Module 26—Share-based Payment
IFRS Foundation: Training Material for the IFRS® for SMEs

including the full text of
Section 26 Share-based Payment
of the International Financial Reporting Standard (IFRS)
for Small and Medium-sized Entities (SMEs)
issued by the International Accounting Standards Board in July 2009

with extensive explanations, self-assessment questions and case studies
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This training material has been prepared by IFRS Foundation education staff and has not been approved by the International Accounting Standards Board (IASB). The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the International Financial Reporting Standard (IFRS) for SMEs, which was issued by the IASB in July 2009.

INTRODUCTION

This module, issued in September 2013, focuses on the accounting for, and reporting of, share-based payment transactions in accordance with Section 26 Share-based Payment of the IFRS for SMEs that was issued in July 2009 and the related non-mandatory guidance subsequently provided by the IFRS Foundation SME Implementation Group. It introduces the learner to the subject, guides the learner through the official text, develops the learner’s understanding of the requirements through the use of examples and indicates significant judgements that are required in accounting for share-based payment transactions. Furthermore, the module includes questions designed to test the learner’s knowledge of the requirements and case studies to develop the learner’s ability to account for share-based payment transactions in accordance with the IFRS for SMEs.

Learning objectives

Upon successful completion of this module you should know the financial reporting requirements for share-based payment transactions in accordance with the IFRS for SMEs as issued in July 2009. Furthermore, through the completion of case studies that simulate aspects of the real world application of that knowledge, you should have enhanced your competence to account for share-based payment transactions in accordance with the IFRS for SMEs. In particular you should, within the context of the IFRS for SMEs, 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;
- apply the measurement principle for recording equity-settled share-based payment transactions, including shares and share options;
- account for modification of terms and 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;
- understand how to account for government-mandated share-based payment plans;
- demonstrate an understanding of the significant judgements that are required in accounting for share-based payment transactions; and
- disclose share-based payment arrangements in financial statements.

Share-based payment is a complex area and it is likely that not all SMEs will have share-based payments. This is a comprehensive module and you should consider your particular audience and whether it is necessary to deliver the entire module. Share-based payment transactions inevitably involve valuation issues and this module highlights the issues. You may find IFRS 13 Fair Value Measurement and the educational material on “Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments” (see IFRS Foundation website at http://www.ifrs.org/Use-around-the-world/Education/FVM/Pages/FVM.aspx) useful reference documents.

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IFRS for SMEs

The IFRS for SMEs is intended to be applied 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 includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is non-mandatory includes:

- a preface, which provides a general introduction to the IFRS for SMEs and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a disclosure checklist;
- the Basis for Conclusions, which summarises the IASB’s main considerations in reaching its conclusions in the IFRS for SMEs; and
- the dissenting opinion of an IASB member who did not agree with the publication of the IFRS for SMEs.

In the IFRS for SMEs the Glossary is part of the mandatory requirements.

In the IFRS for SMEs there are appendices in Section 21 Provisions and Contingencies, Section 22 Liabilities and Equity and Section 23 Revenue. Those appendices are non-mandatory guidance.

Furthermore, the SME Implementation Group (SMEIG), which is responsible for assisting the IASB on matters related to the implementation of the IFRS for SMEs, has published implementation guidance in the form of questions and answers (Q&As). The Q&As are intended to provide non-mandatory and timely guidance on specific accounting questions that are being raised with the SMEIG by users implementing the IFRS for SMEs.

When the IFRS for SMEs was issued in July 2009, the IASB undertook to assess entities’ experience of applying the IFRS for SMEs following the first two years of application and to consider whether there is a need for any amendments. To this end, in June 2012, the IASB issued a Request for Information: Comprehensive Review of the IFRS for SMEs. It is currently expected that an Exposure Draft proposing amendments to the IFRS for SMEs will be issued in the second half of 2013.

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, financial performance and cash flows that is useful for economic decision-making by a broad range of users (eg owners who are not involved in managing the business, potential owners, existing and potential lenders and other creditors) who are not in a position to demand reports tailored to meet their particular information needs. Section 26:

- sets out recognition and measurement principles for share-based payment transactions, equity-settled, cash-settled and share-based payment transactions with equity and cash alternatives, and describes how the measurement principle is applied to shares, share options and share appreciation rights;
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- stipulates how vesting conditions are to be incorporated;
- specifies the accounting for modification of terms, cancellations, and settlement of share-based payment awards;
- contains a relaxation for accounting for some group plans;
- describes the accounting for government-mandated plans; and
- specifies disclosure requirements for share-based payment arrangements.

A share-based payment transaction is a transaction in which an entity receives goods or services as consideration for issuing its own equity instruments, or in exchange for a liability based on the price of the entity’s shares or other equity instruments.

In summary, Section 26 requires the fair value of the goods or services received in an equity-settled share-based payment transaction to be recognised in the financial statements either as an asset or, if the asset recognition criteria are not met, as an expense. If the fair value of the goods or services cannot be estimated reliably, and this is assumed to be the case for transactions for employee services, they are measured by reference to the fair value of the equity instruments granted. Specific guidance is included specifying how vesting conditions should be dealt with. The measurement of the asset or expense in an equity-settled share-based payment transaction is identical regardless of how the entity will source the shares, for example, whether it will issue new shares or will use treasury shares. The goods or services received in a cash-settled share-based payment transaction are recognised at an amount equal to the fair value of the liability for the cash-settled share-based payment. The liability for a cash-settled share-based payment transaction is remeasured through profit or loss until it is settled.

As stated above, the measurement principle in Section 26 for equity-settled share-based payment transactions applies regardless of how the entity will source the shares. The important distinction made, for equity-settled share-based payment transactions, is that when an asset does not arise, there is an expense rather than a direct decrease in equity. Having recognised an asset or expense, the other side of the entry is to equity and Section 26 does not distinguish where in equity this entry is made. The exact entries made when shares are given to the other party will depend on the legal requirements in the jurisdiction in which the entity is based.
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REQUIREMENTS AND EXAMPLES

The contents of Section 26 Share-based Payment of the IFRS for SMEs are set out below and shaded grey. Terms defined in the Glossary of the IFRS for SMEs are also part of the requirements. They are in bold type the first time they appear in the text of Section 26. The notes and examples inserted by the IFRS Foundation education staff are not shaded. The insertions made by the staff do not form part of the IFRS for SMEs and have not been approved by the IASB.

Scope of this section

26.1 This section specifies the accounting for all share-based payment transactions including:

(a) equity-settled share-based payment transactions, in which the entity acquires goods or services as consideration for equity instruments of the entity (including shares or share options);

(b) cash-settled share-based payment transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity’s shares or other equity instruments of the entity; and

(c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

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 (rather than 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 (eg upon cessation of employment) or at the employee’s option.

Notes

A share-based payment transaction is a transaction in which the entity receives goods or services (including employee services) as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity’s shares or other equity instruments of the entity (see Glossary). Goods include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets.

In an equity-settled share-based payment transaction, an entity receives goods or services in exchange for equity instruments in itself; this is regardless of whether the
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An entity will issue new instruments, such as shares, or whether it will use shares it has already purchased or that it will purchase.

A cash-settled share-based payment transaction occurs when an entity receives goods or services in exchange for a payment in cash, or other assets, which is calculated based on the price of the entity's shares or other equity instruments.

Entities commonly use share-based payments as a form of currency. One scenario involves an early-stage entity, sometimes called a start-up entity, with limited cash that issues shares in exchange for goods or services. While this helps the start-up entity to manage cash flow, the payment in shares may also be attractive to the vendor or service provider, because the shares received represent an investment, which might have a favourable upside if the share value increases. A second common context for the use of share-based payments involves remunerating employees. Share-based compensation plans can motivate employees to higher levels of performance and build a sense of shared ownership in the entity. Generally, equity compensation schemes provide the employee with the right to receive equity in the entity if the performance of the entity exceeds predetermined levels. Typical performance measures include increases in earnings per share, revenue or market share or attaining a particular Total Shareholder Return (TSR) result relative to that of competitors.

Companies that do not have a listed company in the same group as themselves may have to create a market in the shares so that the employees can ultimately sell their shares. Share-appreciation rights address this issue by giving the employee the right to receive compensation equal to the share price appreciation (the excess of the price/value of the share at the date of exercise over a pre-established price). Entities may pay the share appreciation in cash, in shares, or in a combination of both, although if paid in shares the problem of the lack of a market for the shares arises again.

Equity instruments issued in a business combination in exchange for control of the acquiree are addressed in Section 19 Business Combinations and Goodwill.

An issue of shares for cash is not a share-based payment transaction if it does not involve the delivery of goods or services. There have been issues around where goods and services are received but that cannot be specifically identified and this can be a judgemental issue. An apparent discount might be an indicator that additional consideration has been or will be received. See paragraph 26.17.

