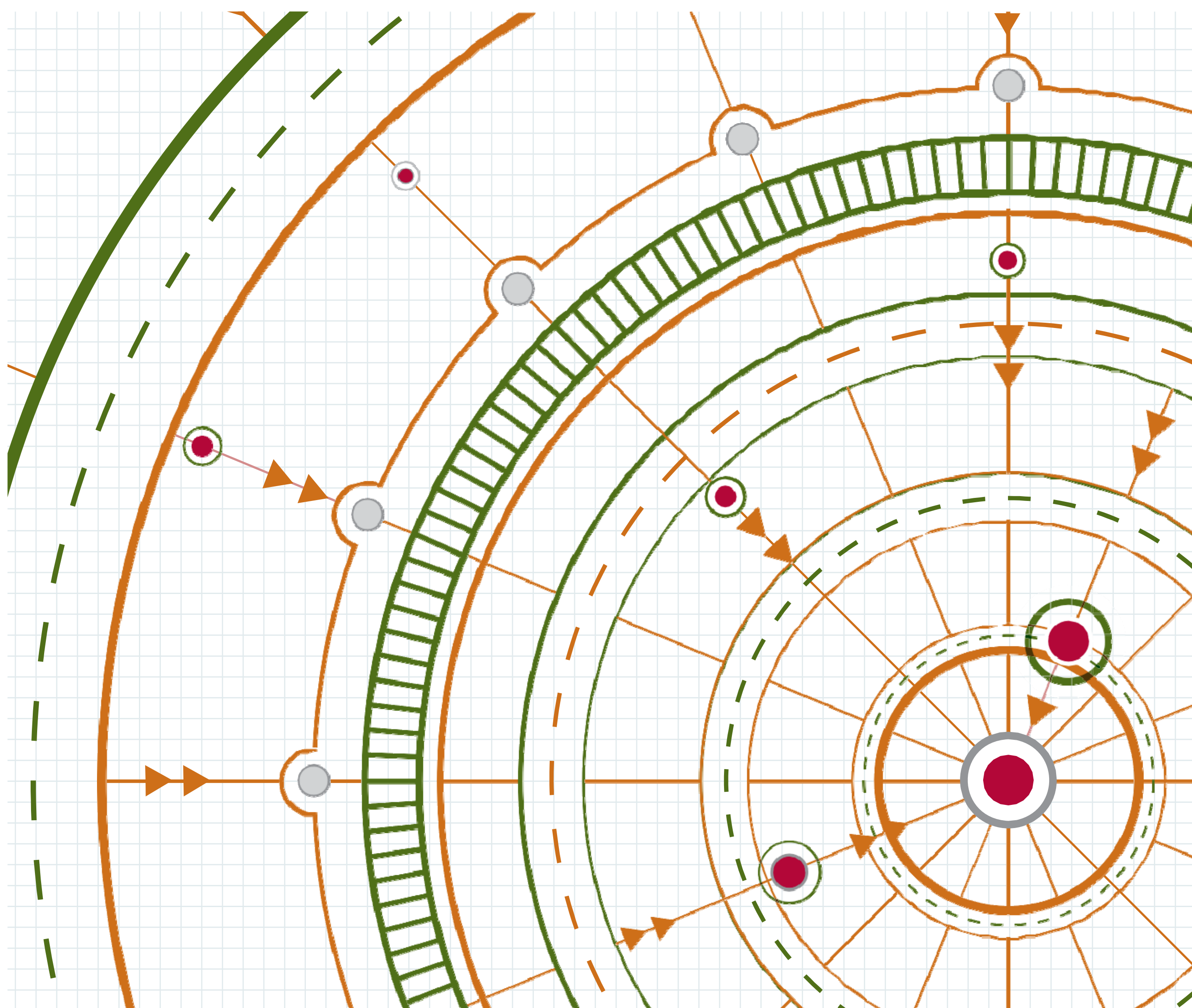
IFRS for SMEs® Standard (2015) + Q&As

IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

Module 26—Share-based Payment



IFRS®

IFRS® Foundation Supporting Material for the *IFRS for SMEs*® Standard

including the full text of
Section 26 *Share-based Payment*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

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Module 26—Share-based Payment

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.

This module has been prepared by IFRS Foundation education staff.

The contents of Section 26 *Share-based Payment* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 26. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the IFRS for SMEs* Standard.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the general requirements for presenting share-based payment transactions applying Section 26 *Share-based Payment* of the *IFRS for SMEs* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in presenting share-based payment transactions. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provides a practical opportunity to apply the requirements to share-based payment transactions applying the *IFRS for SMEs* Standard.

Module 26—Share-based Payment

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- identify share-based payment transactions;
- apply the recognition requirements for share-based payment transactions, including the requirements when there are vesting conditions;
- account for equity-settled share-based payment transactions, including shares and share options;
- account for modifications, cancellations and settlements of equity-settled share-based payment transactions;
- account for cash-settled share-based payment transactions, including share-based payment transactions with cash-settled alternatives;
- demonstrate how to account for share-based payment transactions in which the identifiable consideration appears to be less than the fair value of the equity instruments granted or the liability incurred;
- disclose share-based payment arrangements in financial statements; and
- demonstrate an understanding of the significant judgements required in accounting for share-based payment transactions.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (November 2018) the SMEIG has not issued any Q&As relevant to this module

Module 26—Share-based Payment

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

The objective of Section 26 is to prescribe general requirements for presenting share-based payment transactions.

A share-based payment transaction is one in which an entity receives goods or services as consideration for its equity instruments, or by incurring a liability based on the price or value of its shares or other equity instruments. Section 26 specifies the accounting for all share-based payment transactions including those that are equity-settled, cash-settled and those in which the terms of the arrangement provide a choice of whether the entity settles cash (or other assets) or by issuing equity instrument.

In summary, Section 26 sets out the following requirements.

- the fair value of the goods or services received in an equity-settled share-based payment transaction is recognised in the financial statements either as an asset or, if the asset recognition criteria are not met, as an expense. There is a corresponding increase in equity.[1]
- if the fair value of the goods or services cannot be estimated reliably, as for employee services, the goods and services are measured by reference to the fair value of the equity instruments granted. (Specific guidance is included, on how to account for vesting conditions, modifications, cancellations and settlements.)
- goods or services received in a cash-settled share-based payment transaction are measured at the fair value of the liability incurred. At each reporting date the fair value of the liability is remeasured through profit or loss until it is settled.
- share-based payment transactions that provide a choice of settlement in cash or equity are generally accounted for as cash-settled share-based payment transactions. However, if an entity has a past practice of settling the transactions by issuing equity instruments, or the choice of settlement has no commercial substance, the entity is required to account for the transaction as an equity-settled share-based payment transaction.

Section 26 provides relief for group entities by permitting a share-based payment expense to be measured on the basis of a reasonable allocation of the expense for the group.

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(1) The *IFRS for SMEs* Standard and this module refers to an 'increase' in equity when referring to the credit entry for share-based payment transactions. However, if an entity has negative equity, for example if the entity's accumulated trading losses exceed other forms of equity, then the credit to equity would result in a decrease in the amount of negative equity.

Module 26—Share-based Payment

What has changed since the 2009 *IFRS for SMEs* Standard?

The following are the changes made to Section 26 by the 2015 Amendments:

- alignment of the scope and definitions with IFRS 2 *Share-based Payment* to clarify that share-based payment transactions involving equity instruments of other group entities are in the scope of Section 26 (see paragraphs 26.1−26.1A and related definitions in the glossary of the *IFRS for SMEs* Standard);
- clarification that Section 26 applies to all share-based payment transactions even if the identifiable consideration appears to be less than the fair value of the equity instruments granted or the liability incurred (see paragraphs 26.1B and 26.17);
- clarification of the accounting treatment for vesting conditions and modifications to grants of equity instruments (see paragraphs 26.9, 26.12 and three new definitions in the glossary of the *IFRS for SMEs* Standard); and

clarification that the simplification provided for group plans relates only to the measurement of a share-based payment expense; relief is not provided from its recognition (see paragraphs 26.16 and 26.22).

In addition this module reproduces other editorial changes.

Module 26—Share-based Payment

REQUIREMENTS AND EXAMPLES

Scope of this section

26.1 This section specifies the accounting for all **share-based payment transactions** including those that are equity- or cash-settled or those in which the terms of the arrangement provide a choice of whether the entity settles the transaction in **cash** (or other **assets**) or by issuing **equity** instruments.

26.1A A share-based payment transaction may be settled by another group entity (or a shareholder of any **group** entity) on behalf of the entity receiving the goods or services. This section also applies to an entity that:

(a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction; or

(b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than the payment for goods or services supplied to the entity receiving them.

26.1B In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this section applies (see paragraph 26.17).

26.2 **Cash-settled share-based payment transactions** include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (instead of an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (for example, upon cessation of employment) or at the employee's option.

Notes

The *IFRS for SMEs* Standard defines a share-based payment transaction (see the Glossary) as follows:

A transaction in which the entity:

(a) receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement; or

(b) 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 include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. An issue of shares for cash or other financial assets is not a share-based payment transaction if it does not involve the delivery of goods or services. Such transactions are covered by other sections of the *IFRS for SMEs*

Standard, for example Section 22 *Liabilities and Equity*. Furthermore, equity instruments issued by an acquirer in a business combination in exchange for control of the acquiree are specifically addressed in Section 19 *Business Combinations and Goodwill*. Consequently, Section 26 does not apply to transactions in which the entity acquires goods as part of the net assets acquired in a business combination.

Nevertheless, there may be circumstances in which goods and services are received but they cannot be specifically identified and the exercise of judgement may be required. An apparent discount might be an indicator that additional consideration has been or will be received; see paragraph 26.17.

The definition of a share-based payment transaction above refers to a share-based payment arrangement. The *IFRS for SMEs* Standard defines a share-based payment arrangement (see the Glossary) as follows:

> An agreement between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive:
>
> (a) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity; or
>
> (b) equity instruments (including shares or share options) of the entity or another group entity
>
> provided the specified vesting conditions, if any, are met.

Entities sometimes use their shares, or options over their shares, as a form of currency. For example, an early-stage entity, sometimes called a start-up entity, with limited cash might issue its shares in exchange for goods or services from a strategic partner. While this practice may help the start-up entity to manage its cash flow, the payment in shares may also be attractive as an investment to a vendor or service provider who thinks that the value of the shares may increase.

Another common scenario is the use of share-based compensation to remunerate employees. Share-based compensation plans can motivate employees to higher levels of performance and build a sense of shared ownership in the entity. They might be provided as a way of retaining key members of staff and as part of succession planning. Generally, share-based payment schemes provide employees with the right to receive equity in the entity or a cash payment based on the entity’s share price if the performance of the entity exceeds predetermined levels. Typical performance measures include increases in earnings per share, revenue targets and market share.

By definition, SMEs are entities whose equity instruments are not traded in a public market. Consequently, employees of SMEs have no public market for selling their shares. An SME that is part of a group might grant its employees shares or share options in a listed company in the group. Alternatively, an SME might issue share appreciation rights that give employees the right to receive compensation equal to the share price’s appreciation (ie the excess of the estimated value of the share at the date of exercise over a pre-established amount). Entities may pay the share appreciation in cash, in shares, or in a combination of both.

Module 26—Share-based Payment

Section 26 applies to the accounting for all share-based payment transactions including:

- equity-settled share-based payment transactions,
- cash-settled share-based payment transactions, and
- share-based payment transactions in which the terms of the arrangement provide a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

The *IFRS for SMEs* Standard defines an equity-settled share-based payment transaction (see the Glossary) as follows:

> A share-based payment transaction in which the entity:
>
> (a) receives goods or services as consideration for its own equity instruments (including shares or share options); or
>
> (b) receives goods or services but has no obligation to settle the transaction with the supplier.

The *IFRS for SMEs* Standard defines a cash-settled share-based payment transaction (see the Glossary) as follows:

> 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 equity instruments (including shares or share options) of the entity or another group entity.

Examples—share-based payment transactions within the scope of Section 26

Ex 1 **As part of its ordinary activities, Entity A contracted a consultant to advise on business development and strategy. The consultant agreed to accept ordinary shares of Entity A as payment for his services.**

Entity A is paying for services in its own shares rather than in cash. It accounts for this equity-settled share-based payment transaction in accordance with Section 26.

Ex 2 **Entity A establishes an equity compensation plan and grants options to its employees. The options entitle the holder to purchase one ordinary share of Entity A, at a fixed price, during a five-year period.**

Entity A is using the share options as a form of employee remuneration. It accounts for this equity-settled share-based payment transaction in accordance with Section 26.

Ex 3 **To address concerns about the loss of experienced staff to a competitor and the cost of training new staff, Entity A introduces a new bonus scheme as part of its employee remuneration package. On 1 May 20X0 it grants share appreciation rights (SARs) to its employees. On 30 April 20X3 Entity A will pay to each employee an amount, in cash, equal to the increase in the value of one of its shares over the three-year period from 1 May 20X0 for every SAR the employee holds, provided the employee is still employed by Entity A on 30 April 20X3.**

Although the payment is in cash, the amount is based on the price of Entity A's shares; the amount paid for each SAR equals the increase in the value of one of Entity A's shares over a specified three-year period. Entity A accounts for this cash-settled share-based payment transaction in accordance with Section 26.

Ex 4 **The management of Entity B, like Entity A in Example 3 above, has been concerned about the loss of experienced staff to a competitor and the cost of training new staff. Consequently, on 1 May 20X0 it introduces a new bonus scheme as part of its employee remuneration package. On 30 April 20X3 Entity B will give to each employee shares in Entity B whose fair value on 1 May 20X0 equals 5% of his or her annual salary on 1 May 20X0, provided the employee is still employed by Entity B on 30 April 20X3.**

Entity B is using the shares as a form of employee remuneration. It accounts for this equity-settled share-based payment transaction in accordance with Section 26.

Ex 5 **A strategic consultant provides professional services to Entity B, which is a subsidiary of Entity A. The consultant agrees to accept ordinary shares of Entity A as payment for its services to Entity B.**

Entity A, Entity B's parent, pays the third party by issuing its ordinary shares as full payment on behalf of Entity B. Entity A accounts for this transaction as an equity-settled share-based payment transaction in accordance with Section 26. In Entity A's separate financial statements it may recognise the debit as an increase to its "Investment in Entity B" asset. This acknowledges that the share-based payment increases the value of the parent's investment in the subsidiary. In Entity B's individual financial statements, Entity B accounts for a share-based payment transaction based on a reasonable allocation of the expense in Entity A's consolidated financial statements.

Examples—transactions outside the scope of Section 26

Ex 6 **Management of Entity C, like Entity A and Entity B in Examples 3 and 4 above, has been concerned about the loss of experienced staff to a competitor and the cost of training new staff. Consequently, on 1 May 20X0 it introduces a new bonus scheme as part of its employee remuneration package. On 30 April 20X3 Entity C will pay to each employee an amount, in cash, equal to 5% of his or her annual salary on 1 May 20X0, provided the employee is still employed by Entity C on 30 April 20X3.**

Although the payment is a cash incentive aimed at retaining staff, as in Example 3, the amount is not based on the price of Entity C's shares as it was in that example. Furthermore, although the bonus is a percentage of salary, as in Example 4, the payment here is in cash rather than in the form of shares as it was in that example.

The bonus payment is not in Entity C's shares and is not based on the price of Entity C's shares. It is therefore not a share-based payment and it is outside the scope of Section 26.

