



# Share-based payments

IFRS 2 handbook



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# A changing environment

IFRS 2 *Share-based Payment* has remained unchanged for a number of years and is likely to remain that way for the foreseeable future. However, the world around us is rapidly changing.

For companies, this means responding to major changes such as inflation, natural disasters, geopolitical events and – of course – climate-related matters. As companies adapt their businesses to our changing world, the terms and conditions included in share-based payment arrangements continue to evolve, leading to additional questions about how to apply the principles of the accounting standard. Therefore, this edition includes guidance on, for example, the accounting for environmental-, social- and governance- (ESG) related conditions in share-based payment arrangements – an emerging area of focus and importance for many companies.

This handbook aims to help you apply IFRS 2 in practice and explains the conclusions that we have reached on many interpretative issues. It's based on actual questions that have arisen in practice around the world and includes illustrative examples and journal entries to elaborate on or clarify the practical application of IFRS 2.

We hope you find it helpful as you apply the complex accounting and valuation requirements of this accounting standard to share-based payment transactions.

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# 1 Introduction

## 1.1 Background

Historically, the range of specific requirements for the accounting for share-based payments in national GAAP has been diverse. Some countries have a relatively long tradition of accounting for share-based payments. For example, in the US, APB 25 *Accounting for Stock Issued to Employees* was issued in 1972, and in 2005 was superseded by ASC Topic 718 *Compensation – Stock Compensation* (formerly known as FAS 123(R)). In Canada, HB 3870 *Stock-Based Compensation and Other Stock-Based Payments* has been in effect for a number of years and contains recognition requirements for share-based payment transactions. In contrast, some countries in the EU still have no requirements for the recognition and measurement of share-based payment transactions in place for entities not required to apply IFRS Accounting Standards.

### *IFRS 2.BC29–BC60*

Share-based payments were first observed in the 1960s, primarily in the US. Consequently, the history of international requirements for the accounting for share-based payments is relatively short compared with other areas of accounting. The development phase of these requirements internationally was accompanied by controversial discussions about whether the recognition of cost for share-based payments that are settled in own equity instruments is justified at all – i.e. whether such accounting would meet the objectives of financial reporting. Some argued that transactions settled in equity are transactions between the shareholders and the third party, rather than between the entity and the third party. Some people still express concerns about accounting entries that result in a debit to expense and a credit to equity.

Previously, IAS 19 *Employee Benefits* contained disclosure requirements for equity compensation issued to employees, but there were no recognition or measurement requirements in IFRS Accounting Standards for such transactions before the publication of IFRS 2 *Share-based Payment*. The first milestone in the development of today's accounting standard was in July 2000 when the G4+1 – which included the IASB's predecessor, the International Accounting Standards Committee – issued a discussion paper on the topic. The debates resulted in mandatory requirements for share-based payment transactions – i.e. IFRS 2 – being issued in 2004. Modifications to address practice issues continue to the date of this publication.

Document <sup>1</sup>	Issued	Effective for annual periods beginning on or after
Discussion paper <i>Accounting for Share-based Payment</i>	July 2000	-
Exposure draft ED 2 <i>Share-based Payment</i>	7 November 2002	-
IFRS 2 <i>Share-based Payment</i>	19 February 2004	1 January 2005
IFRIC 8 <i>Scope of IFRS 2</i> <sup>2</sup>	12 January 2006	1 May 2006
IFRIC 11 <i>IFRS 2 – Group and Treasury Share Transactions</i> <sup>2</sup>	2 November 2006	1 March 2007
Amendments <i>Vesting Conditions and Cancellations</i>	17 January 2008	1 January 2009
<i>Improvements to IFRSs 2009</i>	16 April 2009	1 July 2009

Document <sup>1</sup>	Issued	Effective for annual periods beginning on or after
Amendments <i>Group Cash-settled Share-based Payment Transactions</i>	18 June 2009	1 January 2010
Amendments within the <i>Annual Improvements Project 2010</i>	6 May 2010	1 July 2010
Amendments within the <i>Annual Improvements to IFRSs 2010–2012 Cycle</i>	12 December 2013	1 July 2014
Amendments <i>Classification and Measurement of Share-based Payment Transactions</i>	20 June 2016	1 January 2018
<i>Amendments to References to the Conceptual Framework in IFRS Standards</i>	March 2018	1 January 2020
<p><b>Notes</b></p> <p>1. Besides the pronouncements listed in the table, IFRS 2 has been amended as a consequence of amendments to other accounting standards, principally the revised version of IFRS 3 <i>Business Combinations</i> issued in 2008, which itself was amended by the <i>Improvements to IFRSs 2010</i>. Other accounting standards, including IFRS 10 <i>Consolidated Financial Statements</i>, IFRS 11 <i>Joint Arrangements</i> and IFRS 13 <i>Fair Value Measurement</i> issued in May 2011, and IFRS 9 <i>Financial Instruments</i> issued in July 2014, have also made minor consequential amendments to IFRS 2.</p> <p>2. IFRIC 8 and IFRIC 11 were withdrawn by the amendments <i>Group Cash-settled Share-based Payment Transactions</i> issued in June 2009.</p>		

IFRIC 8 addressed the issue of whether IFRS 2 applies to share-based payment transactions in which the entity cannot specifically identify some or all of the goods or services received. Places where this issue arose included South Africa, where such payments were being made to historically disadvantaged individuals as a result of Black Economic Empowerment schemes.