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

**Ex 1** Entity A, as part of its ordinary activities, contracted for advice regarding a new marketing campaign from a local PR consultancy. The consultancy agreed to accept ordinary shares of Entity A as payment for its services.

Entity A is paying for services in shares rather than in cash. It accounts for this equity-settled share-based payment transaction in accordance with Section 26.
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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 5-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 a cash payment, 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 an Entity A share over a specified three-year period. Entity A accounts for this cash-settled share-based payment transaction in accordance with Section 26.

Ex 4  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 per cent of their 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.

Example—employee bonus outside the scope of Section 26

Ex 5  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 per cent of their 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 Example 3. The bonus is a percentage of salary, as in Example 4, but in Example 4 the payment is in the form of shares whereas in this example the payment is in cash. Because the bonus payment is not in shares and is not based on the price of Entity C’s shares, it is not a share-based payment and so is outside the scope of Section 26.
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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 6 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. It recognises an increase in assets (the computers) and a corresponding increase in equity for the shares issued in exchange for the computers.

In accordance with Section 17 Property, Plant and Equipment, Entity A depreciates the computers on the basis of their estimated useful lives and residual values.

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.

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

Ex 7 The facts are the same as in Example 1, namely, that Entity A, as part of its ordinary activities, contracted for advice regarding a new marketing campaign from a local PR consultancy and the consultancy agreed to accept ordinary shares of Entity A as payment for its services.

Paragraphs 18.14 and 18.15 require expenditure on advertising and promotional activities to be recognised as an expense. Consequently, Entity A records a marketing expense, in the same way as it would have done had it paid in cash. The transaction increases expenses and increases 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 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—vesting conditions

Vest means 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 (see Glossary).

Vesting conditions are 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. For example, employees may be awarded shares in the entity, but they will receive those shares only if the entity's profit before tax in a particular period exceeds a certain threshold 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 vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied (IFRS 2 Appendix A).

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

Examples—recognition when there are no vesting conditions

Ex 8  On 31 December 20X1 Entity A grants each employee 10 ordinary shares. There are no vesting conditions.

Because there are no vesting conditions, on 31 December 20X1 (grant date) employees of Entity A have an unconditional right to the shares. Consequently, on 31 December 20X1, Entity A recognises the staff cost in respect of the services received and a corresponding amount in equity.

Ex 9  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 exercise their options from 31 December 20X2. If an employee were to leave employment at Entity A before 31 December 20X2, they would still be entitled to exercise the options after 31 December 20X2.

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

Example—recognition when there are vesting conditions

Ex 10  The facts are the same as in Example 9. However, in this example, exercise of the share options is conditional upon the employee working for the entity throughout 20X2.

Because exercise is conditional upon the employee working throughout 20X2 (a vesting condition that is a service condition—see discussion below), the services to be rendered
by the employees as consideration for the share options will be received in 20X2 (the vesting period). Consequently, because those services are rendered by the employee in 20X2, Entity A recognises a staff cost and a corresponding amount in equity in 20X2.

Note: if it is also a condition that the employee must still be employed by Entity A at the date of exercise of the share option, the vesting period remains the year to 31 December 20X2; it is not extended to the date the option is actually exercised if this is after 31 December 20X2. The reason is that if an employee wishes to leave at any point after 31 December 20X2, the employee will be entitled to exercise his/her share options before leaving (providing that it is after 31 December 20X2). Consequently, it is only if the employee leaves before 31 December 20X2 that he/she will forfeit his/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 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—measurement of equity-settled share-based payment transactions**

When goods or services are received in an equity-settled share-based payment transaction, the transaction will be measured at an amount equal to the fair value of the goods or services received.

If that fair value cannot be estimated reliably, then the transaction is measured at an amount equal to the fair value of the equity instruments granted.

It is assumed that when the transaction is for services from employees, or from others providing similar services, the fair value of the services received cannot be estimated reliably and the transaction is measured at an amount equal to the fair value of the equity instruments granted.

A share option that is out of the money, that is, it has an exercise price that is higher than the current fair value of the share, may still have value, the value being dependent on the extent to which it is out of the money and the expectations about the future fair value of the share.
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This can be summarised as:

1. **Is the equity-settled share-based payment transaction for employee services or for similar services from others?**
   - **Yes**
   - **No**

2. **Can the fair value of the goods or services be estimated reliably?**
   - **Yes**
   - **No**

3. **Measure the transaction at the fair value of the goods or services received**
4. **Measure the transaction at the fair value (in accordance with Section 26) of the equity instruments granted**

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**Fair value measurement under Section 26 of the IFRS for SMEs**

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 *Glossary*).

When the fair value of the goods or services received can be estimated reliably, measuring fair value using the definition above should be consistent with the fair value as used generally within the *IFRS for SMEs*.

When the transaction is recognised and measured at the fair value of the equity instruments granted, either because the fair value of the goods or services cannot be estimated reliably or because it is a transaction for services from employees or others providing similar services, Section 26 contains some special requirements. As a result of these special requirements, some amounts will be measured at fair value using the definition above while others will be measured with certain features of the instruments being ignored for the purposes of measuring fair value of the equity. 
instrument granted. For example, when measuring the fair value of an instrument containing a service condition, an entity is required by Section 26 to measure fair value as though the instrument did not contain the service condition. See the Notes below paragraph 26.9 for a fuller explanation.

When the transaction is with employees or others providing similar services, the transaction is measured by reference to the fair value of the equity instruments granted and the date at which fair value is measured is the date of grant of the equity instruments. On the other hand, when the transaction is with anyone else, 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.

In addition, Section 26 contains a hierarchy for determining the fair value (after application, if necessary, of the special rules) of shares (see paragraph 26.10) and of share options and equity-settled share appreciation rights (see paragraph 26.11).

The measurement principle in Section 26 for equity-settled share-based payment transactions applies regardless of how the entity will source the shares. The important distinction made, for equity-settled share-based payment transactions, is that when an asset does not arise, there is an expense rather than a direct decrease in equity. Having recognised an asset or expense, the other side of the entry is to equity and Section 26 does not distinguish where in equity this entry is made.

The exact entries made when shares are transferred to the other party will depend on the legal requirements in the jurisdiction in which the entity is based and, in some jurisdictions, how the shares are sourced, for example whether new shares are issued or whether treasury shares are used. The examples in the remainder of this module that illustrate journal entries assume, unless stated otherwise, that the entity will be issuing new shares and that it is a requirement that proceeds for the issue of shares that are in excess of the par value(1) of the shares are to be recognised in a share premium account. The journal entries may be different in particular jurisdictions and in different circumstances.

**Examples—measurement, no vesting conditions**

**Ex 11** The facts are the same as in Example 6, in which Entity A purchased 100 computers for its call centre in exchange for issuing 20,000 of its ordinary shares. Assume that the cash selling price for each computer is CU500(2) and that the shares have a par value of CU1.

The selling price, assuming the purchase is from an independent vendor in an arm’s length transaction, is the best measure of the fair value of the computers and of Entity A’s ordinary shares being exchanged. In this example, fair value is consistent with that used generally within the IFRS for SMEs.

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(1) The term ‘par value’ is not used in all jurisdictions. Par value, when used, refers to the nominal value of a share, assigned by the company’s charter on formation.

(2) In this example, and in all other examples in this module, monetary amounts are denominated in ‘currency units (CU)’. 
Consequently, Entity A accounts for the transaction as follows:

\[
\begin{align*}
\text{Dr} & \quad \text{Asset: Property, plant and equipment—computers} & \text{CU50,000} \\
& \quad \text{Cr} & \quad \text{Equity—ordinary share capital} & \text{CU20,000} \\
& \quad \text{Cr} & \quad \text{Equity—share premium account} & \text{CU30,000}
\end{align*}
\]

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 on the basis of their estimated useful lives and residual values using a depreciation method that reflects the consumption of the service potential of the computers.

**Ex 12** The facts are the same as in Example 7, namely, that Entity A, as part of its ordinary activities, contracted for advice regarding a new marketing campaign from a local PR consultancy and the consultancy agreed to accept ordinary shares of Entity A as payment for its services. Assume that the consultancy advice had an invoice price of CU3,000 and that Entity A issued 100 ordinary shares with a par value of CU10 each.

The invoice value of the consultancy fees is the best measure of the fair value of the marketing advice and of Entity A’s ordinary shares being exchanged, assuming an arm’s length transaction between market participants.

Consequently, Entity A accounts for the transaction as follows:

\[
\begin{align*}
\text{Dr} & \quad \text{Profit or loss—marketing expense} & \text{CU3,000} \\
& \quad \text{Cr} & \quad \text{Equity—ordinary share capital} & \text{CU1,000} \\
& \quad \text{Cr} & \quad \text{Equity—share premium account} & \text{CU2,000}
\end{align*}
\]

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

**Ex 13** Entity A contracts with an IT consultancy company to receive services in setting up and installing 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 give 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.