Ex 7 **SME A issues 10,000 new shares in exchange for receiving 80% of the ordinary shares of SME B.**

An issue of shares for cash or other financial assets is not a share-based payment transaction if it does not involve the delivery of goods or services. Such transactions are covered by other sections of the *IFRS for SMEs* Standard. This transaction is a business combination that is effected by the transfer of SME A's equity instruments to the previous owners of the shares in SME B. Equity instruments issued by an acquirer (Entity A) in a business combination in exchange for control of the acquiree (Entity B) are specifically addressed in Section 19 *Business Combinations and Goodwill*.

Recognition

26.3 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an **equity-settled share-based payment transaction** or a **liability** if the goods or services were acquired in a cash-settled share-based payment transaction.

Example—recognition: goods received in exchange for equity

Ex 8 **Entity A purchased 100 computers for its call centre in exchange for issuing 20,000 of its ordinary shares.**

Entity A recognises the computers when it acquires them and accounts for them in accordance with Section 17 *Property, Plant and Equipment*. It recognises an increase in assets (the computers) and a corresponding increase in equity for the shares issued in exchange for the computers.

26.4 When the goods or services received or acquired in a share-based payment transaction do not qualify for **recognition** as assets, the entity shall recognise them as **expenses**.

Notes

Typically, an expense arises from the consumption of goods or services. For example, services are typically consumed immediately, in which case an expense is recognised as the counterparty renders service. Goods might be consumed over a period of time (for example, an item of equipment used over its useful life) or sold at a later date (for example, inventories), in which case an expense is recognised when the goods are consumed or sold (for example depreciation of equipment or the cost of goods sold for inventory). However, sometimes it is necessary to recognise an expense before the goods or services are consumed or sold, because they do not qualify for recognition as assets.

Example—service received that does not qualify for recognition as an asset

Ex 9 **As part of its ordinary activities, Entity A contracted a consultant to advise on a new marketing campaign. The consultant agreed to accept ordinary shares of Entity A as payment for his services.**

Paragraphs 18.14 and 18.15 require expenditure on advertising and promotional activities to be recognised as an expense. Entity A recognises a marketing expense, in the same way as it would have done had it paid in cash. Entity A also recognises a corresponding increase in equity.

Recognition when there are vesting conditions

26.5 If the share-based payments granted to employees vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those share-based payments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the employee as consideration for the share-based payments have been received. In this case, on the **grant date** the entity shall recognise the services received in full, with a corresponding increase in equity or liabilities.

26.6 If the share-based payments do not vest until the employee completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those share-based payments will be received in the future, during the **vesting period**. The entity shall account for those services as they are rendered by the employee during the vesting period, with a corresponding increase in equity or liabilities.

Notes

The *IFRS for SMEs* Standard defines vest (see the Glossary) as follows:

> Become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.

Vesting conditions are conditions that need to be met in order for the employee or supplier to become entitled to the share based payment. For example, employees may

be awarded shares in an entity, but subject to the condition that they will receive those shares only if the entity's profit before tax in a particular period exceeds a certain amount and if they remain employed with the entity throughout that period. (See the notes below paragraph 26.9 for a fuller discussion about vesting conditions.)

The *IFRS for SMEs* Standard defines the vesting period (see the Glossary) as follows:

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

Vesting conditions are common in employee share option plans and employee long-term incentive plans.

Examples—recognition when there are no vesting conditions

Ex 10 **On 31 December 20X1 Entity A grants each employee 10 ordinary shares. There are no vesting conditions.**

Because there are no vesting conditions there are no further conditions to be met for employees to be entitled to the shares. Consequently, on 31 December 20X1 (the grant date) employees of Entity A are unconditionally entitled to the shares and Entity A recognises the staff cost in respect of the services received and a corresponding increase in equity.

Ex 11 **On 31 December 20X1 Entity A grants 10 share options to each of its employees to reward them for their past performance. There are no vesting conditions and the options can be exercised at any time after 31 December 20X2.**

At 31 December 20X1 there are no further conditions to be met for employees to be entitled to the share options. The share options can be exercised after 31 December 20X2. If an employee were to leave employment at Entity A before 31 December 20X2, he or she would still keep his or her share options and be entitled to exercise those options after 31 December 20X2.

Because there are no vesting conditions, on 31 December 20X1 (the grant date) employees of Entity A are unconditionally entitled to the share options. Consequently, on 31 December 20X1 Entity A recognises the staff cost in respect of the services received and a corresponding increase in equity.

Example—recognition when there are vesting conditions

Ex 12 **The facts are the same as in Example 11. However, in this example, exercise of the share options is conditional upon an employee working for the entity throughout 20X2.**

The exercise of the share options is conditional upon the employees working throughout 20X2. This vesting condition is a service condition (discussed below). The services to be rendered by the employees as consideration for the share options will be received in 20X2 (the vesting period). Consequently, Entity A recognises the staff cost and a corresponding increase in equity in 20X2.
Note: even if it is also a condition that an employee must still be employed by Entity A at the date of the exercise of the share option, the vesting period remains as the year to 31 December 20X2. Even if the option is actually exercised after 31 December 20X2, the vesting period does not extend to that later date because after 31 December 20X2 all the specified vesting conditions would already have been satisfied. Consequently, it is only if the employee leaves before 31 December 20X2 that he or she would forfeit his or her share options.

Measurement of equity-settled share-based payment transactions

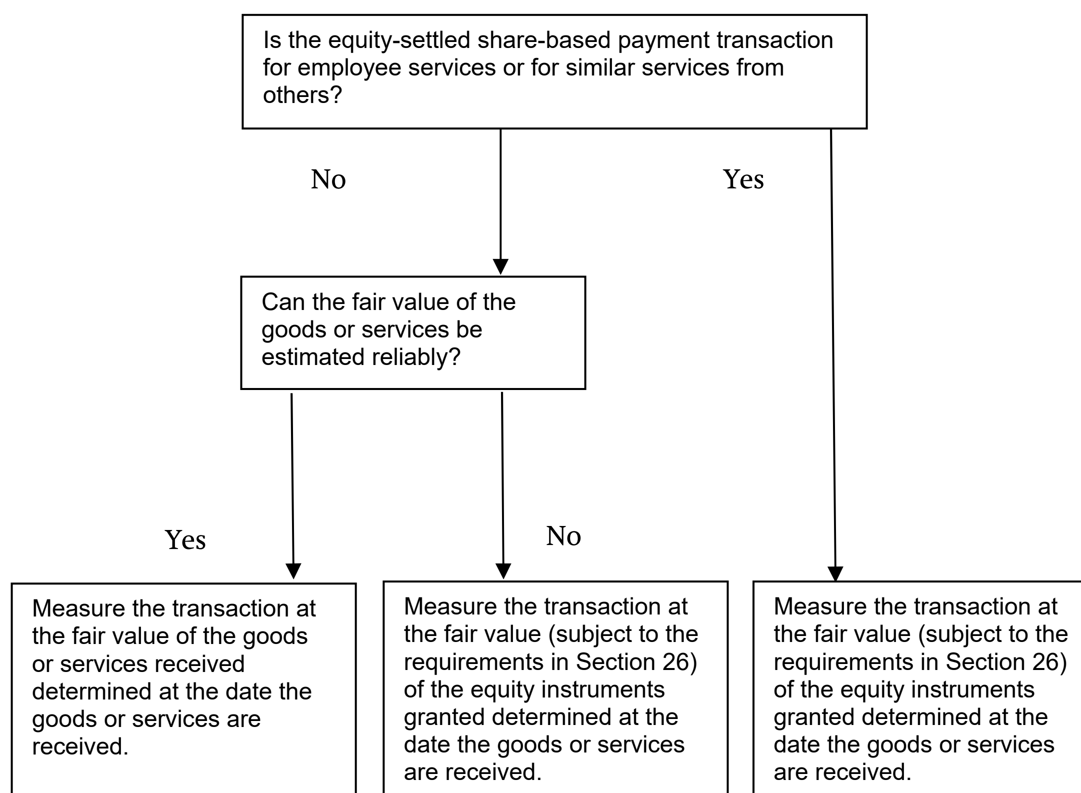
Measurement principle

26.7 For equity-settled share-based payment transactions, an entity shall measure the goods or services received, and the corresponding increase in equity, at the **fair value** of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received.

26.8 For transactions with employees (including others providing similar services), the fair value of the equity instruments shall be measured at the grant date. For transactions with parties other than employees, the **measurement** date is the date when the entity obtains the goods or the counterparty renders service.

Notes

The requirements in paragraph 26.7 are summarised in the following decision tree.



Fair value measurement of equity-settled share-based payment transactions under Section 26 of the IFRS for SMEs Standard

Fair value is defined as 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 (see the Glossary).

When the fair value of the goods or services received can be estimated reliably, the entity measures the goods or services received, and the corresponding increase in equity, at the fair value of the goods or services received. That fair value is measured applying the definition of fair value in the paragraph above and the fair value measurement requirements set out in paragraphs 11.27–11.32.

However, when the transaction is measured at the fair value of the equity instruments granted because it is a transaction for services from employees or others providing similar services, or because the fair value of other goods or services also cannot be estimated reliably, Section 26 contains special requirements (see paragraph 26.9). As a result of these special requirements, the measurement of the fair value of the equity instruments might not be consistent with other fair value requirements in the *IFRS for SMEs* Standard.

An equity-settled share-based payment transaction with employees, or others providing similar services, is measured by reference to the fair value of the equity instruments granted; and the date at which that fair value is measured is the date of grant of the equity instruments. When the transaction is for other goods or services, the date at which fair value is measured is the date at which the goods or services are received, even when the fair value of the goods or services received is measured by reference to the fair value of the equity instruments granted.

Section 26 contains a hierarchy for determining the fair value of shares (see paragraph 26.10) and of share options and equity-settled share appreciation rights (see paragraph 26.11).

The measurement principles in Section 26 for equity-settled share-based payment transactions do not differentiate depending on how an entity will source the shares, for example, whether new shares are issued or whether treasury shares are used. Furthermore, Section 26 does not distinguish where in equity the entry should be made. The exact journal entries made when shares are transferred to the other party—for example, which component of equity should be credited—will depend on the legal requirements of the jurisdiction in which the entity is based; and, in some jurisdictions, how the shares are sourced.

Note: For the purposes of illustrating the requirements in Section 26, the examples below recognise the credit to equity as ordinary share capital (for the par value of the shares) and in a share premium account (for the fair value in excess of the par value of the share).

Examples—measurement, transactions for goods or non-employee services, no vesting conditions

Ex 13 **Entity A purchased 100 computers for its call centre in exchange for issuing 20,000 of its ordinary shares. The cash selling price for each computer is CU500[2] and the shares have a par value of CU1.**

The entity determines that the selling price, which is from an independent vendor in an arm's length transaction, is the best measure of the fair value of the computers.

Consequently, Entity A accounts for the transaction as follows:

Dr	Asset: Property, plant and equipment—computers	CU50,000	
	Cr Equity—ordinary share capital		CU20,000
	Cr Equity—share premium account		CU30,000

To recognise the receipt of equipment in exchange for the issue of 20,000 Entity A ordinary shares.

Note: in accordance with Section 17, Entity A will depreciate the computers over their estimated useful lives to their residual values using a depreciation method that reflects the consumption of the service potential of the computers.

Ex 14 **As part of its ordinary activities, Entity A contracted a consultant to advise on a new marketing campaign. The consultant agreed to accept ordinary shares of Entity A as payment for his services. The consultant advice had an invoice price of CU3,000 and Entity A issued 100 ordinary shares with a par value of CU10 each.**

The entity determines that the invoice value of the consultant fees is the best estimate of the fair value of the marketing advice. Consequently, Entity A accounts for the transaction as follows:

Dr	Profit or loss—marketing expense	CU3,000	
	Cr Equity—ordinary share capital		CU1,000
	Cr Equity—share premium account		CU2,000

To recognise the receipt of marketing advice in exchange for the issue of 100 Entity A ordinary shares.

Ex 15 **Entity A contracts an IT consultancy company to setup and install its IT systems. The company provides 20 hours of consultancy services to Entity A. The usual hourly billing rate of the consultant providing the services was CU10 at the start of the contract, but was increased to CU12 on the consultant's promotion part way through the contract. The consultant did five hours' work for Entity A after his promotion and 15 hours before his promotion. The IT company agreed to accept 30 ordinary shares, with a par value of CU1 each, in Entity A as compensation for its services. Entity A issued new shares to the IT consultancy company.**

The value of the IT consultancy services received by Entity A is CU210 ((15 × CU10) + (5 × CU12)); the measurement date is when the counterparty renders the service and so the change in billing rate is reflected in the pricing of the transaction.

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[2] In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units' (CU).

The entries shown below, which Entity A will make to record the transaction, reflect an assumption that the IT services are eligible for capitalisation as part of the cost of Entity A's IT equipment:

Dr	Asset: Property, plant and equipment—IT equipment	CU210	
	Cr Equity—ordinary share capital		CU30
	Cr Equity—share premium account		CU180

To recognise the capitalisation of IT consultancy services received in exchange for the issue of 30 Entity A ordinary shares.

Example—measurement, transaction with employees, no vesting condition

Ex 16 **On 31 December 20X1 Entity A grants each of its 100 employees 10 ordinary shares with a par value of CU1. There are no vesting conditions. The fair value on 31 December 20X1, the grant date, of the 1,000 shares granted is CU5,000.**

The fair value of the employees' services must be measured by reference to the fair value of the shares awarded, rather than the fair value of the employee services. Because there are no vesting conditions the services in exchange for the shares have already been provided by employees, therefore the measurement date is the grant date of the shares. At grant date Entity A will make the following entry to record the equity compensation:

Dr	Profit or loss—staff expense*	CU5,000	
	Cr Equity—ordinary share capital		CU1,000
	Cr Equity—share premium account		CU4,000

To recognise the receipt of employee services in exchange for issuing 1,000 Entity A ordinary shares

* The expense reflects an assumption that, in this example, the employee compensation does not qualify for recognition as an asset, ie 'capitalisation', for example, as part of the cost of inventory.

26.9 A grant of equity instruments might be conditional on employees satisfying specified **vesting conditions** related to service or performance. An example of a vesting condition relating to service is when a grant of shares or share options to an employee is conditional on the employee remaining in the entity's employ for a specified period of time. Examples of vesting conditions relating to performance are when a grant of shares or share options is conditional on a specified period of service and on the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a **market vesting condition**). Vesting conditions are accounted for as follows:

(a) all vesting conditions related to employee service or to a non-market performance condition shall be taken into account when estimating the number of equity instruments expected to vest. Subsequently, the entity shall revise that estimate if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. Vesting conditions related to employee service or to a non-market performance condition shall not be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date.

(b) all market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date, with no subsequent adjustment to the estimated fair value, irrespective of the outcome of the market or non-vesting condition, provided that all other vesting conditions are satisfied.

Notes

The *IFRS for SMEs* Standard defines vesting conditions (see the Glossary) as follows:

> 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 conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period). A performance condition might include a market vesting condition.

