the vesting date of that tranche
- U.S. GAAP allows accounting policy choice between straight-line amortization or accelerated amortization similar to IFRS

Award	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Tranche 1 [(10,000 ÷ 4)]	$2,500			
Tranche 2 [(10,000 ÷ 4) × 1/2]	$1,250	$1,250		
Tranche 3 [(10,000 ÷ 4) × 1/3]	$833	$833	$833	
Tranche 4 [(10,000 ÷ 4) × 1/4]	$625	$625	$625	$625
IFRS Expense	$5,208	$2,708	$1,459	$625
U.S. GAAP straight-line expense	$2,500	$2,500	$2,500	$2,500

This example does not consider differences in fair value.

Modification of vesting condition

- A service or performance condition for vesting that the company expects will not be satisfied is changed to a condition that the company expects will be satisfied
  - Examples
    - Employee terminates employment before vesting in the award, but the company eliminates the vesting condition upon the employee's termination.
    - Award has a sales target for vesting. The company determines that meeting the target is not probable and modifies the award to make vesting probable.
- Incremental expense to be recognized:

IFRS	U.S. GAAP
Greater of fair value at modification date or fair value at grant date	Fair value at modification date

Classification of awards

Key potential differences	IFRS	U.S. GAAP
Awards that can be redeemed for cash upon a contingent event	Generally liability	Equity (if occurrence of event is not probable)
Awards that can be net settled to satisfy minimum tax withholding	Net settled portion is typically a liability	Equity
Awards granted by a subsidiary but settled in parent company's equity	Liability	Equity
Awards indexed to a factor other than a service, performance or market condition (e.g. exercise price indexed to the Consumer Price Index)	Equity (assuming the award is not cash-settled)	Liability

Taxes

Areas	U.S. GAAP	IFRS
Deferred tax asset	Based on U.S.GAAP expense recognized (generally, grant-date fair value amortized over vesting period)	Based on expected tax deduction (generally, intrinsic value) re-measured at each reporting date
Tax expense in P/L	Based on deferred tax assets (DTA) If tax benefit realized at exercise is greater than DTA, windfall is recorded in additional paid-in capital (APIC) pool, which can be used to offset future shortfalls from other grants. Shortfalls that cannot be offset by APIC pool are recognized as tax expense	Based on DTA but limited to IFRS expense times tax rate. If DTA exceeds IFRS expense, the excess is recorded in equity, but cannot be used to offset future shortfalls from other awards
Payroll taxes		• Under IFRS, payroll or other employment taxes are accrued over service period. The liability is re-measured at each balance sheet date until settlement • Under U.S. GAAP, payroll tax liabilities are recognized when the taxes are levied

Overview of key potential differences

Item	U.S GAAP	IFRS
Date for measuring share-based payments to non-employees	• Earlier of the date of counterparty's commitment to perform or the date of actual performance	• The date the entity obtains the goods or counterparty renders the services
Employee share purchase plan (ESPP)	• No compensation cost is recognized if the ESPP qualifies as non-compensatory	• ESPP is deemed compensatory
Plan with graded vesting	• Either on straight line basis or on accelerated basis	• Accelerated basis
Payroll taxes on employee stock-based compensation	• Liability is recognized in the period the tax is levied	• Liability is recognized at grant date or as services are provided
Deferred taxes related to SBP transactions	• On the basis of GAAP expense recognition	• On the basis of the expected tax deduction
Measurement of awards granted by non-public entities	• Different measurement alternatives for public and non-public entities	• No difference between public and non-public entities