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:

\[
\begin{align*}
\text{Dr} & \quad \text{Asset: Property, plant and equipment—IT equipment} & \text{CU210} \\
& \quad \text{Cr} & \quad \text{Equity—ordinary share capital} & \text{CU30} \\
& \quad \text{Cr} & \quad \text{Equity—share premium account} & \text{CU180}
\end{align*}
\]

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 14 The facts are the same as in Example 8, namely that Entity A grants each employee 10 ordinary shares on 31 December 20X1. There are no vesting conditions.

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 the services were provided by employees, the measurement date is the grant date of the shares. If the fair value on 31 December 20X1, the grant date, of all of the shares granted is £5,000, Entity A will make the following entry to record the equity compensation:

\[
\begin{align*}
\text{Dr} & \quad \text{Profit or loss—staff expense}^{(3)} & \quad \text{CU}5,000 \\
\text{Cr} & \quad \text{Equity} & \quad \text{CU}5,000 \\
\end{align*}
\]

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, i.e., ‘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. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity’s employ for a specified period of time. There might be performance conditions that must be satisfied, such as 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). All vesting conditions related to solely 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 necessary, if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. All market vesting conditions and non-vesting conditions shall be 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.

Notes

Vesting conditions are 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

\footnote{The exact entries within equity will depend upon a number of factors, such as whether Entity E uses existing shares, for example, uses shares held in treasury, or issues new shares, and if it issues new shares, upon what the legal requirements are in the jurisdiction in which Entity E was incorporated.}
Module 26 – Share-based Payment

require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and to meet specified performance targets (such as a specified increase in the entity’s profit over a specified period of time) (IFRS 2, Appendix A)\(^{(4)}\).

A performance condition might include a market condition. A *market condition* is 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 (IFRS 2, Appendix A).\(^{(5)}\)

The following flow chart 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:

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\(^{(4)}\) In the absence of explicit guidance in the *IFRS for SMEs* an entity can (but is not required to), in accordance with paragraph 10.6, consider the requirements and guidance in full IFRSs.

\(^{(5)}\) An unlisted entity may determine the price of its shares using a valuation technique as discussed in paragraphs 26.10(c) and 26.11(c).
An example of a market performance condition is achieving a specified increase in a share price and an example of a non-market performance condition is achieving a specified increase in profit.

Employee share-based payment transactions generally have vesting conditions attached. 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 vesting conditions**—the grant date ‘fair value’ of the equity instruments granted does not reflect these conditions. The fair value is measured as though these conditions did not exist. Instead, the conditions are reflected by estimating how they will affect the number of the equity instruments that will vest and accounting only for this number. 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. Only the number of equity instruments actually 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 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)—the grant date ‘fair value’ of the equity instruments granted is calculated taking these conditions into account. Having allowed, in measuring the grant date fair value of the equity instruments, for the possibility that the condition may not be satisfied, no adjustment is 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 was not met, there will still be a charge in the financial statements, equal to the grant date fair value (calculated by reflecting the conditions) multiplied by the number of equity instruments granted and adjusted only for the number not vesting, if any, as a result of service and non-market performance conditions not being satisfied.

- **Non-vesting conditions**—the grant date ‘fair value’ of the equity instruments granted is calculated taking into account non-vesting conditions. 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 conditions and other features of the equity instrument.

The requirements above mean that the approach to valuing an equity instrument at grant date is different when a vesting condition is a service condition or a non-market based performance condition, compared to when it is a non-vesting condition or a market-based performance condition. The IASB concluded that, for practicality and subjectivity reasons, the effect of service and non-market performance vesting conditions should not be included in the valuation of the instruments at grant date. However, these concerns about practical difficulties do not apply to market-based conditions because they can be incorporated into valuation models (IFRS 2 paragraphs BC 178 to BC 184).

The result of applying the requirements above is that for an equity-settled share-based payment transaction when there are service conditions or a non-market-based
performance condition, the resulting fair value amount does not represent fair value in accordance with the definition set out in the IFRS for SMEs. The difference is that the service conditions or non-market-based performance conditions have been excluded from the measurement; in other words, the measurement assumes that such conditions do not exist. As discussed above, the way in which the conditions are reflected in accounting for share-based payment transactions is by adjusting the number of equity instruments that the charge is applied to in calculating the expense.

Section 26 contains a hierarchy for determining the fair value (after application, if necessary, of the special rules in respect of vesting conditions) of shares (see paragraph 26.10) and of share options and equity-settled share appreciation rights (see paragraph 26.11).

**Example—measurement, transaction with employees, non-vesting and vesting conditions**

**Ex 15** Entity A runs a copper mining business. On 1 June 20X0 it introduces a long-term incentive scheme under which its sales employees will receive, in aggregate, 1,000 Entity A shares on 1 June 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.

Assume that dividends declared on the shares will accrue to the employees during the three-year period, that is, 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.

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. Accordingly it must be reflected in the fair value of the share award. This is the only condition; the employees will receive the shares on 1 June 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 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.

If Entity A instead changed the condition to be that the employees receive the shares on 1 June 20X3 if they were still employed on 31 May 20X3 (with no further conditions, including no condition about the level of the copper commodity index), the condition would be a service condition and thus, in accordance with Section 26, would not be reflected in the fair value of the share awards. The amount that Entity A would recognise in respect of the equity-settled share-based payment transaction would therefore be CU10,000 if all the employees remain employed by Entity A on 31 May 20X3. If some of the employees were no longer employed by Entity A on 31 May 20X3, the amount recognised would be CU10 multiplied by the number of shares that were given to those who were still employees; thus, if only 800 shares were given to employees, CU8,000 (CU10 × 800) would be recognised.
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The amount would be recognised as an expense over the three-year service period. For each period Entity A would estimate how many employees would still be employed by it on 31 May 20X3 and this would form the basis for the amount recognised. As Entity A prepares each set of financial statements it will update the estimate of employees expected to be employed by it on 31 May 20X3. For example, assume that Entity A prepares annual financial statements for the year ended 31 May and that:

- 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;
- 750 shares vest on 1 June 20X3 based on the number of employees still employed on 31 May 20X3.

The journal entries would be:

**Year 1 (Year ended 31 May 20X1)**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss—staff costs*</td>
<td>Equity</td>
</tr>
<tr>
<td>CU2,600</td>
<td>CU2,600</td>
</tr>
</tbody>
</table>

*To recognise the receipt of employee services in exchange for shares*

Calculation: 780 shares expected to vest \( \times \) CU10 grant date fair value of each share \( \times \) \( \frac{1}{3} \) years vesting period = CU2,600 recognised in Year 1.

**Year 2 (Year ended 31 May 20X2)**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss—staff costs*</td>
<td>Equity</td>
</tr>
<tr>
<td>CU2,400</td>
<td>CU2,400</td>
</tr>
</tbody>
</table>

*To recognise the receipt of employee services in exchange for shares*

Calculation: \( (750 \text{ shares expected to vest} \times \text{CU10 grant date fair value of each share} \times \frac{2}{3} \text{ years vesting period}) \) less CU2,600 recognised in Year 1 = CU2,400 recognised in Year 2.

**Year 3 (Year ended 31 May 20X3)**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss—staff costs*</td>
<td>Equity</td>
</tr>
<tr>
<td>CU2,500</td>
<td>CU2,500</td>
</tr>
</tbody>
</table>

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

Calculation: \( (750 \text{ shares (which vest on 1 June)} \times \text{CU10 grant date fair value of each share}) \) less CU5,000 recognised in Years 1 & 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.

If Entity A instead changed the condition so that the employees will only receive the shares on 1 June 20X3 if they are still employed on 31 May 20X3 and if the company’s profit before tax (PBT) increased by an average of five per cent per annum over the three-year period, then neither condition would be reflected in the fair value of the award. Accordingly, the total charge recognised in Entity A’s financial statements over the three years would be CU10 multiplied by the number of shares that were given to employees on 1 June 20X3. Thus, if the PBT target were not met and so no shares were...
given to employees, the aggregate expense over the three years in Entity A’s financial statements would be zero. 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 subsequently be reversed. If the PBT target were met but, because some employees had left during the three years, only 750 shares were given to employees, the charge would be CU7,500 (CU10 × 750) in total over the three years. The charge, if any, would be recognised over the three-year service period by initially estimating the expected outcome and each year revising that number in such a way that in the final year it is trued up to the actual outcome.

Alternatively, if Entity A only gives the shares to the employees on 1 June 20X3 if they are still employed by Entity A on 31 May 20X3 and if the company’s shares are worth at least CU11 on that date, the share price condition (a market condition) would be reflected in the fair value, but the service condition would not be reflected. 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 amount that Entity A would recognise in respect of the equity-settled share-based payment transaction would therefore be CU7.50 multiplied by the number of shares it expects to give to employees because they are still employed by Entity A on 31 May 20X3. If the share price condition is not met but, if it had been, 750 shares would have been given to employees, Entity A will recognise CU5,625 (CU7.50 × 750) in respect of the share award scheme even though no shares are actually given to employees. The amount would be recognised over the three-year service period; as 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 employed on 31 May 20X3.