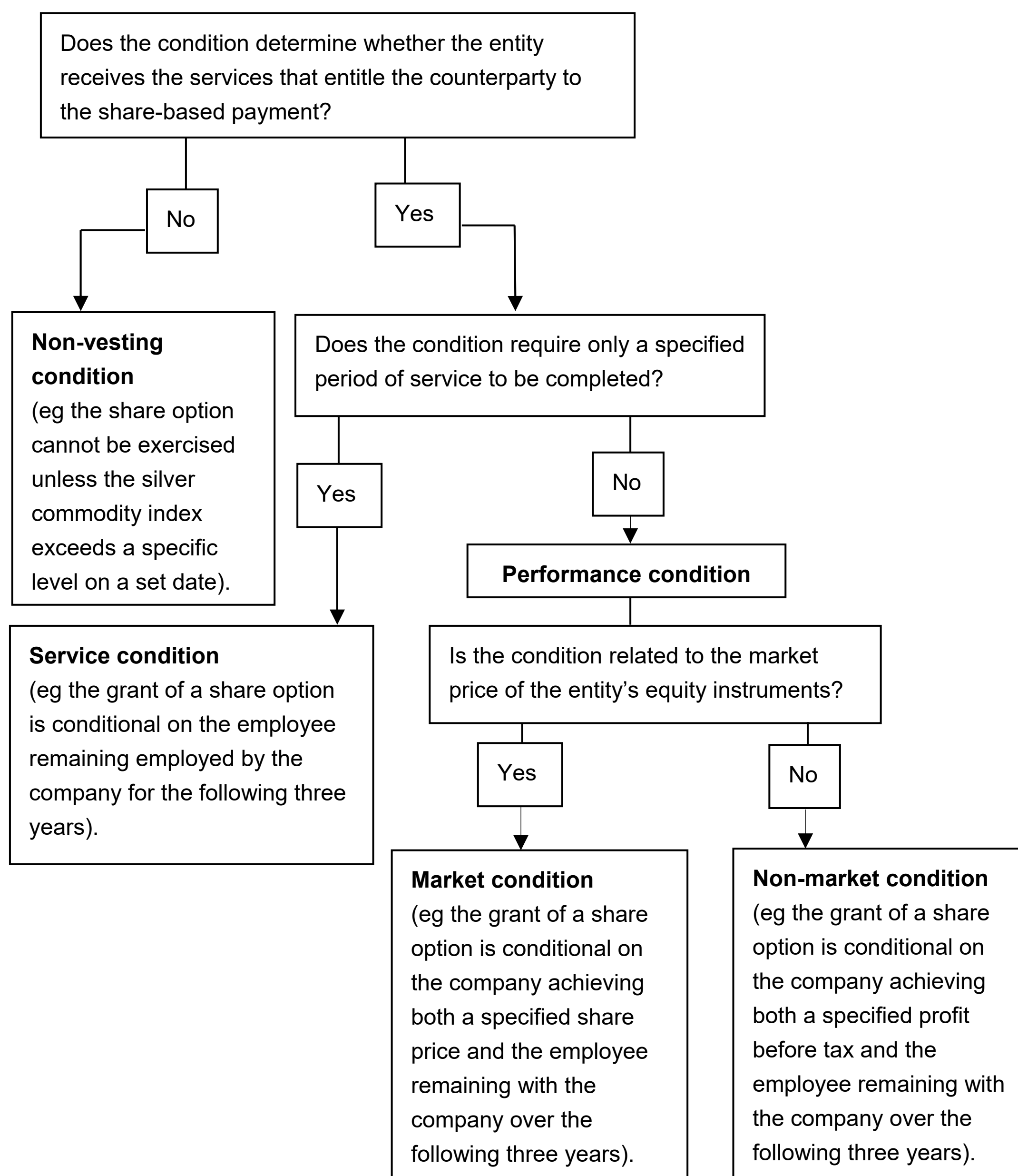
In other words, the services delivered to the entity need to, at a minimum, meet the conditions specified by the vesting conditions in order for the employee (or other service provider) to become entitled to the share-based payment. Vesting conditions are often specified in share-based payments with employees. They are conditions intended to incentivise an employee or supplier to act in a way that provides a benefit to the entity. For example an employee staying in service for three years and also possibly meeting certain performance targets during that period.

The *IFRS for SMEs* Standard defines a *mark*et vesting condition (see the Glossary) as follows:

> 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, 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.

Non-vesting conditions are conditions attached to share-based payments that do not meet the definition of vesting conditions.

The following decision tree illustrates the evaluation of whether a condition is a service or performance condition, or a non-vesting condition, and gives an example of each of the various conditions as they might apply to a share option.



Employee share-based payment transactions generally have vesting conditions. Guidance on how to reflect these conditions in the measurement of the fair value of the equity instruments is set out in paragraph 26.9. The conditions are taken into account as follows:

- Service conditions and non-market performance conditions—these vesting conditions are not taken into account in determining the grant date fair value of the equity instruments granted, ie the fair value is measured as though these conditions did not exist. Instead, these conditions are reflected by estimating how they will affect the number of equity instruments expected to vest. The estimate of the number of equity instruments expected to vest as a result of these

conditions is revised throughout the vesting period, as subsequent information comes to light; revisions to the estimate are reflected prospectively and previous estimates are not restated, in accordance with paragraph 10.16. Applying this approach, only the number of equity instruments satisfying these vesting conditions is ultimately recognised in the financial statements, that is, the final charge is the grant date fair value (calculated by excluding these conditions) multiplied by the actual number of equity instruments that vest as a result of these conditions.

- Market performance conditions (eg a condition involving a target share price, or specified increase in share price)—these vesting conditions are taken into account in determining the grant date fair value of the equity instruments granted. Having allowed, in measuring the grant date fair value of the equity instruments, for the possibility that the condition may not be satisfied, no subsequent adjustment is then made to the measurement of the transaction amount, including the number of equity instruments included in the calculation, irrespective of the outcome of the market condition. Thus, even if no equity instruments ultimately vest, because this condition is not met, there will still be a charge in the financial statements. That charge will be equal to the grant date fair value (which was calculated by reflecting this condition) multiplied by the number of equity instruments granted and adjusted only for the number of instruments not vesting, if any, as a result of service and non-market performance conditions not being satisfied (as discussed in the previous bullet point).
- Non-vesting conditions—these conditions are taken into account in determining the grant date fair value of the equity instruments granted. Accordingly, no adjustment is made to the number of equity instruments included in the calculation of the transaction amount, irrespective of the outcome of the condition. In other words, the treatment is identical to that of market performance conditions.

The requirements outlined above mean that the approach to valuing an equity instrument at the grant date and subsequently measuring the transaction will be different when considering service conditions and non-market performance conditions, versus considering market performance conditions and non-vesting conditions. The Board concluded that, for practicality and subjectivity reasons, the effect of service and non-market performance conditions should not be included in the valuation of the instruments at the grant date. However, the concerns about practical difficulties do not apply to market vesting conditions because market vesting conditions can be incorporated into option pricing models.[3]

Paragraph 26.10 sets out a ‘three-tier’ hierarchy for determining the fair value of shares. Paragraph 26.11 contains a similar measurement hierarchy for share options and equity-settled share appreciation rights. However, in applying these hierarchies, paragraph 26.9 must also be considered in determining which vesting conditions to include in that fair value measurement.

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(3) For the Board’s more detailed reasoning, see paragraphs BC178–BC184 of IFRS 2 *Share-based Payment*, the full IFRS Standard upon which Section 26 is based.

Examples—comparing the accounting treatment for different kinds of vesting and non-vesting conditions

Ex 17 **Entity A runs a copper-mining business. On 1 June 20X0 as part of a long-term incentive scheme, Entity A provisionally awarded its sales employees a total, in aggregate, of 1,000 Entity A shares receivable on 31 May 20X3 if the copper commodity index on 31 May 20X3 is 8,000 or above, whether or not they are employees on 31 May 20X3. Entity A has a year end of 31 May.**

Dividends declared on the shares accrue to the employees during the three-year period. In other words, if the condition is met, the employees will receive the shares together with the dividends that have been declared on those shares during the three years to 31 May 20X3.[(4)]

The entity estimates that on 1 June 20X0 its shares are valued at CU10 each.

The condition regarding the copper commodity index imposed by Entity A is a non-vesting condition because it is a condition that does not require the employees to complete any service or performance conditions in order for the award to vest. Accordingly, it must be reflected in the fair value of the share award. This is the only condition attached to the share award; the employees will receive the shares on 31 May 20X3 if the condition is met regardless of whether they are still employed by Entity A on 31 May 20X3. Entity A estimates that a third party, in an arm's length transaction, would only pay CU7 to purchase the share awards, that is, the effect of the condition is to reduce the value of the shares by CU3 each at 1 June 20X0.

The amount that Entity A recognises in respect of the equity-settled share-based payment transaction would be CU7,000 and this would be recognised regardless of the level of the copper commodity index on 31 May 20X3. It would thus be recognised whether the employees receive the shares or not. Because there is no vesting period, this amount would be recognised in full immediately.

Ex 18 **The facts are as in Example 17. However, instead of a condition that the copper commodity index on 31 May 20X3 is 8,000 or above, here the condition is that the sales employees must remain in employment until 31 May 20X3. In other words, remaining in employment is the only condition attached to the share award.**

Entity A prepares annual financial statements for the year ended 31 May and:

- **on 1 June 20X0 it estimates that 800 shares will vest;**
- **at the end of the first year (31 May 20X1) it has revised this estimate to 780;**
- **at 31 May 20X2 it has further revised this estimate to 750; and**
- **750 shares vest on 31 May 20X3 based on the number of employees still employed on that date.**

The requirement to remain in employment is a service condition and thus, in accordance with Section 26, would not be reflected in the fair value of the share awards. The grant date fair amount of each share is CU10.

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(4) If dividends on the shares did not accrue to the employees during the three years, an adjustment may need to be made to the fair value of the shares at grant date, ie CU10 less an adjustment for the lack of dividend rights.

The grant date fair value amount would be recognised as an expense over the three-year service period adjusted by the number of shares expected to vest. Consequently, for each period, Entity A estimates how many eligible employees are expected to be employed on 31 May 20X3 and this forms the basis for that adjustment. The journal entries would be:

Year 1 (Year ended 31 May 20X1)

Dr	Profit or loss—staff costs*	CU2,600	
	Cr Equity		CU2,600

To recognise the receipt of employee services in exchange for shares

Calculation: 780 shares expected to vest × CU10 grant date fair value of each share × $^1/_3$ of vesting period elapsed = CU2,600 recognised in Year 1.

Year 2 (Year ended 31 May 20X2)

Dr	Profit or loss—staff costs*	CU2,400	
	Cr Equity		CU2,400

To recognise the receipt of employee services in exchange for shares

Calculation: (750 shares expected to vest × CU10 grant date fair value of each share × $^2/_3$ of vesting period elapsed) less CU2,600 recognised in Year 1 = CU2,400 recognised in Year 2.

Year 3 (Year ended 31 May 20X3)

Dr	Profit or loss—staff costs*	CU2,500	
	Cr Equity		CU2,500

To recognise the receipt of employee services in exchange for shares

Calculation: (750 shares (which vest on 1 June) × CU10 grant date fair value of each share) less CU5,000 recognised in Years 1 and 2 = CU2,500 recognised in Year 3.

* Because the sales staff costs do not qualify for recognition as an asset, the staff costs are recognised as an expense.

Ex 19 **The facts are the same as in Example 17. However, instead of a condition that the copper commodity index on 31 May 20X3 is 8,000 or above, here the conditions are that over the three-year period ended 31 May 20X3 both:**

- **the sales employees must remain in employment; and**
- **the company's profit before tax (PBT) must increase by an average of 5% per year.**

The condition for the employees to remain in employment is a service condition and the condition for the company to achieve a specified PBT is a non-market performance condition. Consequently, neither of these vesting conditions would be reflected in the grant date fair value of the award. Accordingly, the total expense recognised in Entity A's financial statements over the three years would be CU10 multiplied by the number of shares actually given to employees on 31 May 20X3.

Like Example 18, the expense recognised in the years ended 31 May 20X1 and 31 May 20X2 would be based on the entity's estimate of how many shares will vest on 31 May 20X3. However, in this example the estimates would be based on entity's expectations both as to how many employees will leave before 31 May 20X3 and whether PBT will increase by an average of 5% per year over the three-year period ended 31 May 20X3. The estimate would be revised each year until the final year (year ended 31 May 20X3) when the total expense is 'trued up' to the actual outcome.

Examples of scenarios:

- in a scenario where the PBT target were not met, meaning that no shares are given to employees, the aggregate expense over the three years in Entity A's financial statements would be zero. However, if the PBT target were initially expected to be met there might be a charge in the first year or first two years that would then be reversed in subsequent years.
- In a different scenario where the PBT target were met but, because some employees had left during the three years, only 750 shares were given to employees, the expense would be CU7,500 (CU10 × 750) in total over the three years.

Ex 20 **The facts are the same as in Example 17. However, instead of a requirement for the copper commodity index on 31 May 20X3 to be 8,000 or above, here the requirement is both that:**

- **the sales employees must remain in employment over the three-year period ended 31 May 20X3; and**
- **the company's shares must be worth at least CU11 (ie the estimated share price) on 31 May 20X3.**

Entity A estimates that a third party, in an arm's length transaction, would only pay CU7.50 to purchase the share awards if they had the share price condition but no other condition; that is, the effect of the share price condition is to reduce the value of the shares by CU2.50 each.

The share price condition (a market condition) would be reflected in the grant date fair value, but the service condition would not be reflected in that fair value.

The amount that Entity A would recognise in respect of the equity-settled share-based payment transaction would be CU7.50 multiplied by the number of shares it expects to give to employees based on the number employed by Entity A on 31 May 20X3.

Even if the target share price is not met the entity will recognise an expense for the share awards based solely on how many shares would have vested considering only the service condition. For example, if 750 shares would have been given to employees had the share price been met, Entity A will recognise CU5,625 (CU7.50 × 750) in respect of the share award scheme over the three-year period even though no shares are actually given to employees. As explained in Examples 18 and 19 above, the amount would initially be calculated by estimating the number of employees expected to remain employed by the entity and each year revising that number in such a way that in the final year it is 'trued up' to the actual number of employees employed on 31 May 20X3.

Examples—measurement when there are service vesting conditions

Ex 21 **Entity B grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee working for the entity over the next three years (ie the vesting condition is a service condition of three years). The entity estimates that, on the date of grant, the fair value of each share option is CU15; the fair value of CU15 is measured as though there is no service condition. On the basis of a weighted-average probability, the entity estimates that 20% of employees will leave during the three-year period and therefore forfeit their rights to the share options.**[5]

[5] This example is based on Scenario 1 of Example 1A set out in the Implementation Guidance to IFRS 2, *Share-based Payment*.

If everything turns out exactly as expected, Entity B makes the following entries in the years during the vesting period, for services received as consideration for the share options.

Year 1

Dr	Profit or loss—staff costs*	CU200,000	
	Cr Equity		CU200,000

To recognise the receipt of employee services in exchange for share options

Calculation: 50,000 options granted × 80% = 40,000 options expected to vest. 40,000 × CU15 grant date fair value of each option × $^1/_3$ of vesting period elapsed = CU200,000 recognised in Year 1.

Year 2

Dr	Profit or loss—staff costs*	CU200,000	
	Cr Equity		CU200,000

To recognise the receipt of employee services in exchange for share options

Calculation: 50,000 options granted × 80% = 40,000 options expected to vest. 40,000 × CU15 grant date fair value of each option × $^2/_3$ of vesting period elapsed – CU200,000 = CU200,000 recognised in Year 2. Cumulative expense at the end of Year 2 is CU400,000 (CU200,000 recognised in Year 1 and CU200,000 recognised in Year 2).

