SHARE OPTIONS: HAVE YOU THOUGHT THROUGH THE CONSEQUENCES?

Share options are one of the more common remuneration tools that companies use to reward their employees. Along with salary, bonus and other benefits, they are a common way to ensure loyalty and motivate staff.

In the past, there was no accounting treatment mandated for share options as these were seen as 'equity' or 'shareholder' transactions. However with the issuance of IFRS 2, Share-based Payments, the accounting specified in the standard can have unexpected consequences on the financial reporting of the entity.

This is according to Bruce Mackenzie, director of W Consulting, an independent IFRS consulting and training company, who says that many companies do not consider the accounting required with share options until it is too late. “In addition the accounting under the IFRS for SMEs is almost identical to that in IFRS 2, so this impacts companies at all levels.”

“In terms of IFRS 2, share options are classified as either equity-settled or cash-settled options. There is also accounting specified for hybrid situations where either the company or the employee can elect to receive equity or cash. Where a company issues options that are settled in shares, such schemes are deemed to be equity-settled and for such schemes, the company is required to fair value the options issued to staff, and recognise the cost over the vesting period (being the period over which the employee becomes entitled to the shares).”

Mackenzie advises that it should be noted that the fair value is fixed on day one, and the amount expensed is only adjusted for changes in non-market conditions (such as expected number of staff who will receive shares). The cost is accounted for in profit and loss, with the credit recorded in equity.

“Over the last year we have seen share prices fall. As a result many such options are now worthless, or heavily out of the money. However, even though the share price might be below the strike price, the company granting the options MUST continue to expense these every year as changes in the share price do not impact the annual expensing of the options.”

This means that a company could have an expense for share options even when it knows there is only a remote chance of ever issuing shares.

“Cash-settled share-based payments schemes are where employees receive cash as opposed to shares. The difference from other forms of remuneration is that these schemes pay the employees cash based on movements in the company's share price,” explains Mackenzie. “So, for example, if the share price increases by R10, and an employee has 20 options that vest, the employee will receive R200 in cash.”

The problem with these types of schemes is that the obligation to pay the employee cash meets the definition of a financial liability and as a result, the company will account for the charge under cash-settled schemes by debiting profit and loss and crediting a liability account.

"Some people see this as a double hit on the company as both earnings and the Statement of Financial Position are impacted negatively. In addition, cash-settled schemes require annual fair value calculations as the amount of cash payable to the employee changes annually and needs to be reflected."

"Share option accounting is not simple and share options are not always the simplest form of motivating employees. You will most likely need to consult specialists to understand the accounting, tax and legal implications of any scheme and in addition, specialists may be required to calculate the fair values of the options. Companies looking at introducing share options should ensure that they understand the implications thoroughly before signing the legal documents and binding themselves in such schemes. Otherwise the results may not be what you expected!" concludes Mackenzie.

About the Author

Bruce Mackenzie is a director at W.consulting, an independent IFRS consulting and training company. Bruce is a CA(SA), Registered Auditor, FCCA, and JSE Approved IFRS Advisor. W.consulting is a SAICA Alliance Partner. For details visit www.wconsulting.co.za

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