Finally, if dividends on the shares did not accrue to the employees during the three years, an adjustment would need to be made for this so that the fair value of an award with no market or non-vesting conditions would not be CU10, but would be CU10 less an adjustment for the lack of dividend rights.

Examples—measurement when there are service vesting conditions

**Ex 16** 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 per cent of employees will leave during the three-year period and therefore forfeit their rights to the share options.\(^{(6)}\)

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.

\(^{(6)}\) This example is based on Scenario 1 of IFRS 2 IG Example 1A.
Module 26 – Share-based Payment

Year 1
Dr  Profit or loss—staff costs*  
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 years vesting period = CU200,000 recognised in Year 1.

Year 2
Dr  Profit or loss—staff costs*  
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. Similarly to year 1, 40,000 × CU15 grant date fair value of each option × 1/3 years vesting period = 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*  
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 years vesting period = 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; this might be to retained earnings, but the exact location within equity might depend on local legal requirements. Thus the net effect on equity each year is nil.

If the share options are subsequently exercised, the entity will give shares to the employees in exchange for receiving cash, the option exercise price; the entity will need to record this. Exactly how it 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, it 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 will vest in instalments over the vesting period. For example, an employee is 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 IFRS 2(7) 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 from the exercise of the options)”. The same approach could be taken by an entity applying the IFRS for SMEs.

(7) In the absence of explicit guidance in the IFRS for SMEs an entity can (but is not required to), in accordance with paragraph 10.6, consider the requirements and guidance in full IFRSs.
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Ex 17 The facts are the same as in Example 16. 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 per cent (100 employees) to 15 per cent (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 per cent to 12 per cent (60 employees).
- During Year 3, a further 15 employees leave (i.e. 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).  

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

**Year 1**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss—staff costs*</td>
<td>Equity</td>
<td>CU212,500</td>
</tr>
</tbody>
</table>

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 years vesting period = CU212,500 recognised in Year 1.

**Year 2**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss—staff costs*</td>
<td>Equity</td>
<td>CU227,500</td>
</tr>
</tbody>
</table>

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 years vesting period = 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**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss—staff costs*</td>
<td>Equity</td>
<td>CU224,500</td>
</tr>
</tbody>
</table>

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 years vesting period = 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 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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(8) This example is based on Scenario 2 of IFRS 2 IG Example 1A.
Examples—measurement when there are market vesting and service conditions

Ex 18 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 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 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 years)

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 years) 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 19 The facts are the same as in Example 18. 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 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 × \(\frac{1}{3}\) years)

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 × \(\frac{2}{3}\) years) 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). It is irrelevant to the accounting that the market condition (share price target) is not satisfied because that possibility 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 18.

Ex 20 The facts are the same as in Example 18. 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 × \(\frac{1}{3}\) years)
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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 that are 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 or share appreciation rights 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 should 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 vesting conditions, the measurement valuation is fair value as defined and used in other Sections of the IFRS for SMEs. For equity instruments for which there are service conditions and/or non-market vesting conditions, the measurement is fair value 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 market price if one is available. Generally, entities
using the IFRS for SMEs will not have an observable market price available, in which case such entities look to Tier Two and, if that is not possible, to Tier Three.

Further guidance on valuing shares where there is no observable market price available can be found in the educational material on “Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments” (see IFRS Foundation website at http://www.ifrs.org/Use-around-the-world/Education/FVM/Pages/FVM.aspx). The following table illustrates the valuation approaches and valuation techniques presented in that educational material:

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

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 the shares. At the end of 20X5 Entity T, under the plan, grants to employees the rights to 1,500 shares, which they will receive 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 shares in issue; all its shares have identical rights.

The only conditions to which the share award is subject are service conditions and non-market vesting conditions. These will be reflected in the staff costs expense\(^{(9)}\) by taking them into account, not when measuring the fair value of a share but, instead, when calculating the number of shares to apply that fair value to. The fair value of the shares at grant date (31 December 20X5) needs to be measured and this will be identical to the fair value of the shares of Entity T already in issue, with no adaptation necessary for the service and non-market vesting 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 move to Tier Two and see whether it can measure the fair value of the shares using entity-specific observable market data. An example of entity-specific observable market data would be if one of the shareholders in Entity T had recently sold all its shares to a

\(^{(9)}\) The amount will be recognised as an expense unless some or all of it qualifies for capitalisation.
third party. 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 moves to Tier Three and measures 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 then applying the chosen method requires further judgement. For example, when using an income method, in which future amounts, for example, cash flows (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 on “Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments” (see http://www.ifrs.org/Use-around-the-world/Education/FVM/Pages/FVM.aspx).

**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 it will deduct the fair value of its debt to give, as at the end of 20X5, the fair value of its equity in total. From this it can 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 conditions and non-market vesting conditions).

Entity T estimates its FCFF by first estimating its earnings before interest and tax (EBIT) and using that to derive free cash flow.
Module 26 – Share-based Payment

**Forecast of EBIT**

Entity T has a detailed budget for 20X6 and an outline budget for 20X7\(^{(10)}\). The Revenue and EBIT information from those budgets is as follows:

<table>
<thead>
<tr>
<th></th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>400</td>
<td>410</td>
</tr>
<tr>
<td>EBIT</td>
<td>100</td>
<td>102.5</td>
</tr>
</tbody>
</table>

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

Before scheduling these amounts, Entity T looks at 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:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>360</td>
<td>367</td>
<td>375</td>
<td>384</td>
<td>392</td>
</tr>
<tr>
<td>EBIT</td>
<td>86</td>
<td>88</td>
<td>121</td>
<td>87</td>
<td>98</td>
</tr>
<tr>
<td>EBIT as a percentage of revenue</td>
<td>24%</td>
<td>24%</td>
<td>32%</td>
<td>23%</td>
<td>25%</td>
</tr>
<tr>
<td>Increase in revenue from previous year</td>
<td>1.94%</td>
<td>2.18%</td>
<td>2.4%</td>
<td>2.08%</td>
<td>2.08%</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th></th>
<th>20X1CU’000</th>
<th>20X2CU’000</th>
<th>20X3CU’000</th>
<th>20X4CU’000</th>
<th>20X5CU’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>360</td>
<td>367</td>
<td>375</td>
<td>384</td>
<td>392</td>
</tr>
<tr>
<td>EBIT</td>
<td>86</td>
<td>88</td>
<td>121</td>
<td>87</td>
<td>98</td>
</tr>
<tr>
<td>Add/(deduct) non-recurring items</td>
<td>-</td>
<td>-</td>
<td>(25)</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>EBIT excluding non-recurring items</td>
<td>86</td>
<td>88</td>
<td>96</td>
<td>92</td>
<td>98</td>
</tr>
<tr>
<td>EBIT as a percentage of revenue</td>
<td>24%</td>
<td>24%</td>
<td>26%</td>
<td>24%</td>
<td>25%</td>
</tr>
<tr>
<td>Increase in revenue from previous year</td>
<td>1.94%</td>
<td>2.18%</td>
<td>2.4%</td>
<td>2.08%</td>
<td>2.08%</td>
</tr>
</tbody>
</table>

\(^{(10)}\) 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.
Module 26 – Share-based Payment

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:

<table>
<thead>
<tr>
<th>20X6</th>
<th>20X7</th>
<th>20X8</th>
<th>20X9</th>
<th>20Y0</th>
<th>20Y1</th>
<th>20Y2</th>
<th>......</th>
</tr>
</thead>
<tbody>
<tr>
<td>CU'000</td>
<td>CU'000</td>
<td>CU'000</td>
<td>CU'000</td>
<td>CU'000</td>
<td>CU'000</td>
<td>CU'000</td>
<td>......</td>
</tr>
<tr>
<td>Basis</td>
<td>Budget</td>
<td>Budget</td>
<td>2%↑</td>
<td>2%↑</td>
<td>2%↑</td>
<td>1%↑</td>
<td>1%↑</td>
</tr>
<tr>
<td>EBIT</td>
<td>100</td>
<td>102.5</td>
<td>104.6</td>
<td>106.6</td>
<td>108.8</td>
<td>112.1</td>
<td>113.2</td>
</tr>
</tbody>
</table>

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.\(^{(1)}\)