Year 3

Dr	Profit or loss—staff costs*	CU200,000	
	Cr Equity		CU200,000

To recognise the receipt of employee services in exchange for share options

Calculation: 40,000 options vested × CU15 grant date fair value of each option × $^3/_3$ of vesting period elapsed = CU600,000 recognised cumulatively to the end of Year 3. CU600,000 less CU200,000 recognised in Year 2 less CU200,000 recognised in Year 1 = CU200,000 recognised in Year 3.

* These entries assume that the staff costs do not qualify for capitalisation.

In each of the three years, an expense is recognised in arriving at profit or loss for the year. The credit entry is to equity, for example this might be to retained earnings or a separate share option reserve. The exact location within equity will often depend on local legal requirements.

If the share options are subsequently exercised, the entity will give shares to the employees in exchange for receiving cash (equal to the option exercise price). How this transaction is accounted for will depend upon the legal requirements in the entity's jurisdiction and, in some jurisdictions, upon how the entity sources the shares that it gives to the employees. For example, the entity might issue new shares or use shares held as treasury shares.

Note: in this example, the share options granted all vest at the same time (ie at the end of Year 3). In some situations, share options or other equity instruments might vest in instalments over the vesting period. For example, an employee might be granted 100 share options, which vest in instalments of 25 share options at the end of each of the next four years. There is no explicit guidance in Section 26 dealing with awards that vest in instalments. Paragraph IG11 of the Guidance on implementing IFRS 2 *Share-based Payment*[6] explains that in such a scenario, 'the entity should treat each instalment as a separate share option grant, because each instalment has a different vesting period, and hence the fair value of each instalment will differ (because the length of the vesting period affects, for example, the likely timing of cash flows arising

[6] In accordance with paragraph 10.6, an entity may, but is not required to, consider the requirements and guidance in full IFRS Standards when the *IFRS for SMEs* Standard does not provide explicit guidance.

from the exercise of the options)'. The same approach could be taken by an entity applying the *IFRS for SMEs* Standard.

Ex 22 **The facts are the same as in Example 21. However, in this example not everything turns out exactly as expected. In particular:**

- **During Year 1, 20 employees leave.**
- **At the end of Year 1 the entity revises its estimate of total employee departures over the three-year period from 20% (100 employees) to 15% (75 employees).**
- **During Year 2, a further 22 employees leave.**
- **At the end of Year 2 the entity revises its estimate of total employee departures over the three-year period from 15% to 12% (60 employees).**
- **During Year 3, a further 15 employees leave (ie a total of 57 employees forfeited their rights to the share options during the three-year period, and a total of 44,300 share options (443 employees × 100 options per employee) vested at the end of Year 3.**[7]

Entity B records the equity compensation scheme using the following entries.

Year 1

Dr	Profit or loss—staff costs*	CU212,500	
	Cr Equity		CU212,500

To recognise the receipt of employee services in exchange for share options

Calculation: 50,000 options granted × 85% = 42,500 options expected to vest. 42,500 × CU15 grant date fair value of each option × $^1/_3$ of vesting period elapsed = CU212,500 recognised in Year 1.

Year 2

Dr	Profit or loss—staff costs*	CU227,500	
	Cr Equity		CU227,500

To recognise the receipt of employee services in exchange for share options

Calculation: 50,000 options granted × 88% = 44,000 options expected to vest. 44,000 × CU15 grant date fair value of each option × $^2/_3$ of vesting period elapsed = CU440,000 recognised cumulatively to the end of Year 2. CU440,000 less CU212,500 recognised in Year 1 = CU227,500 recognised in Year 2.

Year 3

Dr	Profit or loss—staff costs*	CU224,500	
	Cr Equity		CU224,500

To recognise the receipt of employee services in exchange for share options

Calculation: 44,300 options vested × CU15 grant date fair value of each option × $^3/_3$ of vesting period elapsed = CU664,500 recognised cumulatively to the end of Year 3. CU664,500 less CU227,500 recognised in Year 2 less CU212,500 recognised in Year 1 = CU224,500 recognised in Year 3.

* These entries assume that the staff costs do not qualify for capitalisation.

On the vesting date, the entity revises the estimate to equal the number of equity instruments that ultimately vested, because the only vesting condition was a service condition.

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(7) This example is based on Scenario 2 of Example 1A set out in the Implementation Guidance to IFRS 2 *Share-based Payment*.

Examples—measurement when there are market vesting and service conditions

Ex 23 **At the beginning of Year 1, Entity C grants to a senior executive 10,000 share options, conditional upon: (i) the executive remaining in the entity's employment until the end of Year 3 (ie this vesting condition is a service condition); and (ii) the share price being valued at CU65 or more at the end of Year 3 (ie this vesting condition is a market condition, which is a type of performance condition). Both the service condition and the market condition were satisfied at the end of Year 3.**

Entity C uses an option pricing model to measure the fair value of the options at the grant date to be CU24 per option. The valuation reflects the market-based performance condition but not the service condition, as explained in the notes following paragraph 26.9.

Entity C expects the service condition to be satisfied.

Entity C makes the following entries during the vesting period, to recognise the services received as consideration for the share options.

Year 1

Dr	Profit or loss—staff costs*	CU80,000	
	Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24 × $^1/_3$ of vesting period elapsed)

Year 2

Dr	Profit or loss—staff costs*	CU80,000	
	Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24 × $^2/_3$ of vesting period elapsed) less CU80,000 recognised in Year 1

Year 3

Dr	Profit or loss—staff costs*	CU80,000	
	Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24) less CU160,000 recognised in Years 1 and 2

* These entries assume that the staff costs do not qualify for capitalisation.

Entity C recognises the services received from the executive because the service condition is satisfied (as expected, the executive remained in service throughout the three-year service period).

Ex 24 **The facts are the same as in Example 23. However, in this example, although three years of service is provided by the executive, the share options do not vest because the market condition is not satisfied; the fair value of a share in Entity C is only estimated to be valued at CU60 at the end of the three-year period.**

Entity C makes the following entries during the three years, to recognise the services received as consideration for the share options.

Year 1

Dr Profit or loss—staff costs*	CU80,000	
Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24 × $^1/_3$ of vesting period elapsed)

Year 2

Dr Profit or loss—staff costs*	CU80,000	
Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24 × $^2/_3$ of vesting period elapsed) less CU80,000 recognised in Year 1

Year 3

Dr Profit or loss—staff costs*	CU80,000	
Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24) less CU160,000 recognised in Years 1 and 2

* These entries assume that the staff costs do not qualify for capitalisation.

Entity C recognises the services received from the executive because the service condition is satisfied (as expected, the executive remained in service throughout the three-year service period). Even though the market condition (share price target) is not satisfied, the accounting is not affected because the possibility that the market condition would not be met was taken into account when estimating the grant date fair value of the share options at CU24. Thus the entries are identical to those in Example 23.

Ex 25 **The facts are the same as in Example 23. However, in this example, the executive forfeited the options when he resigned from Entity C in Year 2.**

Entity C expected the service condition to be satisfied. However, the executive resigned in Year 2.

Entity C makes the following entries during the three years, to recognise the services received as consideration for the share options.

Year 1

Dr Profit or loss—staff costs*	CU80,000	
Cr Equity—reserves		CU80,000

To recognise the receipt of employee services in exchange for 10,000 share options

(10,000 options × CU24 × $^1/_3$ of vesting period elapsed)

Year 2

Dr Equity—reserves	CU80,000	
Cr Profit or loss—staff costs*		CU80,000

To reverse the charge for the recognition of receipt of employee services in exchange for 10,000 share options (following the resignation of the employee)

Year 3: No entries.

* These entries assume that the staff costs do not qualify for capitalisation.

Service conditions are taken into account when estimating the number of equity instruments expected to vest. Consequently, when the executive resigned in Year 2 it became certain that none of the options would vest because the service condition could not be satisfied. Consequently, the amount recognised in Year 1 is reversed in Year 2 and no further entries are made for this share-based payment.

Shares

26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) if an observable market price is available for the equity instruments granted, use that price.

(b) if an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as:

(i) a recent transaction in the entity's shares; or

(ii) a recent independent fair valuation of the entity or its principal assets.

(c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is **impracticable**, indirectly measure the fair value of the shares using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value. Any valuation method used shall be consistent with generally accepted valuation methodologies for valuing equity instruments.

Notes

As discussed above, Section 26 sets out some specific requirements for the measurement of the equity instruments issued in an equity-settled share-based payment transaction. The starting point is fair value. For equity instruments for which there are no service conditions and no non-market performance conditions, the measurement valuation is fair value as defined and used in other sections of the *IFRS for SMEs* Standard. For equity instruments for which there are service conditions and/or non-market performance conditions, the measurement is also fair value as defined and used in other sections of the *IFRS for SMEs* Standard except that the fair value is determined as if these conditions were not present.

Section 26 contains a three-tier hierarchy for measuring the fair value of shares (and for measuring the fair value of share options and equity-settled share appreciation rights—see below). The first tier is to use an observable market price if one is available. However, by definition, SMEs are entities whose equity instruments are not traded in a public market. Consequently, generally, there will not be an observable market price available for the shares of entities using the *IFRS for SMEs* Standard. Consequently, such entities are required to use Tier Two or, if that is not possible, Tier Three.

Some entities engage valuation experts to assist them in developing fair value estimates for shares, particularly if they have significant share-based payments or lack sufficient valuation expertise. Further guidance on approaches to valuing shares where there is no observable market price available can be found in the educational material 'IFRS 13 *Fair Value Measurement:* Unquoted equity instruments within the scope of IFRS 9 *Financial Instruments'* (see IFRS Foundation website at https://www.ifrs.org/-/media/feature/supporting-implementation/ifrs-13/education-ifrs-13-eng.pdf). Although such guidance is written in the context of the fair value measurement requirements in full IFRS Standards and SMEs are not required to consider guidance on full IFRS Standards, the underlying valuation approaches described in that guidance would also be appropriate to use under the *IFRS for SMEs* Standard and so SMEs might find that education material helpful.

The following table illustrates the valuation approaches and valuation techniques presented in that educational material:

Valuation approaches	Valuation techniques
Market approach	• Transaction price paid for an identical or a similar instrument in an investee • Comparable company valuation multiples
Income approach	• Discounted cash flow (or DCF) method • Dividend discount model (DDM) • Constant-growth DDM • Capitalisation model
A combination of approaches might be used	• Adjusted net asset method

Ex 26 **Entity T, a small private company, establishes a bonus plan in which employees are granted ordinary shares on the basis of achieving specified, non-market, performance targets. Upon receipt of the shares, employees have the unconditional right to sell them. At the end of 20X5 Entity T grants to employees the rights to 1,500 shares. The employees will receive the shares in one year's time if they are still employed by the company at that date, and if the specified profit before tax target has been met. Entity T only has one class of issued shares; all its shares have identical rights.**

The only conditions to which the share award is subject is a service condition and a non-market performance condition. They will be reflected in the staff costs expense[8] by taking them into account, not when measuring the fair value of a share, but,

[8] The amount will be recognised as an expense unless some or all of it qualifies for capitalisation.

instead, when calculating the number of shares to which that fair value should be applied. The fair value of the shares at the grant date (31 December 20X5) needs to be measured and this will be identical to the fair value of the existing issued shares of Entity T, with no adjustment necessary for the service and non-market performance conditions. Once Entity T has measured the fair value of its shares, it would need to make an adjustment to that fair value to reflect the fact that dividends will not accrue to the employees during the vesting period (if this is the case).

Because Entity T's shares do not trade in a public market, Entity T must first consider Tier Two of the measurement hierarchy in paragraph 26.10 to establish whether it can measure the fair value of the shares using 'entity-specific observable market data'. An example of entity-specific observable market data could include the price resulting from a recent sale of its shares to a third party by one of the shareholders in Entity T. If such data is available, Entity T would need to assess whether there had been any subsequent significant internal or external changes in the environment in which it operates that would change the price of the transaction if it were it to take place now, ie at the measurement date, rather than when it did take place.

However, if observable market data about the entity is not available, the entity is required to use Tier Three of the hierarchy. Tier Three requires the entity to measure the fair value indirectly using the most appropriate 'valuation method that uses market data to the greatest extent practicable'. Determining the most appropriate valuation method requires judgement; and further judgement is required about the assumptions used in applying that chosen method. For example, when using an income method, in which future amounts—such as free cash flows to the firm, or income and expenses—are discounted, judgements and estimates that need to be made include forecasting future earnings and/or cash flows, and determining an appropriate discount rate.

The calculation below provides an example of how Entity T might measure the fair value of its shares. Given specific circumstances, one valuation technique might be more appropriate than another. Consequently, entities may choose to use other valuation techniques or, when using a discounted cash flow method, as illustrated below, entities may consider that different assumptions portray better the specific facts and circumstances surrounding the measurement. Additional valuation techniques are set out in the educational material 'IFRS 13 *Fair Value Measurement*: Unquoted equity instruments within the scope of IFRS 9 Financial Instruments' mentioned in the notes above.

Approach being used

Entity T has looked at the different valuation methods available and decided that the most appropriate method for its shares is to use a discounted cash flow method. Entity T discounts its expected free cash flow to the firm (FCFF) to derive the fair value of its debt and equity combined, referred to as enterprise value. From this amount Entity T will deduct the fair value of its debt to give, as at the end of 20X5, the fair value of its equity in total. Entity T can then derive a value per share. Because the shares will not be received by the employees until the following year, the employees will not receive any dividends payable during 20X6. Consequently, Entity T will deduct the present value of the dividends it expects to pay per share in 20X6 from the value of a share to give the value of the award to the employees as at the end of 20X5 (ignoring the service condition and non-market vesting condition).

Entity T estimates its FCFF by first estimating its earnings before interest and tax (EBIT) and using that to derive free cash flow.

Forecast of EBIT

Entity T has a detailed budget for 20X6 and an outline budget for 20X7.[9] The revenue and EBIT information from those budgets is as follows:

	20X6	20X7
	CU	CU
Revenue	400	410
EBIT	100	102.5
EBIT as a percentage of revenue	25%	25%

Entity T assesses the outlook for the industry in which it operates and the outlook for the economy as a whole. No major changes in the foreseeable future are expected. Consequently, Entity T concludes that it expects a 2% growth rate for each of the three years from 20X8 to 20Y0 and thereafter a growth rate of 1%. It also concludes that it expects to maintain an EBIT margin as a percentage of revenue of 25%.

Before scheduling these amounts, Entity T examines its performance during the last five years to see whether past performance supports these assumptions. The figures for the last five years are as follows:

	20X1	20X2	20X3	20X4	20X5
	CU	CU	CU	CU	CU
Revenue	360	367	375	384	392
EBIT	86	88	121	87	98
EBIT as a percentage of revenue	24%	24%	32%	23%	25%
Increase in revenue from previous year		1.94%	2.18%	2.4%	2.08%

Entity T's net earnings in 20X3 included a non-recurring credit of CU25,000 and in 20X4 included a non-recurring charge of CU5,000. Making these adjustments gives the following results:

	20X1	20X2	20X3	20X4	20X5
	CU'000	CU'000	CU'000	CU'000	CU'000
Revenue	360	367	375	384	392
EBIT	86	88	121	87	98
Add/(deduct) non-recurring items	-	-	(25)	5	-
EBIT excluding non-recurring items	86	88	96	92	98
EBIT as a percentage of revenue	24%	24%	26%	24%	25%
Increase in revenue from previous year		1.94%	2.18%	2.4%	2.08%

[9] It is assumed for the purposes of this example that any assumptions in the budgets, and in other aspects of the valuation exercise, would be the same as those that a market participant would use.