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

<table>
<thead>
<tr>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>CU’000</td>
<td>CU’000</td>
</tr>
<tr>
<td>EBIT</td>
<td>100</td>
</tr>
<tr>
<td>Multiply by: (1.0 less unlevered effective tax rate of 30%)</td>
<td>× 0.7</td>
</tr>
<tr>
<td></td>
<td>70</td>
</tr>
<tr>
<td>Add: annual depreciation and amortisation</td>
<td>26</td>
</tr>
<tr>
<td>Less: reinvestment requirements</td>
<td>(26)</td>
</tr>
<tr>
<td>Less: increase in net working capital</td>
<td>(2.4)</td>
</tr>
<tr>
<td>FCFF</td>
<td>67.6</td>
</tr>
</tbody>
</table>

\(^{(1)}\) 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:

\[
FCFF = EBIT (1 - t) + \text{Depreciation and amortisation} - \text{RR} - \text{Net increases in NWC}
\]
Entity T extrapolates this, using the same two per cent and one per cent growth rate expectations for the adjustments to get from EBIT to FCFF as it used to extrapolate EBIT, as follows:

<table>
<thead>
<tr>
<th></th>
<th>20X6</th>
<th>20X7</th>
<th>20X8</th>
<th>20X9</th>
<th>20Y0</th>
<th>20Y1</th>
<th>20Y2</th>
<th>………</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBIT</td>
<td>100</td>
<td>102.5</td>
<td>104.6</td>
<td>106.6</td>
<td>108.8</td>
<td>112.1</td>
<td>113.2</td>
<td></td>
</tr>
<tr>
<td>Adj*</td>
<td>(32.4)</td>
<td>(32.7)</td>
<td>(33.4)</td>
<td>(34.0)</td>
<td>(34.7)</td>
<td>(37.3)</td>
<td>(37.6)</td>
<td></td>
</tr>
<tr>
<td>FCFF</td>
<td>67.6</td>
<td>69.8</td>
<td>71.2</td>
<td>72.6</td>
<td>74.1</td>
<td>74.8</td>
<td>75.6</td>
<td>………</td>
</tr>
</tbody>
</table>

*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 is the cash flows of the entity that are 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 given in the Educational material on “Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments” (see http://www.ifrs.org/Use-around-the-world/Education/FVM/Pages/FVM.aspx).

Entity T estimates its cost of equity using the capital asset pricing model (CAPM) 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 per cent.

**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 that are 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:

\[
\text{Enterprise Value} = \sum PV^* \text{ of FCFF for 20X6–20Y0} + \text{PV of Terminal Value for 20Y1+}
\]

*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 to 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 it is calculated at the end of 20Y0 and is the discounted amount, at that date, of the cash flows that are estimated to be generated in 20Y1 and subsequent years.

Entity T's enterprise value is therefore calculated as:
### Module 26 – Share-based Payment

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>20X6</th>
<th>20X7</th>
<th>20X8</th>
<th>20X9</th>
<th>20Y0</th>
<th>End of 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>FCFF (CU’000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Terminal Value (a)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>712,77143</td>
</tr>
<tr>
<td>Discount factor (b)</td>
<td>0.94703</td>
<td>0.84935</td>
<td>0.76175</td>
<td>0.68318</td>
<td>0.61272</td>
<td>0.58026</td>
<td></td>
</tr>
<tr>
<td>PV of FCFF for 20X6 to 20Y0 and PV of terminal value (in CU’000)</td>
<td>686.138</td>
<td>64.0191</td>
<td>59.2848</td>
<td>54.2366</td>
<td>49.5992</td>
<td>45.4027</td>
<td>413.5956</td>
</tr>
</tbody>
</table>

(a) The terminal value at the end of 20Y0 is the discounted amount, at that date, of the cash flows that are estimated to be generated in 20Y1 and subsequent years. It is calculated at that date because thereafter a constant 1 per cent per annum 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 to 20Y0 inclusive assume that the cash flows are even throughout each year and have been calculated as follows: \(1/(1 + \text{WACC})^{n - 0.5}\), 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 \(1/(1 + \text{WACC})^n\).

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 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

\(\text{To recognise the receipt of employee services in exchange for 1,500 share awards}\)

\(1,500 \text{ options} \times \text{CU14.014}\)

* These entries assume that the staff costs do not qualify for capitalisation.
Module 26 – Share-based Payment

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 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) should 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 should derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Notes

For share options granted to employees of an SME, there will not be many cases in which market prices are available. Equally, entity-specific observable market data for equivalent options will generally not be available either. Companies will therefore generally be using Tier Three. In the absence of explicit guidance in the IFRS for SMEs, an entity, in accordance with paragraph 10.6, can, but is not required to, consider the requirements and guidance in full IFRSs. The notes below are taken from the application guidance in IFRS 2.

All option pricing models take into account, as a minimum, the following factors:

(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 (IFRS 2, B6).

Other factors that knowledgeable, willing market participants would consider in setting the price shall also be taken into account (except for service and non-market vesting conditions that are excluded from the fair value calculation by Section 26 and IFRS 2). For example, a share option granted to an employee typically cannot be exercised during specified periods (e.g., during the vesting period or, for options granted over shares in a listed parent, during periods specified by securities regulators). This factor shall be taken into account if the option pricing model applied would
otherwise assume that the option could be exercised at any time during its life (IFRS 2, B7 and B8).

However, if an entity uses an option pricing model that values options that can be exercised only at the end of the options' life, no adjustment is required for the inability to exercise them during the vesting period (or in other periods during the options’ life), because the model assumes that the options cannot be exercised during those periods (IFRS 2, B8).

Factors that a knowledgeable, willing market participant would not consider in setting the price of a share option (or other equity instrument) shall not be taken into account when estimating the fair value of share options (or other equity instruments) granted. For example, for share options granted to employees, factors that affect the value of the option from the individual employee's perspective only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant (IFRS 2, B10). (12)

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

Ex 22 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 share 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.

<table>
<thead>
<tr>
<th>Year 1</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr</td>
<td></td>
<td>CU12,500</td>
</tr>
<tr>
<td>Cr</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit or loss—staff costs*</td>
<td>CU12,500</td>
<td></td>
</tr>
<tr>
<td>Equity—reserves</td>
<td></td>
<td>CU12,500</td>
</tr>
</tbody>
</table>

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

(15,000 options × CU2.50 × 1/3)

(12) Note that proprietary option pricing software is available to companies that need to develop fair value estimates for options. In addition, some companies contract with valuation experts to assist them in this process.
An unlisted entity is unlikely to have historical market-based share price information to consider when estimating expected volatility, which is one of the inputs to option pricing models. Some factors that the entity may consider to estimate volatility are set out below.

- In some cases, an unlisted entity that regularly issues options or shares to employees (or other parties) might have set up an internal market for its shares. The volatility of those share prices could be considered when estimating expected volatility.

- Alternatively, the entity could consider the historical or implied volatility of similar entities that are listed, for which share price or option price information is available, to use when estimating expected volatility. This may be appropriate if the entity has based the value of its shares on the share prices of similar listed entities.

- If the entity has not based its estimate of the value of its shares on the share prices of similar listed entities, and has instead used another valuation methodology to value its shares, the entity could derive an estimate of expected volatility consistent with that valuation methodology. For example, the entity might value its shares on a net asset or earnings basis. It could consider the expected volatility of those net asset values or earnings.

(IFRS 2, B27–B30)
Modifications to the terms and conditions on which equity instruments were granted

26.12 If an entity modifies the vesting conditions 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, 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.

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 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.

Paragraph 26.12 discusses modifications to grants of equity-settled share-based payment transactions with employees. The guidance could, in accordance with paragraph 10.5, also be applied to grants to parties other than employees that are measured by reference to the fair value of the equity instruments granted rather than the fair value of the goods or services received.
Examples—modifications

Ex 23 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 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.\(^\text{[13]}\)

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, and 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 expected employee departures over the three-year vesting period is 110 employees. The entity estimates that, at the date of repricing, the fair value of each of the original share options granted (i.e. 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 expected employee departures over the three-year vesting period to 105 employees.

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

\[
\begin{align*}
\text{Dr Profit or loss—staff costs*} & \quad \text{CU195,000} \\
\text{Cr Equity—reserves} & \quad \text{CU195,000}
\end{align*}
\]

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

\[
((500 \text{ employees less 110 expected to forfeit}) \times 100 \text{ options} \times \text{CU15} \times \frac{1}{3} \text{ years})
\]

Year 2

\[
\begin{align*}
\text{Dr Profit or loss—staff costs*} & \quad \text{CU259,250} \\
\text{Cr Equity—reserves} & \quad \text{CU259,250}
\end{align*}
\]

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

\[
((500 \text{ employees less 105 expected to forfeit}) \times 100 \text{ options} \times [(\text{CU15} \times \frac{2}{3} \text{ years}) + (\text{CU3 repricing} \times \frac{1}{2} \text{ years})]) \text{ less CU195,000 recognised in Year 1})
\]

\(^{[13]}\) Adapted from IFRS 2 IG Example 7.
Module 26 – 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 (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, 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 24 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. 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 and are therefore reflected by recognising an expense only in respect of those instruments that vest. 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).

(14) Adapted from IFRS 2 IG Example 8.
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

Sometimes a new award is granted in connection with a cancellation or settlement. It may be appropriate to account for the combined effect of the cancellation or settlement and the new award as a modification of the original grant, which is the treatment required by IFRS 2, paragraph 28(c)(15) when a new grant is identified as a replacement for cancelled instruments.

The IFRS for SMEs is silent on how an entity should account for a 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, 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 purchase of a share. This might suggest that the payment is deducted from equity. As stated above, the IFRS for SMEs 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 is charged as an additional charge for the services of the employees. This treatment would also be consistent with that required by IFRS 2, paragraph 28(b).

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

Example—cancellations

Ex25 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.

\[\text{(15)}\] In the absence of explicit guidance in the IFRS for SMEs an entity can (but is not required to), in accordance with paragraph 10.6, consider the requirements and guidance in full IFRSs.
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 × 3/3 years)

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 × 3/3 years) 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 staff costs. 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.
Module 26 – Share-based Payment

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

As explained above, a cash-settled share-based payment transaction occurs when an entity receives goods or services in exchange for a payment in cash, or other assets, which is calculated based on the price of the entity's shares or other equity instruments. The payment is ‘based on’ the price of the entity’s shares or other equity instruments; it may be a multiple of the entity’s share price, say, 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, say, 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. However, because cash is ultimately paid out, the liability has to be remeasured each year 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 26 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 shown below.\(^{[16]}\)

\(^{[16]}\) Based on IFRS 2 IG example 12.
### Module 26 – Share-based Payment

#### Year Calculation

<table>
<thead>
<tr>
<th>Year</th>
<th>Calculation</th>
<th>Expense* (CU)</th>
<th>Liability (CU)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(500—95) employees × 100 SARs × CU14.40 × 1/3</td>
<td>194,400</td>
<td>194,400</td>
</tr>
<tr>
<td>2</td>
<td>(500—100) employees × 100 SARs × CU15.50 × 2/3—CU194,400</td>
<td>218,933</td>
<td>413,333</td>
</tr>
<tr>
<td>3(a)</td>
<td>(500—97—150) employees × 100 SARs × CU18.20—CU413,333 + 150 employees × 100 SARs × CU15.00</td>
<td>47,127</td>
<td>460,460</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>225,000</td>
<td></td>
</tr>
<tr>
<td>4(b)</td>
<td>(253—140) employees × 100 SARs × CU21.40—CU460,460 + 140 employees × 100 SARs × CU20.00</td>
<td>(218,640)</td>
<td>241,820</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>280,000</td>
<td></td>
</tr>
<tr>
<td>5(c)</td>
<td>CU0—CU241,820 + 113 employees × 100 SARs × CU25.00</td>
<td>(241,820)</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>282,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>40,680</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>787,500</td>
<td></td>
</tr>
</tbody>
</table>

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

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 is because the fair value reflects the fact that the SARs are exercisable until the end of Year 5 and so, in addition to the intrinsic 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/her SARs he/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.
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 Part Three.

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 Part Three.

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, whereby 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

Often, share-based payment transactions with cash alternatives are 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 identical terms.

Examples—cash alternative

Ex 27 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 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.

The fair value of the cash-settled and equity-settled options is the same, so the option has not been structured in such a way that the equity 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 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:
Module 26 – Share-based Payment

<table>
<thead>
<tr>
<th>Year</th>
<th>Calculation</th>
<th>Expense* (CU)</th>
<th>Cumulative liability (CU)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,000 phantom shares × CU52 × 3/3</td>
<td>17,333</td>
<td>17,333</td>
</tr>
<tr>
<td>2</td>
<td>1,000 phantom shares × CU55 × 2/3— CU17,333</td>
<td>19,334</td>
<td>36,667</td>
</tr>
<tr>
<td>3</td>
<td>1,000 phantom shares × CU60— CU36,667</td>
<td>23,333</td>
<td>60,000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>60,000</td>
</tr>
</tbody>
</table>

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

If an employee chooses to take shares rather than cash at the end of Year 3, the IFRS for SMEs does not specify the accounting. If the employee chose to take shares there would no longer be a liability and Entity W would transfer the CU60,000 out of liabilities. The remaining question is how to account for the debit side of the entry. One possible treatment would be to debit the amount to equity. This is the treatment required by IFRS 2, paragraph 39(17), which states that the cash forgone is regarded as consideration for the equity instruments issued.

Ex 28 Entity W grants to a number of employees the right to choose either 1,200 shares or a right to 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 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.

The fair value of the equity-settled option is significantly higher than that of the cash-settled option, so that economically the expectation is that each employee will choose the equity rather than the cash and the cash option 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 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:

[17] In the absence of explicit guidance in the IFRS for SMEs an entity can (but is not required to), in accordance with paragraph 10.6, consider the requirements and guidance in full IFRSs.
Module 26 – Share-based Payment

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 × \(\frac{1}{3}\) years)

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 × \(\frac{2}{3}\) years) 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:

<table>
<thead>
<tr>
<th>Year</th>
<th>Calculation</th>
<th>Expense (CU)</th>
<th>Equity (CU)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1,200 shares × CU50 × (\frac{1}{3})</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>2</td>
<td>1,200 shares × CU50 × (\frac{2}{3}) = CU20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>3</td>
<td>1,200 shares × CU50—CU40,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>60,000</td>
<td></td>
</tr>
</tbody>
</table>
Module 26 – Share-based Payment

Group plans

26.16 If a share-based payment award is granted by a parent entity to the employees of one or more subsidiaries in the group, and the parent presents consolidated financial statements using either the IFRS for SMEs or full IFRSs, such subsidiaries are permitted to recognise and measure share-based payment expense (and the related capital contribution by the parent) on the basis of a reasonable allocation of the expense recognised for the group.

Government-mandated plans

26.17 Some jurisdictions have programmes established under law by which equity investors (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). These are equity-settled share-based payment transactions within the scope of this section. 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.

Example—cannot identify the specific goods or services received under government-mandated plan

Ex 29 Following the introduction of new legislation, an entity gives 100 shares to each of ten employees meeting 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. Consequently, because there is no asset identified as part of the transaction, 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 (eg 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.
   (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 recognises and 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.

(b) the total carrying amount at the end of the period for liabilities arising from share-based payment transactions.
Ex 30 The following example illustrates the disclosure requirements for share-based payments.\(^{(18)}\)

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.

<table>
<thead>
<tr>
<th>Type of arrangement</th>
<th>Senior management share option plan</th>
<th>General employee share option plan</th>
<th>Executive share plan</th>
<th>Senior management share appreciation rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of grant</td>
<td>1 January 20X4</td>
<td>1 January 20X5</td>
<td>1 January 20X5</td>
<td>1 July 20X5</td>
</tr>
<tr>
<td>Number granted</td>
<td>50,000</td>
<td>75,000</td>
<td>50,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Contractual life</td>
<td>10 years</td>
<td>10 years</td>
<td>4 years</td>
<td>3 years</td>
</tr>
<tr>
<td>Settlement type</td>
<td>Equity</td>
<td>Equity</td>
<td>Equity</td>
<td>Cash</td>
</tr>
<tr>
<td>Vesting conditions</td>
<td>1.5 years’ service and achievement of a room occupancy target, which was achieved.</td>
<td>Three years’ service.</td>
<td>Four years’ service and achievement of a target growth in profit before tax.</td>
<td>Three years’ service and achievement of a target increase in revenue per available room.</td>
</tr>
</tbody>
</table>

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 liability for the share appreciation rights was also estimated by applying a binomial option pricing model. The binomial option pricing model was chosen by the directors because it allows for the early exercise of options and is regarded as suitable for when options have 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.

Share price, for the executive share plan 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, and when

\(^{(18)}\) The illustrative example is not intended to be a template or model and is therefore not exhaustive. For example, it does not illustrate the disclosure requirements in paragraph 26.21.
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.

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

<table>
<thead>
<tr>
<th></th>
<th>20X4</th>
<th>20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of options</td>
<td>Weighted average exercise price</td>
</tr>
<tr>
<td>Outstanding at start of year</td>
<td>0</td>
<td>–</td>
</tr>
<tr>
<td>Granted</td>
<td>50,000</td>
<td>CU40</td>
</tr>
<tr>
<td>Forfeited</td>
<td>(5,000)</td>
<td>CU40</td>
</tr>
<tr>
<td>Exercised</td>
<td>0</td>
<td>–</td>
</tr>
<tr>
<td>Outstanding at end of year</td>
<td>45,000</td>
<td>CU40</td>
</tr>
<tr>
<td>Exercisable at end of year</td>
<td>0</td>
<td>CU40</td>
</tr>
</tbody>
</table>

Expense arising from share-based payment transactions: 495,000
Closing balance of liability for share appreciation rights: 98,867

Closing balance of liability for share appreciation rights: 98,867
SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the IFRS® for SMEs to transactions and events often requires judgement. Information about significant judgements and key sources of estimation uncertainty is useful in assessing the financial position, financial performance and cash flows of an entity. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Furthermore, in accordance with 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 require disclosure of information about particular judgements and estimation uncertainties.