Entity T concludes that the figures for the past five years, together with its analysis of the outlook for the future, support its assumptions. Accordingly, its calculations will be based on EBIT as follows:

	20X6	20X7	20X8	20X9	20Y0	20Y1	20Y2	……
	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	
Basis	Budget	Budget	2%↑	2%↑	2%↑	1%↑	1%↑	…….
EBIT	100	102.5	104.6	106.6	108.8	109.9	111.0	

Conversion from EBIT to Free Cash Flow to Firm

In order to perform the discounted cash flow calculation, Entity T needs to convert from EBIT to free cash flow.

Free Cash Flow to Firm (FCFF) is the cash flows available to all the capital providers of an entity, which in Entity T's case is the debt and equity holders.[10]

Using the budgets for 20X6 and 20X7, Entity T calculates FCFF for those two years as follows:

	20X6	20X7
	CU'000	CU'000
EBIT	100	102.5
Multiply by: (1.0 less unlevered effective tax rate of 30%)	× 0.7	× 0.7
	70	71.8
Add: annual depreciation and amortisation	26	27
Less: reinvestment requirements	(26)	(26)
Less: increase in net working capital	(2.4)	(3)
FCFF	67.6	69.8

[10] FCFF are the cash flows available to all of the investee's capital providers (equity and debt holders) after all operating expenses and corporate taxes (computed using market participants' expectations of the investee's effective unlevered income tax rate, (t)) have been paid, and any necessary reinvestment requirements (RR), such as capital expenditures in fixed assets, and net working capital (NWC) have been made. FCFF can be expressed as follows:
FCFF = EBIT (1 − t) + Depreciation and amortisation − RR − Net increases in NWC.

Entity T deduces FCFF from EBIT using the same growth-rate expectations as it used to extrapolate EBIT, as follows:

	20X6	20X7	20X8	20X9	20Y0	20Y1	20Y2	……..
	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	
EBIT	100	102.5	104.6	106.6	108.8	109.9	111.0	
Adj*	(32.4)	(32.7)	(33.4)	(34.0)	(34.7)	(35.0)	(35.3)	
FCFF	67.6	69.8	71.2	72.6	74.1	74.9	75.7	………

* The adjustments are annual depreciation and amortisation less reinvestment requirements less the increase (or plus the decrease) in net working capital less unlevered tax.

Calculation of discount rate: weighted average cost of capital

FCFF stands for the entity's cash flows available to all of its capital providers (ie debt holders and equity holders). Accordingly, the appropriate discount rate should reflect the cost of raising both debt and equity financing in proportion to their use (ie the weighted average cost of capital (WACC)).

WACC uses, as inputs, the cost of debt and the cost of equity. Guidance on how to estimate these, and the calculation of WACC, is provided in the educational material 'IFRS 13 *Fair Value Measurement*: Unquoted equity instruments within the scope of IFRS 9 *Financial Instruments'* (mentioned in the notes above).

Entity T estimates its cost of equity using the capital asset pricing model and estimates its cost of debt by reference to long-term bonds raised in the market by companies with similar creditworthiness. As a result it estimates its WACC to be 11.5%.

Calculation of the enterprise value

Using FCFF and WACC, Entity T can calculate the enterprise value. FCFF are cash flows from assets, before any debt payments but after making reinvestments needed for future growth. Thus, the resulting enterprise value is the fair value of the business to the debt and equity providers combined. Entity T calculates enterprise value as follows:

Enterprise Value = Σ PV* of FCFF for 20X6–20Y0 + PV of Terminal Value for 20Y1 onwards

* PV means 'present value'.

The present value of FCFF is calculated for each of the years in Entity T's explicit forecast period, that is, before Entity T assumes a constant growth rate into perpetuity. The present value of FCFF is therefore calculated for 20X6−20Y0. The terminal value is calculated for the period after the explicit forecast period, that is, for the years for which it is assumed there is a constant growth rate into perpetuity. For Entity T the terminal value is calculated at the end of 20Y0 and is the discounted amount, at that date, of the cash flows estimated to be generated in 20Y1 and subsequent years.

Entity T's enterprise value is therefore calculated as follows:

	Total	20X6	20X7	20X8	20X9	20Y0	End of 20Y0
FCFF (CU'000)		67.6	69.8	71.2	72.6	74.1	
Terminal Value (a)							712.77143
Discount factor (b)		0.94703	0.84935	0.76175	0.68318	0.61272	0.58026
PV of FCFF for 20X6–20Y0 and PV of terminal value (in CU'000)	686.138	64.0191	59.2848	54.2366	49.5992	45.4027	413.5956

(a) The terminal value at the end of 20Y0 is the discounted amount, at that date, of the cash flows estimated to be generated in 20Y1 and subsequent years. It is calculated at that date because thereafter a constant 1% per year growth has been assumed into perpetuity. It has been calculated by dividing (FCFF for 20Y0 × 1.01) by 0.105 (being WACC less assumed future growth, ie 11.5 less 1.0).

(b) The discount factors for the years 20X6—20Y0 inclusive assume that the cash flows are even throughout each year and have been calculated as follows: 1/(1 + WACC) ^ (n – 0.5), where n represents the number of years from the measurement date. The discount factor applied to the terminal value at the end of 20Y0 assumes cash flows at the end of the year and has been calculated as 1/(1 + WACC) ^ n.

The above calculations result in an enterprise value of CU686,138.

Calculation of the fair value of an equity share

The fair value of an equity share at 31 December 20X5 is found by deducting the fair value of debt (less cash and cash equivalents) at that date from the enterprise value estimated above and dividing the answer by the number of shares in issue.

Assuming 40,000 shares in issue and that the fair value of Entity T's debt at 31 December 20X5 is CU125,000, the fair value of an equity share is:

$$\frac{\text{(CU686,138 less CU125,000)}}{40{,}000} = \text{CU14.028}$$

Calculation of the fair value of the employee awards

As discussed above, for the purposes of valuing the employee share awards, Entity T would need to make an adjustment to reflect the fact that dividends will not accrue to the employees during the vesting period. If the present value of the dividend expected to be paid during 20X6 is CU0.014, the value of the employee awards at 31 December 20X5 would be CU14.014 per share (CU14.028 less CU0.014). Note that no adjustment is made for the service conditions and non-market vesting conditions.

Assuming the performance target is met and that none of the employees leave, Entity T will make the following entry to record the share-based payment transaction:

Dr	Profit or loss—staff costs*	CU21,021	
	Cr Equity—reserves		CU21,021

To recognise the receipt of employee services in exchange for 1,500 share awards

(1,500 shares × CU14.014)

* These entries assume that the staff costs do not qualify for capitalisation.

Share options and equity-settled share appreciation rights

26.11 An entity shall measure the fair value of share options and equity-settled share appreciation rights (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) if an observable market price is available for the equity instruments granted, use that price.

(b) if an observable market price is not available, measure the fair value of share options and share appreciation rights granted using entity-specific observable market data such as (a) for a recent transaction in the share options.

(c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an option pricing model. The inputs for the model (such as the weighted average share price, exercise price, expected volatility, option life, expected dividends and the risk-free interest rate) shall use market data to the greatest extent possible. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity shall derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Notes

Shares and share options of SMEs are not traded in a public market. Consequently, it will be rare that either market prices or entity-specific observable market data are available for these equity instruments. SMEs will therefore need to use an option pricing model to value their share options and equity-settled share appreciation rights (ie Tier Three of the measurement hierarchy set out in paragraph 26.11).

All option pricing models take into account, as a minimum, the following factors or inputs:(11)

(a) the exercise price of the option;

(b) the life of the option;

(c) the current price of the underlying shares;

(d) the expected volatility of the share price;

(e) the dividends expected on the shares (if appropriate); and

(f) the risk-free interest rate for the life of the option.

(11) based on the factors listed paragraph B6 of IFRS 2 *Share-based Payment*, and in paragraph 26.11(c).

Section 26 does not contain detailed guidance on selecting and applying an appropriate option pricing model and determining the inputs used in that model. The only requirements specified in paragraph 26.11 (c) are that:

- market data is used to the greatest extent possible when determining the inputs;
- paragraph 26.10 is applied in determining the input used for the share price; and
- the estimate of expected volatility must be consistent with the valuation methodology used to determine the fair value of the shares under paragraph 26.10.

Option pricing software is available to entities that need to develop fair value estimates for options. In addition, as noted above for share valuations, some entities engage valuation experts to assist them in this process. Nevertheless, in understanding how to value share options and equity-settled share appreciation rights an entity may, but is not required to, consider the Application Guidance that forms part of IFRS 2 *Share-based Payment*, which includes some guidance on selecting an option pricing model and determining the inputs into the model (see paragraphs B4-B41 of IFRS 2). There is also significant publicly available valuation guidance in the market on how to select and apply different option-pricing models.

Examples—fair value of share options and equity-settled share appreciation rights

Ex 27 **At the beginning of Year 1, Entity S grants senior executives 15,000 share options, conditional upon the executives remaining in the entity's employment until the end of Year 3. In addition, the share options cannot be exercised unless the value of the entity's shares has increased from CU25 at the beginning of Year 1 to above CU30 at the end of Year 3 (ie this vesting condition is a market condition). If the share price is above CU30 at the end of Year 3, the share options can be exercised at any time during the next seven years (ie by the end of Year 10). At the end of Year 1 the entity expects that none of the senior executives will leave during the three-year vesting period. This is revised at the end of Year 2; the entity estimated that executives with 2,000 options would have left by the end of Year 3. At the end of Year 3 none of the options vested because the share price condition was not met. However, if it had been met then 13,500 options would have vested because the service required to earn 13,500 options had been received.**

Entity S uses an option pricing model to estimate the fair value of the options. As at the grant date (beginning of Year 1) this produces a fair value estimate of CU2.50 per option, which reflects the market vesting condition. Entity S makes the following entries during the service period.

Year 1

Dr Profit or loss—staff costs*	CU12,500	
Cr Equity—reserves		CU12,500

To recognise the receipt of employee services in exchange for Entity S share options

(15,000 options × CU2.50 × 1/3 of vesting period elapsed)

Year 2

Dr Profit or loss—staff costs*	CU9,167	
Cr Equity—reserves		CU9,167

To recognise the receipt of employee services in exchange for Entity S share options

((13,000 options × CU2.50 × 2/3 of vesting period elapsed) less CU12,500)

Year 3

Dr	Profit or loss—staff costs*	CU12,083	
	Cr Equity—reserves		CU12,083

To recognise the receipt of employee services in exchange for Entity S share options

((13,500 options × CU2.50) less CU12,500 less CU9,167)

* These entries assume that the staff costs do not qualify for capitalisation.

Modifications to the terms and conditions on which equity instruments were granted

26.12 An entity might modify the terms and conditions on which equity instruments are granted in a manner that is beneficial to the employee, for example, by reducing the exercise price of an option or reducing the vesting period or by modifying or eliminating a performance condition. Alternatively an entity might modify the terms and conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or adding a performance condition. The entity shall take the modified vesting conditions into account in accounting for the share-based payment transaction, as follows:

(a) if the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

(b) if the modification reduces the total fair value of the **share-based payment arrangement**, or apparently is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred.

The requirements in this paragraph are expressed in the context of share-based payment transactions with employees. The requirements also apply to share-based payment transactions with parties other than employees if these transactions are measured by reference to the fair value of the equity instruments granted, but reference to the grant date refers to the date that the entity obtains the goods or the counterparty renders service.

Notes

When an entity modifies the vesting conditions of equity instruments granted to employees in a share-based payment transaction, the entity continues to account for the instruments granted based on the original terms, conditions and vesting period as at the grant date. In addition, it assesses whether the modification increased the fair value of the instruments by measuring the fair value immediately before the

modification and immediately after the modification. When the modification increased the fair value or increased the number of equity instruments granted, the entity also accounts for the increase; the increase is recognised over the period from the date of the modification to the date when the modified instruments vest.

Examples—modifications

Ex 28 **Entity Z grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee remaining in service over the next three years. The entity estimates that the fair value of each option at the grant date is CU15. On the basis of a weighted-average probability, the entity estimates that 100 employees will leave during the three-year period and will therefore forfeit their rights to the share options.**[12]

Forty employees leave during Year 1. During the year, the economy of the jurisdiction in which the entity operates unexpectedly enters recession and, along with most companies in the jurisdiction, the entity's business, and the fair value of its shares, is adversely affected. At the end of Year 1, the entity reprices its share options by lowering the exercise price. The repriced share options retain the original vesting date; that is, they vest at the end of Year 3. The entity estimates that a further 70 employees will leave during Years 2 and 3, and hence the total number of employees expected to leave over the three-year vesting period is 110. The entity estimates that, at the date of repricing, the fair value of each of the original share options granted (ie before taking into account the repricing) is CU5 and that the fair value of each repriced share option is CU8.

During Year 2, a further 35 employees leave, and the entity estimates that a further 30 employees will leave during Year 3, to bring the total number of employees expected to depart over the three-year vesting period to 105.

During Year 3, a total of 28 employees leave, and hence a total of 103 employees ceased employment during the vesting period. For the remaining 397 employees, the share options vested at the end of Year 3.

The condition that the employee must remain in service over the next three years is a service condition. Entity Z makes the following entries during the vesting period, for services received as consideration for the share options.

Year 1

Dr Profit or loss—staff costs*	CU195,000	
Cr Equity—reserves		CU195,000

To recognise the receipt of employee services in exchange for share options

((500 employees less 110 expected to forfeit) × 100 options × CU15 × $^1/_3$ of vesting period elapsed)

Year 2

Dr Profit or loss—staff costs*	CU259,250	
Cr Equity—reserves		CU259,250

To recognise the receipt of employee services in exchange for share options
((500 employees less 105 expected to forfeit) × 100 options × [(CU15 × $^2/_3$ of vesting period elapsed + (CU3 repricing × $^1/_2$ of period remaining after repricing elapsed)] less CU195,000 recognised in Year 1)

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[12] This example is adapted from Example 7 set out in the Implementation Guidance to IFRS 2 *Share-based Payment*.

Year 3

Dr Profit or loss—staff costs*	CU260,350	
Cr Equity—reserves		CU260,350

To recognise the receipt of employee services in exchange for share options

([(500 employees less 103 forfeited) × 100 options × (CU15 + CU3)] less CU454,250)

* These entries assume that the staff costs do not qualify for capitalisation.

The modification increases the fair value of the equity instruments granted, measured immediately before and after the modification, by CU3. (CU3 is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification—CU8 less CU5.) Because the modification occurred during the vesting period and did not alter the vesting period, Entity Z recognises the incremental fair value granted (CU3 per option) in the measurement of the amount recognised for services received over the remaining period from the modification date until the date when the modified equity instruments vest. This recognition is in addition to the amount based on the grant date fair value of the original equity instruments (CU15 per option), which continues to be recognised over the original vesting period.

Ex 29 **At the beginning of Year 1, Entity Y grants 1,000 share options to each member of its sales team, conditional upon the employee remaining in the entity's employment for three years and on the team selling more than 50,000 units of a particular product over the three-year period. The fair value of the share options is CU15 per option at the grant date.**

During Year 2, the entity increases the sales target to 100,000 units. By the end of Year 3, the entity has sold 55,000 units, and the share options do not vest. Twelve members of the sales team remained in service for the three-year period.[13]

The condition that the employee remains in service over the next three years is a service condition and the sales target condition is a non-market performance condition.

Because the modification to the performance condition (from 50,000 units to 100,000 units) was not beneficial to the employees (it made it less likely that the share options will vest), the entity ignores the modified performance condition when recognising the services received. The entity therefore recognises the services received over the three-year period on the basis of the original grant. None of the vesting conditions are market conditions. Accordingly, the charge is based on whether the options would have vested on the basis of the original conditions. Because the options would have vested based on the original sales condition, the entity ultimately recognises cumulative remuneration expense of CU180,000 over the three-year period (12 employees × 1,000 options × CU15 per option).

(13) This example is adapted from Example 8 set out in the Implementation Guidance to IFRS 2 *Share-based Payment*.

Cancellations and settlements

26.13 An entity shall account for a cancellation or settlement of an equity-settled share-based payment award as an acceleration of vesting, and therefore shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

Notes

The *IFRS for SMEs* Standard is silent on how an entity should account for any payment in settlement or cancellation of a share-based payment award. In accordance with Section 10, an entity would need to determine an appropriate accounting policy; it will have to make the payment (credit cash), so the only decision is what to debit. An entity could consider the substance of the payment; for example, if it is regarded as an amount to purchase the equity instrument earned, it might be regarded as similar to the repurchase of a share. This might suggest that the payment is deducted from equity. As stated above, the *IFRS for SMEs* Standard requires that when there is a modification that increases the fair value of the award, measured at the date of the modification, the increase in fair value is accounted for as an additional charge for the services of the employees. When a payment in settlement or cancellation is in excess of the fair value at the date of settlement or cancellation, it would be consistent with the treatment for modifications if the amount of the payment that exceeds the fair value of the instruments on settlement or cancellation were charged as an additional charge for the services of the employees. This treatment would also be consistent with that required by paragraph 28(b) of IFRS 2 *Share-based Payment*.[14]

The following example assumes that the entity adopts an accounting policy that is consistent with the suggestions in the previous paragraph.

Example—cancellations

Ex 30 **Entity X grants 100 share options to each of its 300 employees. Each grant is conditional upon the employee remaining in service over the next three years. The entity estimates that the fair value of each option is CU10. The entity expects all employees to complete the required service.**

At the end of Year 2, all employees remain with the entity. However, the fair value of an option has declined to CU6. Entity X decides to cancel the option scheme and pay employees CU6.50 per option.

The entity makes the following entries.

Year 1

Dr Profit or loss—staff costs*	CU100,000	
Cr Equity—reserves		CU100,000

To recognise the receipt of employee services in exchange for share options

(300 employees × 100 options × CU10 × $^1/_3$ of vesting period elapsed)

[14] In accordance with paragraph 10.6, an entity may, but is not required to, consider the requirements and guidance in full IFRS Standards when the *IFRS for SMEs* Standard does not provide explicit guidance.

Year 2

Dr	Profit or loss—staff costs*	CU200,000	
	Cr Equity—reserves		CU200,000

To recognise the receipt of employee services in exchange for share options

(300 employees × 100 options × CU10 × $^2/_2$ of vesting period elapsed because of an acceleration of vesting) less CU100,000 expensed in Year 1

Dr	Equity—reserves	CU180,000[a]	
Dr	Profit or loss—staff costs*	CU15,000[b]	
	Cr Asset—cash		CU195,000[c]

To record the cash payment in settlement of Entity X share option plan

[a] Fair value, at the date of cancellation, of the original share options = CU180,000 = (300 employees × 100 options × CU6 fair value of option at date of cancellation).
[b] Excess of cash payment over fair value of cancelled options = CU15,000 = (300 employees × 100 options × CU0.50 payment in excess of CU6 fair value of option at date of cancellation).
[c] Cash payment to employees = CU195,000 = (300 employees × 100 options × CU6.50).

* These entries assume that the staff costs do not qualify for capitalisation.

In Year 2, Entity X records the receipt of employee services as if the share option plan had vested immediately in Year 2. A total of CU100,000 was recognised in Year 1 so an additional CU200,000 is recognised in Year 2. At the time of cancellation, the fair value of the options is CU180,000. The cash payment to employees totals CU195,000, of which CU15,000 is in excess of the fair value of the cancelled options; the CU15,000 excess is charged to profit or loss. CU180,000 is charged to equity, in effect as a purchase of the outstanding equity instruments (the share options). The total cost (charge to profit or loss) of the cancelled scheme is CU315,000.

Cash-settled share-based payment transactions

26.14 For cash-settled share-based payment transactions, an entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each **reporting date** and at the date of settlement, with any changes in fair value recognised in **profit or loss** for the period.

Notes

A cash-settled share-based payment transaction is 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 equity instruments (including shares or share options) of the entity or another group entity. (see the Glossary).

The payment of cash, or other assets, is ‘based on’ the price of the entity’s shares or other equity instruments. Consequently, it may be a multiple of the entity’s share price, for example, equal to the value of 20 shares on a specific date. Or it may be the increase, if any, in an entity’s share price, for example, equal to the value of the increase in 60 shares over a specified period.

When an entity obtains the goods, or as the services are rendered, the entity recognises the goods or services acquired, and a liability to pay for those goods or services, measured initially at the fair value of the liability. The liability has to be remeasured at each reporting date until it is settled; the change in the fair value of the liability is recognised in profit or loss for the period.

In a cash-settled share-based payment transaction, the goods and services received will always be measured at the fair value of the consideration paid for them and never at the fair value of the goods or services received. For transactions with non-employees this represents a difference from equity-settled share-based payment transactions.

Example—cash-settled share-based payment transaction

Ex 31 **Entity X grants 100 cash share appreciation rights (SARs) to each of its 500 employees, on the condition that the employees remain in its employment for the next three years. The SARs are exercisable up to the end of Year 5.**

During Year 1, 35 employees leave. The entity estimates that a further 60 employees will leave during Years 2 and 3.

During Year 2, 40 employees leave and the entity estimates that a further 25 will leave during Year 3. During Year 3, 22 employees leave. At the end of Year 3, all SARs held by the remaining employees vest and 150 employees exercise their SARs. Another 140 employees exercise their SARs at the end of Year 4 and the remaining 113 employees exercise their SARs at the end of Year 5.

The entity estimates the fair value of the SARs at the end of each year in which a liability exists, as shown below. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of Years 3, 4 and 5 are also shown below.[15]

Year	Fair value	Intrinsic value
1	CU14.40	
2	CU15.50	
3	CU18.20	CU15.00
4	CU21.40	CU20.00
5		CU25.00

In Years 3 and 4 there is a difference between the intrinsic value (the amount the employees receive on exercise) and the fair value. This difference arises because the fair value reflects the fact that the SARs are exercisable until the end of Year 5. Consequently, in addition to the intrinsic value, the fair value includes the value of the right to participate in future increases in share price, if any, that may occur between the valuation date and the settlement date. Thus, at the end of Year 3, if an employee exercises his or her SARs, he or she will receive CU15.00 per SAR whereas the value of a SAR held by an employee choosing to exercise at a later date is CU18.20, reflecting the expectation of further share price increases.

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[15] This example is based on Example 12 set out in the Implementation Guidance to IFRS 2 *Share-based Payment*.

Year	Calculation		Expense* (CU)	Year-end Liability (CU)
1	(500 - 95) employees × 100 SARs × CU14.40 × $^1/_3$		194,400	194,400
2	(500 - 100) employees × 100 SARs × CU15.50 × $^2/_3$ - CU194,400		218,933	413,333
3[a]	(500 - 97 - 150) employees × 100 SARs × CU18.20 - CU413,333	47,127		460,460
	+ 150 employees × 100 SARs × CU15.00	225,000		
	Total		272,127	
4[b]	(253 - 140) employees × 100 SARs × CU21.40 - CU460,460	(218,640)		241,820
	+ 140 employees × 100 SARs × CU20.00	280,000		
	Total		61,360	
	CU0 - CU241,820	(241,820)		0
5[c]	+ 113 employees × 100 SARs × CU25.00	282,500		
	Total		40,680	
	Total		787,500	

* Assumes that the staff costs do not qualify for capitalisation.

[a] The calculation for Year 3 comprises three parts. The first part multiplies the fair value at the end of Year 3 by the number of SARs that vested and that were not exercised at the end of Year 3. The second part multiplies the intrinsic value at the end of Year 3 by the number of SARs that were exercised at the end of Year 3, which gives the amount of cash paid out at the end of Year 3. From the sum of these two amounts is deducted the amount provided at the end of Year 2 to give the change in liability for the year (although for convenience it is presented above as a deduction from the first amount); this is the third part of the calculation.

[b] The calculation for Year 4, like that for Year 3, comprises three parts. The first part multiplies the fair value at the end of Year 4 by the number of SARs that remain unexercised at the end of Year 4. The second part multiplies the intrinsic value at the end of Year 4 by the number of SARs that were exercised at the end of Year 4, which gives the amount of cash paid out at the end of Year 4. From the sum of these two amounts is deducted the amount provided at the end of Year 3 to give the change in liability for the year (although for convenience it is presented above as a deduction from the first amount); this is the third part of the calculation.

[c] The calculation for Year 5 comprises two parts. The first part multiplies the intrinsic value at the end of Year 5 by the number of SARs that were exercised at the end of Year 5, which gives the amount of cash paid out at the end of Year 5. From this is deducted the amount provided at the end of Year 4 to give the change in liability for the year.

Note: this example illustrates the use of share appreciation rights for employees as part of their remuneration package. Under such as scheme, the employees will become entitled to a future cash payment (rather than to an equity instrument), which is based on the increase in the entity's share price from a specified level over a specified period of time. The liability is measured, initially, and at the end of each reporting period until settled, at its fair value and changes in fair value are recognised in profit or loss. Similar provisions apply to transactions with non-employees (eg an entity acquires goods or services by incurring liabilities to the supplier of those goods or services in amounts based on the price of the entity's shares or other equity instruments).

Share-based payment transactions with cash alternatives

26.15 Some share-based payment transactions give either the entity or the counterparty a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments. In such a case, the entity shall account for the transaction as a cash-settled share-based payment transaction unless either:

(a) the entity has a past practice of settling by issuing equity instruments; or

(b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument.

In circumstances (a) and (b), the entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraphs 26.7–26.13.

Notes

Share-based payment transactions with cash alternatives are often structured so that the fair value of one settlement alternative is the same as the other. For example, the employee might have the choice of receiving share options or cash-settled share appreciation rights with otherwise identical terms.

Examples—share-based payments with cash alternatives

Ex 32 **Entity W grants to a number of employees the right to choose either 1,000 'phantom shares' (ie a right to a cash payment equal to the fair value of 1,000 shares) or 1,000 shares. The grant is conditional upon the completion of three years' service. At the end of Year 3, each employee chooses either the cash alternative or the equity alternative. In the past, similar share-based payment transactions have never been settled in shares by Entity W.**

At the grant date, the fair value of Entity W's shares is CU50 per share. At the end of Years 1, 2 and 3, the fair value of Entity W's shares is CU52, CU55 and CU60 per share respectively. The entity does not expect to pay dividends in Years 1–3. All employees remain in service at the end of year 3.

The fair value of the cash-settled alternative is not lower than the fair value of the equity-settled alternative. Consequently, the cash settled alternative has not been structured in such a way that the shares will always be chosen by the employees. In addition, such share-based payment transactions in the past have never been settled in shares. In accordance with paragraph 26.15, Entity W accounts for the transaction as a cash-settled share-based payment transaction.

On the grant date the fair value of the cash alternative is CU50,000 (1,000 phantom shares × CU50). The entity recognises the following amounts for each employee that it expects to remain employed by the entity at the end of Year 3:

Year	Calculation	Expense* (CU)	Year-end liability** (CU)
1	1,000 phantom shares × CU52 × $^1/_3$	17,333	17,333
2	1,000 phantom shares × CU55 × $^2/_3$—CU17,333	19,334	36,667
3	1,000 phantom shares × CU60—CU36,667	23,333	60,000
	Total	60,000	

* Assumes that the staff costs do not qualify for capitalisation.

** The liability is equal to the cumulative expense recognised

If an employee chooses to take shares rather than cash at the end of Year 3 there would no longer be a liability and Entity W would transfer the CU60,000 out of liabilities (Dr Liabilities CU60,000). Entity W would be required to recognise the issue of new shares or, alternatively, the use of treasury shares (Cr Equity CU60,000).

Ex 33 **Entity W grants to a number of employees the right to choose either 1,200 shares or a cash payment equal to the fair value of 50 shares (ie 50 'phantom shares'). The grant is conditional upon the completion of three years' service. At the end of Year 3, each employee chooses either the cash alternative or the equity alternative. At the grant date, the fair value of Entity W's shares is determined to be CU50 per share. At the end of Years 1, 2 and 3, the fair values of Entity W's shares are determined to be CU52, CU55 and CU60 per share respectively. The entity does not expect to pay dividends in Years 1–3. Entity W does not expect that any employees will leave during the 3-year service period and at the end of year 3 all employees remain in service.**

The fair value of the equity-settled alternative is significantly higher than that of the cash-settled alternative. Consequently, the expectation is that each employee will choose to receive shares rather than cash and the cash alternative has no commercial substance. In accordance with paragraph 26.15, Entity W therefore accounts for the transaction as an equity-settled share-based payment transaction.

On the grant date, the fair value of 1,200 of Entity W's shares is CU60,000 (1,200 shares × CU50). The entity recognises the following amounts for each employee that it expects to remain employed by the entity at the end of Year 3:

Year 1

Dr	Profit or loss—staff costs*	CU20,000	
	Cr Equity—reserves		CU20,000

To recognise the receipt of employee services in exchange for 1,200 shares

(1,200 shares × CU50 × $^1/_3$ of vesting period elapsed)

Year 2

Dr Profit or loss—staff costs* CU20,000

Cr Equity—reserves CU20,000

To recognise the receipt of employee services in exchange for 1,200 shares

(1,200 shares × CU50 × $^{2}/_{3}$ of vesting period elapsed) less CU20,000 recognised in Year 1

Year 3

Dr Profit or loss—staff costs* CU20,000

Cr Equity—reserves CU20,000

To recognise the receipt of employee services in exchange for 1,200 shares

(1,200 shares × CU50) less CU40,000 recognised in Years 1 and 2

* These entries assume that the staff costs do not qualify for capitalisation.

This can be shown as:

Year	Calculation	Expense (CU)	Equity (CU)
1	1,200 shares × CU50 × 1/3	20,000	20,000
2	1,200 shares × CU50 × 2/3—CU20,000	20,000	20,000
3	1,200 shares × CU50—CU40,000	20,000	20,000
	Total	60,000	

Group plans

26.16 If a share-based payment award is granted by an entity to the employees of one or more group entities, and the group presents **consolidated financial statements** using either the *IFRS for SMEs* or **full IFRS**, the group entities are permitted, as an alternative to the treatment set out in paragraphs 26.3–26.15, to measure the share-based payment expense on the basis of a reasonable allocation of the expense for the group.

Example—group plans

Ex 34 Entity A is a listed company that prepares financial statements in accordance with full IFRS Standards. Entity A has four subsidiaries (Subsidiaries A, B, C and D) and all of them prepare individual financial statements in accordance with the *IFRS for SMEs* Standard. Entity A grants 50 share options in Entity A to each of the sales employees at the subsidiaries, conditional upon the completion of three years' service with the subsidiary. The parent does not require the subsidiaries to pay for the shares needed to settle the grant of share options.