Significant estimates and judgements arise mainly from two sources in the accounting for share-based payments:

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, the 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.

In many situations involving SMEs’ shares, significant estimates and judgements are made in determining share prices because the shares are not actively traded in a market. Directors of SMEs must use their judgement to ensure they adopt the most appropriate valuation method to determine fair value. 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 interest rate must be selected).

In estimating the fair value of share options an option pricing model will generally be used. When option pricing models are used, the following inputs will reflect management’s 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.(19)

(19) IFRS® for SMEs, paragraph 26.11(c).
Module 26 – Share-based Payment

When there is no listed share price, making the judgements and estimates above can be even more problematic; for example, trying to estimate expected volatility when there is no record of historical volatility. If an entity has estimated the share price on a net assets basis, one possibility is to estimate expected volatility of share price by reference to the expected volatility of the net assets (IFRS 2, paragraph B30).\(^{(20)}\)

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 conditions**

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, the entity revises that estimate if necessary, if new information indicates that the number of equity instruments expected to vest differs from previous estimates. Similarly, on vesting date, the entity revises 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 above two main areas of judgement, 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.

\(^{(20)}\) In the absence of explicit guidance in the IFRS for SMEs an entity can (but is not required to), in accordance with paragraph 10.6, consider the requirements and guidance in full IFRSs.
Module 26 – Share-based Payment

COMPARISON WITH FULL IFRSs

Full IFRSs (see IFRS 2 Share-based Payment) and the IFRS for SMEs (see Section 26 Share-based Payment) share the same principles for accounting and reporting of share-based payment transactions. However, the IFRS for SMEs is drafted in simple language with less guidance on how to apply the principles than is provided in full IFRSs, for example, there is less guidance on how to account for cancellations and settlements in Section 26 of the IFRS for SMEs than there is in IFRS 2. The IFRS for SMEs contains fewer disclosure requirements than are in IFRS 2, although in addition to eliminating some of the requirements of IFRS 2, it introduces three disclosures that are not in IFRS 2. In addition, the following highlights some of the recognition and measurement simplifications that have been made.

If, when accounting under IFRS 2, the fair value of equity instruments cannot be estimated reliably, an entity may measure the equity 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). This alternative is not included in Section 26 because intrinsic value requires knowing the fair value of the underlying shares and so this would be required at each date when the share option (or other share-based payment) is being measured, which would be on initial recognition, at the end of each subsequent reporting period and on final settlement.

Paragraph 26.12 of the IFRS for SMEs specifies how to account for the modification of the vesting conditions of an equity-settled share-based payment transaction with an employee. IFRS 2, on the other hand, specifies how to account for the modification of all equity-settled share-based payment transactions when the measurement of the goods or services received is by reference to the fair value of the equity instruments granted; it is not limited to equity-settled share-based payment transactions with employees.

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. The IFRS for SMEs does not address this issue.

IFRS 2 specifies that the effects of expected early exercise shall be taken into account when measuring the fair value of a share-based payment (see paragraph B9 of IFRS 2). The IFRS for SMEs does not have similar explicit requirements.

IFRS 2 also contains application guidance illustrating that when share options or other equity instruments vest in instalments, each instalment should be treated as a separate option grant. The IFRS for SMEs does not contain such guidance.

The IFRS for SMEs contains a simplification with regard to share-based payment transactions with cash alternatives. Paragraph 26.15 specifies that when the 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:

(a) the entity has a past practice of issuing equity instruments under similar transactions; or

(b) the option to settle in cash has no commercial substance.

In circumstances (a) and (b), the transaction is accounted for as being equity-settled.
Module 26 – Share-based Payment

IFRS 2, on the other hand, requires an entity to account for such a 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/or to account for it as an equity-settled share-based payment transaction to the extent that no such liability has been incurred (paragraph 34). In particular, when the holder has the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, IFRS 2 requires the entity to account for the debt component as a cash-settled share-based payment transaction and require the difference, if any, between the fair value of the entire transaction (either the fair value of the goods and services received from non-employees or the fair value of the instrument if held by employees) and the fair value of the debt component to be accounted for as an equity component of the compound financial instrument that is created.

There are a number of terms that are defined differently in the IFRS for SMEs to the way in which they are defined in IFRS 2. In addition, there are a number of defined terms in IFRS 2 that are not included in the IFRS for SMEs.

For share-based payment transactions among group entities, IFRS 2 contains explicit guidance, whereas the IFRS for SMEs is silent on these details. The IFRS for SMEs, however, does allow a simplification: when a parent grants an award to employees of its subsidiary and the parent presents consolidated financial statements using either the IFRS for SMEs or full IFRSs, the subsidiary is permitted to recognise and measure the expense and related capital contribution on a reasonable allocation of the group expense.

Section 26 is silent on the topic of options with a reload feature whereas IFRS 2 contains specific guidance. IFRS 2 does not permit the reload feature to be reflected in the fair value of the options granted at measurement date but instead requires a reload option to be accounted for as a new option if and when granted.
Test your knowledge of the requirements for accounting and reporting share-based payment transactions in accordance with the IFRS for SMEs by answering the questions below.
Once you have completed the test check your answers against those set out below this test.

Mark the box that represents the most correct answer. Assume all amounts are material.

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 (equity-settled share-based payment) 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 employees are unconditionally entitled to those share-based payments.
- (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, which is assumed to always be the case for transactions with an employee or others providing similar services.
Module 26 – Share-based Payment

Question 4
For 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 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
On vesting date, the entity:
- (a) never adjusts for the number of equity instruments that ultimately vest.
- (b) revises the estimate to equal the number of equity instruments that ultimately vest for vesting conditions based on employee service and for vesting conditions based on non-market performance.
- (c) revises the estimate to equal the number of equity instruments that ultimately vest for vesting conditions based on employee service and for vesting conditions based on market performance.
- (d) revises the estimate to equal the number of equity instruments that ultimately vest for all vesting conditions.

Question 7
If measuring the fair value of shares (and the related goods or services received) 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.
Module 26 – Share-based Payment

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

For a cash-settled share-based payment transaction for employee services that is cash-settled immediately it vests and in respect of which it is not appropriate to capitalise the staff costs, the entity:

☐ (a) recognises in profit or loss, in the final year, the cash paid out to the employees.

☐ (b) recognises in profit or loss, evenly over the vesting period, the cash paid out to the employees.

☐ (c) recognises in profit or loss, over the vesting period, the estimate of the cash to be paid out to the employees. Until the liability is settled the fair value of the liability is remeasured at each reporting date, and at the date of settlement, with changes in fair value recognised in profit or loss, resulting in the total of all the charges equating to the amount of cash paid out to the employees.

☐ (d) recognises in profit or loss, over the vesting period, the grant date fair value of the liability.

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:

☐ (a) the entity accounts for the transaction as a cash-settled share-based payment.

☐ (b) the entity accounts for the transaction as a cash-settled share-based payment unless the entity has a past practice of settling by issuing equity instruments.

☐ (c) the entity accounts for the transaction as a cash-settled share-based payment transaction unless the option to settle in cash has no commercial substance.

☐ (d) the entity accounts for the transaction as a cash-settled share-based payment transaction unless the entity has a past practice of settling by issuing equity instruments or the option to settle in cash has no commercial substance.
Module 26 – Share-based Payment

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 certain 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 grant date the value of the company’s shares is CU30; this is the amount per share that a shareholder could expect to receive if he/she sold their shares in the company on that date. The company plans to pay no dividends over the next three years because it has embarked upon a major capital-intensive project, but expects to resume paying dividends after this date. All eligible employees remain employed by Company A at the end of the three-year period. Which of the following are true:

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

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

☐ (c) if the share price on vesting date is CU35, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000) less an adjustment to reflect the share price and employment conditions.

☐ (d) if the share price on vesting date is CU35, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000) less an adjustment to reflect the share price condition.

☐ (e) if the share price on vesting date is CU32, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000).

☐ (f) if the share price on vesting date is CU32, Company A charges, over the three years as remuneration expense, nothing because no shares vest at the end of the three-year period.

☐ (g) if the share price on vesting date is CU32, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000) less an adjustment to reflect the share price and employment conditions.

☐ (h) if the share price on vesting date is CU32, Company A charges, over the three years as remuneration expense, CU30,000 (CU30 × 1,000) less an adjustment to reflect the share price condition.
Module 26 – Share-based Payment

Question 12

The accounting for which of the following transactions is specified in a Section of the IFRS for SMEs 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. Because the fair value of the liability is remeasured at each reporting date, the charge will not be evenly spread over the vesting period and so (b) is incorrect.
Q10 (d) See paragraph 26.15
Q11 (d) & (h) 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 accounting and reporting share-based payment transactions in accordance with the IFRS for SMEs by solving the case studies below.

Once you have completed the case studies check your answers against those set out below this test.

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. Entity M cannot determine directly the fair value of the marketing services received. 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 all employees who worked for the company for the entire year. The intention was to make the bonus approximately equal to one per cent of the total payroll (excluding the bonus), subject to issuing whole numbers of shares. Upon receipt of the shares, which was on 31 December, employees had the immediate and unconditional right to sell the shares. 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 payroll 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.

Part A:
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.

Part B:
Discuss how management might determine the value of the business in order to then determine the fair value of Entity M’s shares.
Module 26 – Share-based Payment

**Answer to case study 1: Part A**

### 30 January 20X1

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit or loss—marketing expense</strong></td>
<td><strong>Equity</strong></td>
<td>CU10,400</td>
</tr>
</tbody>
</table>

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

Note: because the fair value of the marketing services received cannot be measured directly, Entity M estimates their fair value based on the fair value of the shares granted in exchange for the services (see paragraph 26.7) (ie 400 shares × CU26 per share).

### 31 December 20X2

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit or loss—staff bonus</strong></td>
<td><strong>Equity</strong></td>
<td>CU84,000</td>
</tr>
</tbody>
</table>

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

Note: because the share-based payment vests at grant date (at 31 December 20X2), the employees of Entity E have 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 employees' 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

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset: Property, plant and equipment—equipment</strong></td>
<td><strong>Equity</strong></td>
<td>CU110,000</td>
</tr>
</tbody>
</table>

**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 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.
The valuation methods that can be used are not specified in Section 26. In the absence of an observable market price, the entity’s directors must use entity-specific observable market data, such as a recent sale of shares by one of the entity’s shareholders, if available (paragraph 26.10(b)). If such information is not available, the entity’s directors must use their judgement to apply the most appropriate valuation method to determine the fair value of equity instruments (paragraph 26.10(c)). Paragraphs 11.28 and 11.29 of the IFRS for SMEs provide guidance about valuation methods for measuring financial instruments. The fair value of unquoted equity instruments may be determined by estimating the fair value of the business. Often the value attributable to the equity holders is derived indirectly by valuing the business funded by all capital providers, both debt and equity holders, and then deducting from this the fair value of the debt to give the fair value of the business attributable to the equity holders. Valuation techniques that may be relevant for consideration by the directors when valuing the business include the following:

Market approach: the market approach uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business (IFRS 13, paragraph B5). Under a market approach, therefore:

- A recent transaction price for an identical or similar instrument in the same entity would form a good starting-point for valuing the entity; it would be necessary to assess whether there had been any subsequent significant internal or external changes in the environment in which the entity operates that would change the price of the transaction if it were to take place at the measurement date, rather than when it did take place.

- If there are no such recent transactions, an alternative is to determine valuation multiples, such as price-earnings ratio or an earnings (eg EBIT) multiple, for equity instruments in an entity or entities that are similar to the one being valued, for example, a similar entity with equity that is traded or a similar entity that has recently been acquired by another entity. These would form a good starting-point for valuing the entity; it would be necessary to assess differences between the entities that would influence a transaction price and, if the multiple was derived from a recent transaction, to assess whether there had been any subsequent significant changes in the environment in which the entities operate that would change the price of the transaction and whether there were any other factors that would have influenced the price. A valuation derived from a multiple of EBIT would be a valuation of the business funded by all capital providers and the value of the equity would only be determined after deducting the fair value of the debt. Any assumptions would need to be the same as those that a market participant would use.

Income approach: the income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts (IFRS 13, paragraph B10). Examples of valuation techniques that are relevant to valuing a business include: the discounted cash flow (DCF) method; dividend discount model (DDM);

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(21) The material is drawn from IFRS 13 Fair Value Measurement, paragraphs B5–B13, and from the Education material Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments. In the absence of explicit guidance in the IFRS for SMEs an entity can (but is not required to), in accordance with paragraph 10.6, consider the requirements and guidance in full IFRS.
constant-growth DDM; and the capitalisation model. Under the DCF method the future expected cash flows (available to both the equity and debt capital providers or only to the equity capital providers) are discounted by the cost of capital (either the cost of equity and debt combined or the cost of equity only). A large number of estimations is required, for example, when deriving the future expected cash flows management may start by estimating future budgets for the operating activities. Any assumptions would need to be the same as those that a market participant would use.

Adjusted net asset method: this is a method that is more appropriate for an entity whose value derives from holding assets rather than from using the assets as part of a broader business, such as using the assets to generate stock items that are sold to external parties. Similarly, it may be appropriate for businesses that are in the very early stages of development. The method involves valuing the individual assets and liabilities, recognised and unrecognised, of a business. It takes its name from the fact that the method can be depicted as taking the net assets as presented in the statement of financial position and adjusting them from carrying amount to fair value and by including assets and liabilities that may not be recognised in the statement of financial position. The fair values of the individual assets and liabilities can be derived using a variety of valuation techniques; they do not all have to be valued using the same valuation technique. Hence the adjusted net asset method can be seen as a combination of valuation techniques, although all of them should be consistent with the two approaches described above (income approach and market approach) or with the cost approach (which may be relevant for individual assets within the net assets).

When Entity M purchased the equipment on 2 October 20X3, it had a market transaction involving its shares. For the purposes of measuring other share-based transactions, management would need to determine why there was a difference between the selling price of the equipment (CU110,000) and the value of the shares given in exchange for the equipment (CU116,000). For example, it may indicate that the directors need to recalibrate their calculations for measuring the fair value of the shares. However, in this case, assume that the supplier of the equipment wanted shares of a higher total value than if it had received cash, in order to compensate it for the additional risk it has taken on by accepting shares that are not publicly traded; this is likely to be something that was discussed during the negotiations with the supplier of the equipment and so management would be aware of this. The explanation of extra compensation for a less liquid payment might be reasonable in light of the magnitude of this difference.
Module 26 – Share-based Payment

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.

40 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. At 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 at 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 none of Entity N’s employee compensation qualifies for capitalisation.
Module 26 – Share-based Payment

Answer to case study 2

(a) The condition that the 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 \( [(1,000 \text{ employees} - 100 \text{ expected forfeiture}) \times 10 \text{ options} \times \text{CU5 fair value per option}] \). If there were no repricing 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

\[
\begin{align*}
\text{Dr} & \quad \text{Profit or loss—staff costs} & \text{CU14,833} \\
\text{Cr} & \quad \text{Equity—reserves} & \text{CU14,833}
\end{align*}
\]

\[(1,000 \text{ employees} - 110 \text{ expected forfeiture}) \times 10 \text{ options} \times \text{CU5} \times \frac{1}{3} \text{ years} \]

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

For the year ended 31 December 20X2

\[
\begin{align*}
\text{Dr} & \quad \text{Profit or loss—staff costs} & \text{CU23,950} \\
\text{Cr} & \quad \text{Equity—reserves} & \text{CU23,950}
\end{align*}
\]

\[
[(1,000 \text{ employees} - 105 \text{ expected forfeiture}) \times 10 \text{ options} \times ((\text{CU5 original} \times \frac{2}{3} \text{ years}) + (\text{CU2 repricing} \times \frac{1}{2}))] - \text{CU14,833}
\]

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

For the year ended 31 December 20X3

\[
\begin{align*}
\text{Dr} & \quad \text{Profit or loss—staff costs} & \text{CU24,007} \\
\text{Cr} & \quad \text{Equity—reserves} & \text{CU24,007}
\end{align*}
\]

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

To recognise the receipt of employee services in the current year in exchange for ten Entity N share options per employee.
Module 26 – Share-based Payment

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.

The case study is derived from IFRS 2 IG Example 7.
Case study 3

Entity P establishes a share-appreciation rights (SARs) programme that entitles its executives 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 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 on 31 December 20Y4 was also CU12. All executives remain employed by Entity P during the four years.

(a) Prepare a four-year (20Y1–20Y4) schedule calculating the employee compensation pertaining to the 40,000 SARs granted to the executives.

(b) 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 none of Entity P’s employee compensation qualifies for capitalisation.
Module 26 – Share-based Payment

Answer to case study 3

(a) Employee compensation schedule for SARs

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

(b) Journal entries for employee compensation expense

For the year ended 31 December 20Y1

Dr Profit or loss—staff costsCU90,000
Cr Liability—employee share appreciation planCU90,000

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 costsCU210,000
Cr Liability—employee share appreciation planCU210,000

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 planCU60,000
Cr Profit or loss—staff costsCU60,000

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 prior year charge
Module 26 – Share-based Payment

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