Subsidiary A has three times as many sales employees as Subsidiaries B, C and D. All sales employees of Subsidiaries A, B and C are expected to meet the specified service condition. Only half of the sales employees in Subsidiary D are expected to meet the service condition. These estimates do not change during the vesting period.

In its consolidated financial statements Entity A recognises an expense of CU11,000 for the equity-settled share-based payments in each of the three years with a corresponding increase in equity.

The *IFRS for SMEs* Standard does not give further guidance on how an entity determines a reasonable allocation of the expense for the group.

The expense might be allocated between the subsidiaries for the purposes of preparing the subsidiaries' individual financial statements based on the number of sales employees expected to receive the awards at the subsidiaries. Subsidiary A has three times as many employees as Subsidiaries B, C and D. Furthermore, only half of the employees in Subsidiary D are expected to receive the awards. Consequently, the expense might be allocated between the subsidiaries using the following ratio: 6: 2: 2: 1 (ie subsidiary A accounts for an expense equal to 6/(6+2+2+1) = 6/11 of the expense recognised by the parent).

An increase in equity would be recognised as a contribution from the parent in the individual financial statements of the subsidiaries.

Subsidiaries A-D might account for the share-based payments as follows in their individual financial statements:

Subsidiary A:

Years 1-3

Dr	Profit or loss—staff costs*	CU6,000	
	Cr Equity—capital contribution from parent		CU6,000

To recognise the receipt of employee services in exchange for share options in parent entity

(CU11,000 x $^{6}/_{11}$)

Subsidiary B and C:

Years 1-3

Dr	Profit or loss—staff costs*	CU2,000	
	Cr Equity—capital contribution from parent		CU2,000

To recognise the receipt of employee services in exchange for share options in parent entity

(CU11,000 x $^{2}/_{11}$)

Subsidiary D:

Years 1-3

Dr	Profit or loss—staff costs*	CU1,000	
	Cr Equity—capital contribution from parent		CU1,000

To recognise the receipt of employee services in exchange for share options in parent entity

(CU11,000 x $^{1}/_{11}$)

Unidentifiable goods or services

26.17 If the identifiable consideration received appears to be less than the fair value of the equity instruments granted or the liability incurred, this situation typically indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received. For example, some jurisdictions have programmes by which **owners** (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). This indicates that other consideration has been or will be received (such as past or future employee services). The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date. For cash-settled transactions, the liability shall be remeasured at the end of each **reporting period** until it is settled in accordance with paragraph 26.14.

Example—cannot identify the specific goods or services received

Ex 35 **Following the introduction of new legislation, an entity gives 100 shares to each of ten employees who meet certain criteria. Dividends declared on the shares are paid to the employees when they are paid by the entity. The employees are free to sell the shares whenever they wish but, under conditions imposed by the entity, if they sell them within the first five years, they must be sold to another person meeting the same criteria as themselves. The entity estimates that the fair value of a share, taking account of the restrictions in respect of its future sale, is CU6.**

The entity determines that it cannot identify any specific goods or services relating to the awards. However, this would still be considered to be an equity-settled share-based payment transaction under paragraph 26.17. There is no asset identified as part of the transaction and so the total charge of CU6,000 (100 shares × 10 employees × CU6) is recognised as an expense when the shares are granted.

Disclosures

26.18 An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period:

(a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (for example, whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.

(b) the number and weighted average exercise prices of share options for each of the following groups of options:

(i) outstanding at the beginning of the period;

(ii) granted during the period;

(iii) forfeited during the period;

(iv) exercised during the period;

(v) expired during the period;

(vi) outstanding at the end of the period; and

(vii) exercisable at the end of the period.

26.19 For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.

26.20 For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.

26.21 For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.

26.22 If the entity is part of a group share-based payment plan, and it measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).

26.23 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its **financial position**:

(a) the total expense recognised in profit or loss for the period; and

(b) the total **carrying amount** at the end of the period for liabilities arising from share-based payment transactions.

Ex 36 **The following example illustrates the disclosure requirements for share-based payments.**[16]

Extract from the Notes to the Financial Statements of Company Z, which owns and operates a number of hotels, for the year ended 31 December 20X5.

Share-based payment

During the period ended 31 December 20X5 the company had four share-based payment arrangements, which are described below.

Type of arrangement	Senior management share option plan	General employee share option plan	Executive share plan	Senior management share appreciation rights
Date of grant	1 January 20X4	1 January 20X5	1 January 20X5	1 July 20X5
Number granted	50,000	75,000	50,000	25,000
Contractual life	10 years	10 years	4 years	3 years
Settlement type	Equity	Equity	Equity	Cash
Vesting conditions	One and a half years' service and achievement of a room occupancy target, which was achieved.	Three years' service.	Four years' service and achievement of a target growth in profit before tax.	Three years' service and achievement of a target increase in revenue per available room.

The estimated fair value of each share option granted in the general employee share option plan is CU23.60. The fair value of each share option granted was estimated by applying an option pricing model; a binomial option pricing model was used. The model inputs were the estimated fair value of each share at grant date of CU50.00, exercise price of CU50.00, expected volatility of 30 per cent, no expected dividends, contractual life of ten years, and a risk-free interest rate of 5 per cent. To allow for the effects of early exercise, it was assumed that the employees would exercise the options after vesting date when the estimated fair value of each share was twice the exercise price. The binomial option pricing model was chosen by the directors because it allows for the early exercise of options but is also suitable for options with long lives.

The estimated fair value of each share granted in the executive share plan is CU50.00, which is equal to the estimated share price at the date of grant.

The estimated fair value of each share to use as the share price, for the executive share plan, share appreciation rights and as an input to the binomial option pricing model, was estimated using a price/book valuation multiple. The directors chose this method because it is regarded as appropriate for capital-intensive industries. Furthermore, when a minority stake in one of the company's competitors was sold at the start of the year, the transaction price was established using a price/book valuation multiple.

[16] The illustrative example is not intended to be a template or model and is therefore not exhaustive. It does not, for instance, illustrate the disclosure requirements in paragraph 26.21 because there were no modifications during the period.

Further details of the two share option plans are as follows:

	20X4		20X5	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at start of year	0	–	45,000	CU40
Granted	50,000	CU40	75,000	CU50
Forfeited	(5,000)	CU40	(8,000)	CU46
Exercised	0	–	(4,000)	CU40
Outstanding at end of year	45,000	CU40	108,000	CU46
Exercisable at end of year	0	CU40	38,000	CU40

	20X4	20X5
	CU	CU
Expense arising from share-based payment transactions	495,000	1,105,867
Closing balance of liability for share appreciation rights	–	98,867

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—that its management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, applying paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* Standard require disclosure of information about particular judgements and estimation uncertainties.

When accounting for share-based payments, there are two principal situations where significant estimates and other judgements are required to be made: determining the fair value of equity not traded in an active market; and assessing the impact of vesting conditions.

Fair value estimates

For equity-settled share-based payment transactions, an entity measures the goods or services received, and the corresponding increase in equity, at the fair value of the goods or services received. However, if the entity cannot estimate reliably the fair value of the goods or services received, it measures their fair value by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, an entity must measure the fair value of the services received by reference to the fair value of the equity instruments granted, because it is typically not possible to reliably estimate the fair value of the services received.

Because shares in an SME are not traded in an active market, directors of SMEs must use their judgement to ensure they adopt the most appropriate valuation method to determine the fair value of the shares. Furthermore they must make significant estimates and other judgements when applying the chosen valuation method. For example, when using an income-based approach to determine the value of an entity (and its shares), several estimates and judgements must be made. They include estimates of future cash flows and their uncertainty (ie their amount, variation and timing) and the time value of money (an appropriate discount rate must be selected).

To estimate the fair value of share option and equity-settled share appreciation rights, an option pricing model will generally be used. All option pricing models take into account, as a minimum, the following factors and these inputs require management to make judgements and estimates:

(a) weighted-average share price;
(b) exercise price;
(c) expected volatility;
(d) option life;
(e) expected dividends; and
(f) risk-free interest rate.

When there is no listed share price, making judgements and estimates can be difficult; for example, trying to estimate expected volatility when there is no record of historical volatility.

When the share-based payment transaction is cash-settled, it is still necessary to estimate the fair value of the liability and it has to be estimated at each year-end until settlement.

Impact of vesting and non-vesting conditions

Management is required to make a number of estimates when accounting for vesting and non-vesting conditions when measuring equity-settled share based payments. A grant of equity instruments might be conditional upon employees satisfying specified vesting conditions related to service or performance. All vesting conditions related to employee service or to a non-market performance condition are taken into account when estimating the number of equity instruments expected to vest. Subsequently, an entity is required to revise that estimate if new information indicates that the number of equity instruments expected to vest differs from previous estimates. Similarly, on the vesting date, an entity is required to revise the estimate to equal the number of equity instruments that ultimately vested, or would have vested, as a result of the service and non-market performance conditions.
All market vesting and non-vesting conditions are taken into account when estimating the fair value of the shares or share options at the measurement date, with no subsequent adjustment, irrespective of the outcome.

Other judgements

In addition to the two main areas of judgement described above, a further source of uncertainty might concern deciding who are ‘employees and others providing similar services’. Equity-settled share-based payment transactions with employees and others providing similar services are measured by valuing the equity instruments granted, whereas all other equity-settled share-based payment transactions are measured by valuing the goods or services received, and it is only if the value of the goods or services received cannot be estimated reliably that they are measured by reference to the instruments issued.

Module 26—Share-based Payment

COMPARISON WITH FULL IFRS STANDARDS

When accounting for and reporting share-based payment transactions for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (see IFRS 2 *Share-based Payment*) and the *IFRS for SMEs* Standard (see Section 26 *Share-based Payment*) are:

- the *IFRS for SMEs* Standard is drafted in simpler language than that used in full IFRS Standards;
- there is less guidance on how to account for cancellations and settlements in Section 26 of the *IFRS for SMEs* Standard than there is in IFRS 2.
- The *IFRS for SMEs* Standard also contains fewer disclosure requirements than are in IFRS 2. However, while the *IFRS for SMEs* Standard removes some of those requirements, it does introduce three disclosures not in IFRS 2.

The main other differences between Section 26 and IFRS 2 are set out below.

- IFRS 2 requires that in the rare cases that the fair value of equity instruments granted cannot be estimated reliably, an entity measures the instruments at their intrinsic value; the intrinsic value is determined initially and then revised at the end of each reporting period and on final settlement (paragraph 24 of IFRS 2). Section 26 of the *IFRS for SMEs* Standard does not have a similar requirement and so entities are required to use a valuation method to determine the fair value of the equity instruments. Section 26 emphasises that when choosing a valuation technique for the fair value of shares the entity's directors should use their judgement. The IFRS 2 requirement to use intrinsic value in rare cases was not included in Section 26 because the Board observed that it would not provide much of a simplification for SMEs. This is because intrinsic value requires determining the fair value of the underlying shares at each reporting date until settlement (and SMEs, by definition, do not have an active market/quoted price for their shares).

- the *IFRS for SMEs* Standard contains a simplification from IFRS 2 with regards to share-based payment transactions with cash alternatives. Paragraph 26.15 specifies that when a share-based payment transaction gives either the entity or the holder a choice of settlement in cash or equity instruments, the entity must account for the transaction as a cash-settled share-based payment transaction unless either the entity has a past practice of settling by issuing equity instruments; or the option to settle in cash has no commercial substance. In either of these circumstances, the *IFRS for SMEs* Standard requires that the transaction is accounted for as being equity-settled. IFRS 2, on the other hand, requires:

  (a) if the counterparty has the choice of how the transaction is settled, the entity recognises a compound financial instrument and the debt and equity components are accounted for separately as share-based payment transactions under IFRS 2; and
  (b) if the entity has the choice of how the transaction is settled, the entity accounts for the transaction as a cash-settled share-based payment transaction to the extent it has incurred a liability to settle in cash or other assets and an equity-settled share-based payment transaction to the extent that no such liability has been incurred.

- the *IFRS for SMEs* Standard provides a simplification for group entities: when a parent grants an award to employees of its subsidiary and the parent presents consolidated financial statements using either the *IFRS for SMEs* Standard or full IFRS Standards, the subsidiary is permitted to measure the expense and related capital contribution on a reasonable allocation of the group expense. IFRS 2 does not include a similar simplification and instead provides detailed requirements for accounting for share-based payments among group entities.

IFRS 2 includes specific requirements in the following areas that are not covered in the *IFRS for SMEs* Standard (note, these requirements would not necessarily lead to differences in accounting, for example if the SME considered the IFRS 2 requirements in the absence of requirements in the *IFRS for SMEs* Standard):

- IFRS 2 specifies some additional requirements for measuring the fair value of equity instruments, including:
  - the effects of expected early exercise are taken into account when measuring the fair value; and
  - a reload feature is not permitted to be reflected in the fair value of the options granted at measurement date but instead is accounted for as a new option if and when granted.

- IFRS 2 specifies some additional requirements for cancellations and settlements, including:
  - when new equity instruments are granted as a replacement for cancelled instruments, IFRS 2 contains explicit guidance requiring the entity to account for the new grant as though it were a modification of the original instruments.
  - any payments made to an employee on the cancellation or settlement of a grant of equity instruments are accounted for as the repurchase of an equity interest except in the following cases:
    - the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess is recognised as an expense.
    - if the arrangement included liability components, the entity shall remeasure the fair value of the liability at the date of cancellation or settlement. Any payment made to settle the liability component shall be accounted for as an extinguishment of the liability
  - similarly, if an entity repurchases vested equity instruments, the payment made to the employee is accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

In June 2016 the Board issued *Classification and Measurement of Share-based Payment Transactions* (Amendments to IFRS 2). These amendments added guidance to clarify the accounting for

- the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments (namely, that entities should follow the same approach as for equity-settled share-based payments);
- the accounting for share-based payment transactions with a net settlement feature for withholding tax obligations (namely that the arrangement should be classified as equity-settled in its entirety, provided it would have been classified as equity-settled had it not included that feature); and

- a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled (namely that the original liability is derecognised and an equity settled share-based payment is recognised at the modification date fair value to the extent that services have been rendered up to that date).

The *IFRS for SMEs* Standard does not have requirements in these three areas, but could consider this guidance applying paragraphs 10.4-10.6 of the *IFRS for SMEs* Standard.

Module 26—Share-based Payment

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for share-based payment transactions applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

Mark the box next to the most correct statement.

Question 1

An entity recognises the goods or services received or acquired in a share-based payment transaction:

- ☐ (a) only when the share-based payment is cash-settled.
- ☐ (b) when it receives the goods or services.
- ☐ (c) only when the vesting period ends.
- ☐ (d) only on the date that the equity instruments are granted.

Question 2

If share options granted to employees under a share-based payment transaction vest immediately:

- ☐ (a) the entity defers recognition of the services rendered by the employees.
- ☐ (b) the entity records a liability because the employees are owed something.
- ☐ (c) the services are recognised immediately because it is presumed the employees have already provided the related services.
- ☐ (d) the entity accounts for those services as they are rendered by the employee during the vesting period.

Question 3

For equity-settled share-based payment transactions, an entity measures the goods or services received:

- ☐ (a) always at the fair value of the goods and services received.
- ☐ (b) always at the fair value of the equity instruments issued.
- ☐ (c) at the cost of goods and services provided by employees and others providing similar services.
- ☐ (d) at the fair value of the goods or services received unless that fair value cannot be estimated reliably.

Module 26—Share-based Payment

Question 4

For equity-settled share-based payment transactions for employee services, the fair value of the equity instruments is measured:

☐ (a) on the grant date.

☐ (b) on the exercise date.

☐ (c) at the end of the vesting period or exercise period, whichever is later.

☐ (d) at the date when the entity knows how many instruments will vest.

Question 5

For equity-settled share-based payment transactions with parties other than employees, the measurement date is:

☐ (a) the grant date.

☐ (b) the exercise date.

☐ (c) when the entity obtains the goods or the counterparty renders service.

☐ (d) when the warranty period for the goods or services expires.

Question 6

A grant of equity instruments might be conditional on employees satisfying specified vesting conditions related to service or performance. On the vesting date, the entity:

☐ (a) never revises the estimate of the number of equity instruments expected to vest for the number of equity instruments that ultimately vest.

☐ (b) revises the estimate of the number of equity instruments expected to vest to equal the number of equity instruments that ultimately vest for vesting conditions related to employee service and to a non-market performance condition.

☐ (c) revises the estimate of the number of equity instruments expected to vest to equal the number of equity instruments that ultimately vest for vesting conditions related to employee service and to a market performance condition.

☐ (d) revises the estimate of the number of equity instruments expected to vest to equal the number of equity instruments that ultimately vest for all vesting conditions.

Question 7

When measuring the fair value of shares (and the related goods or services received) in an equity-settled share-based payment transaction an entity:

☐ (a) must always use observable market prices of the entity's own shares.

☐ (b) uses observable market prices but only for non-employee share-based transactions.

☐ (c) uses prices established by the entity's directors for that type of share-based transaction.

☐ (d) uses observable market prices, if available, and, if not available, uses other measures according to a measurement hierarchy.

Question 8

For modifications of vesting conditions in an equity-settled share-based payment transaction for employee services, the entity:

- ☐ (a) takes the modified vesting conditions into account by recognising the change in fair value over the period from the date of the modification to the date that the modified equity instruments vest.
- ☐ (b) takes the modified vesting conditions into account only if it is beneficial to employees and does so by recognising the change in fair value over the original vesting period, using a prior period adjustment to adjust for the part of the vesting period that relates to prior periods.
- ☐ (c) takes the modified vesting conditions into account only if it is beneficial to employees and does so by recognising the change in fair value over the period from the date of the modification to the date that the modified equity instruments vest.
- ☐ (d) makes no adjustment to amounts recognised for remuneration expenses.

Question 9

A cash-settled share-based payment transaction is 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:

- ☐ (a) the price (or value) of those goods or services.
- ☐ (b) the price (or value) of equity instruments of the entity or the supplier.
- ☐ (c) the price (or value) of equity instruments of the entity or another group entity.
- ☐ (d) the price (or value) set out in the contractual agreement between the entity and the supplier.

Question 10

For share-based payment transactions offering a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments the entity accounts for the transaction as a cash-settled share-based payment unless:

- ☐ (a) the entity chooses to account for the transaction as an equity-settled share-based payment.
- ☐ (b) the entity has a past practice of settling by issuing equity instruments.
- ☐ (c) the option to settle in cash has no commercial substance.
- ☐ (d) the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.

Question 11

Under an employee long-term incentive plan operated by Company A, 1,000 of Company A's shares will be given to employees in three years' time if the following conditions are met. The shares only vest if the value of a share has risen to CU34 at the end of the three-year period and if the employees are still employed by Company A on the same date. On the grant date the fair value of the company's shares is determined to be CU30 applying Section 26. The company plans to pay no dividends over the next three years. All eligible employees remain employed by Company A at the end of the three-year period. Which of the following is true:

☐ (a) if the share price on the vesting date is CU35, Company A charges, over the three years as remuneration expense, CU35,000 (CU35 × 1,000); and

if the share price on the vesting date is CU32, Company A charges, over the three years as remuneration expense, CU0.

☐ (b) if the share price on the vesting date is CU35, Company A charges, over the three years as remuneration expense, CU35,000 (CU35 × 1,000); and.

if the share price on the vesting date is CU32, Company A charges, over the three years as remuneration expense, CU32,000 (CU32 × 1,000).

☐ (c) if the share price on the vesting date is CU35, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000); and.

if the share price on the vesting date is CU32, Company A charges, over the three years as remuneration expense, CU0.

☐ (d) regardless of the share price on the vesting date, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000).

☐ (e) regardless of the share price on the vesting date, Company A charges, over the three years as remuneration expense, CU0.

Question 12

The accounting for which of the following transactions is specified in a section of the *IFRS for SMEs* Standard other than Section 26:

☐ (a) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a plot of land classified as property, plant and equipment.

☐ (b) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a plot of land classified as investment property.

☐ (c) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a plot of land classified as inventory.

☐ (d) an entity issues 100 of its own ordinary shares to an independent contractor in exchange for accounting services.

☐ (e) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a business.

☐ (f) an entity issues 100 of its own ordinary shares to its employees in exchange for employee services.

Module 26—Share-based Payment

Answers

Q1 (b) see paragraph 26.3.
Q2 (c) see paragraph 26.5.
Q3 (d) see paragraph 26.7.
Q4 (a) see paragraph 26.8.
Q5 (c) see paragraph 26.8.
Q6 (b) see paragraph 26.9.
Q7 (d) see paragraph 26.10.
Q8 (c) see paragraph 26.12.
Q9 (c) see paragraph 26.14.
Q10 (d) see paragraph 26.15.
Q11 (d) see paragraph 26.9.
Q12 (e) see paragraphs 26.1 and 19.11.

Module 26—Share-based Payment

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for presenting share-based payment transactions applying the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed the case studies, check your answers against those set out beneath it.

Case study 1

Entity M, whose shares are not publicly traded, entered into the following share-based payment transactions in 20X1 to 20X3:

(a) On 30 January 20X1 Entity M received marketing services in exchange for 400 of its shares. The counterparty initially quoted a price of CU10,000 based on its normal market rates, but agreed to accept Entity M's shares rather than cash payment. The fair value for Entity M's shares on 30 January was estimated at CU26 per share.

(b) On 31 December 20X2 Entity M established a supplementary annual bonus plan for its sales manager. The intention was to make the bonus approximately equal to 1% of the total salary (excluding the bonus), subject to issuing whole numbers of shares. Upon receipt of the shares, which was on 31 December, the sales manager had the immediate and unconditional right to sell them. Entity M granted 3,000 shares under the plan. Management estimated that the fair value of Entity M's shares on 31 December was CU28 per share. The pre-bonus salary was CU8,401,050.

(c) On 2 October 20X3 Entity M purchased office equipment by issuing 4,000 of its ordinary shares. The selling price for the equipment is CU110,000. Management estimated that the fair value of Entity M's shares on 2 October was CU29 per share.

Prepare Entity M's journal entries for these share-based payment transactions. Ignore the journal entries required in respect of the shares themselves. Assume that none of Entity M's employee compensation qualifies for capitalisation.

Answer to Case study 1

30 January 20X1

		Dr	Cr
Dr	Profit or loss—marketing expense	CU10,000	
	Cr Equity		CU10,000

To recognise the receipt of marketing services in exchange for 400 Entity M shares

Note: the normal market rate of the marketing services, assuming the purchase is from an independent vendor, is the best measurement of the fair value of the marketing services received. Entity M would measure the fair value of the services received at the fair value of the shares granted in exchange for the services only if the fair value of the services cannot be determined reliably (ie 400 shares × CU26 per share = CU10,400).

31 December 20X2

		Dr	Cr
Dr	Profit or loss—staff bonus	CU84,000	
	Cr Equity		CU84,000

To recognise receipt of employee services in exchange for 3,000 Entity M shares

Note: because the share-based payment vests at the grant date (at 31 December 20X2), the sales manager has an unconditional right to trade the shares. No part of the award is for future services (ie the full amount is recognised as an expense on 31 December 20X2). The fair value of the sale manager's services is measured at the fair value of the shares issued in exchange for those services, ie 3,000 shares × CU28 fair value per share (see paragraph 26.7).

2 October 20X3

		Dr	Cr
Dr	Asset: Property, plant and equipment—equipment	CU110,000	
	Cr Equity		CU110,000

To recognise the receipt of equipment in exchange for 4,000 Entity M shares

Note: the normal selling price, assuming the purchase is from an independent vendor, is the best measurement of the fair value of the equipment received. Entity M could measure the fair value of the equipment received at the fair value of the shares granted in exchange for the equipment at CU116,000 (ie 4,000 shares × CU29 each) only if the fair value of the equipment received cannot be estimated reliably (see paragraph 26.7).

After purchase, Entity M depreciates the equipment based on its estimated useful life and residual value.

Case study 2

On 31 December 20X0 Entity N grants 10 share options to each of its 1,000 employees. Each grant is conditional upon the employee remaining in service over the next three years. On 31 December 20X0 management, using an appropriate option pricing model, measures the fair value of each option at CU5. On the basis of a weighted average probability, the entity estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the share options.

Forty employees leave during 20X1. By 31 December 20X1 the market in which Entity N operates has declined significantly and this has had a negative impact on the fair value of Entity N’s business and that of its competitors; consequently Entity N reprices its share options. The repricing of the share options increased the fair value of each share option measured immediately before the repricing by CU2. The vesting date remains unaltered and the repriced share options vest on 31 December 20X3. On 31 December 20X1 management estimates that a further 70 employees will leave during 20X2 and 20X3, and hence the total expected employee departures over the three-year vesting period is 110 employees.

During year 20X2 a further 35 employees leave, and on 31 December 20X2 management estimates that a further 30 employees will leave during 20X3 (ie the total expected employee departures over the three-year vesting period is estimated at 105 employees).

During 20X3 28 employees leave (ie 103 employees ceased employment during the vesting period). For the remaining 897 employees, the share options vested on 31 December 20X3.

Required:

(a) Determine the estimated amount of total remuneration at the date of the grant, before any repricing.

(b) Prepare the journal entries to record remuneration expense in 20X1, 20X2 and 20X3. Assume that the employee compensation does not qualify for capitalisation.

Answer to Case study 2

(a) The condition that an employee remains in service over the next three years is a service condition. The grant date estimate, before any repricing, of total remuneration over the three years is CU45,000 [(1,000 employees less 100 expected forfeiture) × 10 options each × CU5 fair value per option]. If no repricing took place and, as expected, 100 employees left, Entity N would record CU15,000 remuneration expense in each of the years 20X1,20X2 and 20X3. No expense is recognised in 20X0 because none of the services for which the share options are granted are received in 20X0.

(b) Entity N makes the following journal entries during the vesting period, for services received as consideration for the share options issued, taking into account the repricing and updated information on expected vesting.

For the year ended 31 December 20X1

Dr	Profit or loss—staff costs	CU14,833	
	Cr Equity—reserves		CU14,833

(1,000 employees less 110 expected forfeiture) × 10 options × CU5 × $^1/_3$ of vesting period elapsed

To recognise the receipt of employee services in the current year in exchange for 10 Entity N share options per employee.

For the year ended 31 December 20X2

Dr	Profit or loss—staff costs	CU23,950	
	Cr Equity—reserves		CU23,950

[(1,000 employees less 105 expected forfeiture) × 10 options × ((CU5 original × $^2/_3$ of vesting period elapsed) + (CU2 repricing × $^1/_2$ of period remaining after pricing elapsed))]—CU14,833

To recognise the receipt of employee services in the current year in exchange for 10 Entity N share options per employee

For the year ended 31 December 20X3

Dr	Profit or loss—staff costs	CU24,007	
	Cr Equity—reserves		CU24,007

[(1,000—103) employees × 10 options × (CU5 original + CU2 repricing)] less CU38,783 recognised in 20X1 and 20X2

To recognise the receipt of employee services in the current year in exchange for 10 Entity N share options per employee

Note: entities are required to recognise the effects of modifications that increase the total fair value or are otherwise beneficial to the employee, measured immediately before and after the modification. Consequently, Entity N is required to recognise the incremental CU2 fair value per option that results from the repricing. Because the modification occurs during the vesting period, the incremental fair value granted, that is, CU2, is included in the measurement of the amount recognised for services received over the period from the modification date (31 December 20X1) until the date when the modified equity instruments vest (31 December 20X3); that is, it is charged over the last two years of the three-year vesting period. This expense is in addition to the amount based on the grant date fair value of the original equity instruments, CU5, which is recognised over the original vesting period of the three years to 31 December 20X3.

Case study 3

Entity P establishes a programme of share-appreciation rights (SARs) by which its executives are entitled to receive cash equal to the growth, if any, in the fair value of the ordinary shares over a four-year period. On 31 December 20Y0 the executives were granted 40,000 SARs conditional upon each executive remaining in the employment (service) of Entity P for the next four years, ie until 31 December 20Y4 (Year 4). The fair value of P's shares on 31 December 20Y0 was CU30.
The executives will be paid the cash, equal to the increase (if any) in the fair value of the shares over the four years to 31 December 20Y4, in February 20Y5. The fair value of the SARs is measured at CU6 per SAR on 31 December 20Y0, CU9 on 31 December 20Y1, CU15 on 31 December 20Y2, CU8 on 31 December 20Y3 and CU12 on 31 December 20Y4. The intrinsic value of the SARs at the date of exercise (which equals the cash paid out) was also CU12. All executives remain employed by Entity P during the four years.

1. Prepare a four-year (20Y1–20Y4) schedule calculating the employee compensation pertaining to the 40,000 SARs granted to the executives.
2. Prepare the journal entries for employee compensation expense in each of the four years for the 40,000 SARs and the journal entry for the cash payment in 20Y5. Assume that the employee compensation does not qualify for capitalisation.

Answer to Case study 3

(a) Employee compensation schedule for SARs

Date	*Fair value*	*Percentage accrued*	*Expense/ (credit) for year*	*Accrued to date*	*Workings*
	CU	*%*	*CU*	*CU*	
31/12/Y1	9	25	90,000	90,000	(CU9 × 40,000 SARs × 1/4)
31/12/Y2	15	50	210,000	210,000	(CU15 × 40,000 SARs × 2/4) less CU90,000
				300,000	
31/12/Y3	8	75	(60,000)	(60,000)	(CU8 × 40,000 SARs × 3/4) less CU300,000
				240,000	
31/12/Y4	12	100	240,000	240,000	(CU12 × 40,000 SARs) less CU240,000
				480,000	

(b) Journal entries for employee compensation expense

For the year ended 31 December 20Y1

Dr	Profit or loss—staff costs	CU90,000	
	Cr Liability—employee share appreciation plan		CU90,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of Entity P over four years—first year

For the year ended 31 December 20Y2

Dr	Profit or loss—staff costs	CU210,000	
	Cr Liability—employee share appreciation plan		CU210,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of Entity P over four years—second year

For the year ended 31 December 20Y3

Dr	Liability—employee share appreciation plan	CU60,000	
	Cr Profit or loss—staff costs		CU60,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of Entity P over four years—third year—reverse part of the charge in prior years

For the year ended 31 December 20Y4

Dr	Profit or loss—staff costs	CU240,000	
	Cr Liability—employee share appreciation plan		CU240,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of Entity P over four years—final year

For the year ended 31 December 20Y5

Dr	Liability—employee share appreciation plan	CU480,000	
	Cr Asset—cash		CU480,000

To recognise the payment of cash to employees under the share appreciation plan for the four years ended 31 December 20Y4