IFRIC 11 addressed the issue of whether transactions in which the entity chooses or is required to buy equity instruments from another party should be accounted for as equity-settled or as cash-settled. It further addressed the issue of how to account for a transaction in the separate or individual financial statements of a subsidiary, if the equity instruments of the parent are granted either by the parent or by the subsidiary. For those countries applying IFRS 2 to separate financial statements of parents and subsidiaries, the interpretation also contained an important decision by the IFRS Interpretations Committee (formerly the International Financial Reporting Interpretations Committee (IFRIC)) that recharges between group entities should not be taken into account in determining the classification of a share-based payment transaction.

#### IFRS 2.64

Both interpretations were withdrawn by the amendments *Group Cash-settled Share-based Payment Transactions*, which provided expanded guidance for group share-based payments, in particular for cash-settled share-based payment transactions, and incorporated the guidance from IFRIC 8 and IFRIC 11 into IFRS 2.

In December 2004, the Interpretations Committee issued a draft interpretation D11 *Changes in Contributions to Employee Share Purchase Plans*, in which it aimed to resolve the issue of how to account for employee share purchase plans (ESPPs) when an employee ceases to contribute or changes from one ESPP to another. An example of transactions in which these issues arose are those related to the UK's *save as you earn* share-based payment scheme, in which employees invest part of their salary to buy the entity's shares at a discounted price. Commentators responded to the Interpretations Committee that the attempt to interpret IFRS 2 to resolve the issue was unlikely to

be successful without a change in the accounting standard. The Interpretations Committee and the IASB agreed that the accounting standard before those amendments did not address the accounting for conditions that did not relate to the employee's service and as a result the amendments *Vesting Conditions and Cancellations* were issued early in 2008, following an exposure draft issued early in 2006. The amendments changed the definition of vesting conditions and introduced specific accounting requirements for non-vesting conditions.

*Annual Improvements to IFRSs 2010–2012 Cycle* clarified the definition of 'vesting conditions' by separately defining a 'performance condition' and a 'vesting condition'. They also amended the definition of a 'market condition' and addressed circumstances in which an award is conditional on both a service condition and a specified performance target.

*Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2* were issued in relation to certain types of share-based payment transactions. In particular, the amendments clarified the accounting for: (a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; (b) share-based payment transactions with a net settlement feature for withholding tax obligations; and (c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

In addition to the matters that the Interpretations Committee has taken on to its agenda, there have been several instances in which it has declined to take issues related to the accounting for share-based payments on to its agenda and instead issued an agenda decision (see the table below). Agenda decisions do not add or change requirements in IFRS Accounting Standards; they aim to improve consistency in their application. The explanatory material in an agenda decision derives its authority from IFRS Accounting Standards and often provides additional insights into how to apply it. Therefore, companies are expected to change their accounting policy to the extent that their accounting differs from that described in the agenda decision.

Interpretations Committee's agenda decision	IFRIC update	Handbook reference
Employee share loan plans	November 2005	6.5.20
Cash alternative not share-based	May 2006	3.5.20, 8.2.50
Determining grant date	May 2006	6.3.30, 8.2.40
Post-vesting transfer restrictions	November 2006	6.6.10
Incremental fair value	November 2006	9.2.30
Accounting for employee benefit trusts	November 2006	10.6.20
Vesting and non-vesting conditions	September 2010	N/A <sup>1</sup>
Settlement contingent on future events	January 2010	4.6
Share-based payment awards settled net of tax withholdings	September 2010/ November 2010/ March 2011/ March 2013 <sup>2</sup>	4.4.40
Modification of a share-based payment from cash-settled to equity-settled	May 2011/March 2013 <sup>2</sup>	9.2.30
Accounting for reverse acquisitions that do not constitute a business	March 2013	3.5.60
Timing of the recognition of inter-company recharges	May 2013	10.4

Interpretations Committee's agenda decision	IFRIC update	Handbook reference
Price difference between the institutional offer price and the retail offer price for shares in an initial public offering	July 2014	N/A
Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition	September 2022	3.5.70
<p><b>Notes</b></p> <p>1. The Interpretations Committee recommended the noted vesting and non-vesting conditions for consideration in a future agenda proposal for IFRS 2. The issue was included in the 2010–12 cycle of annual improvements. A final amendment was issued in December 2013 and is effective for annual periods beginning on or after 1 July 2014 (see 5.3.10).</p> <p>2. In March 2013, the Interpretations Committee had recommended that share-based payment awards settled net of tax withholdings and modifications of a share-based payment from cash-settled to equity-settled be taken on by the IASB as a narrow-scope amendment project. <i>Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2</i>, issued in June 2016 and effective for annual periods beginning on or after 1 January 2018, addressed these issues.</p>		

In many respects, the requirements for the accounting for share-based payments under IFRS 2 are aligned with those of the related US GAAP standard SFAS 123R *Share-Based Payment* (ASC 718 *Compensation – Stock Compensation*). However, there are still numerous differences, not only in detail but also in basic requirements. For a description of the more significant differences in requirements between IFRS 2 and ASC Topic 718, see Chapter 4.5 'Share-based payments' in our publication [IFRS compared to US GAAP](#).

Share-based payments, in practice, appear in endless variations and often their design is influenced by national tax law and/or company law. IFRS 2 is neither intended nor able to provide detailed guidance for every scenario. However, IFRS 2 is one of the few accounting standards that provide explicit guidance for separate financial statements.

## 1.2 Reasons for granting share-based payments

A 'share-based payment' is either a payment in equity instruments of the entity to the supplier (including employees) of goods or services to the entity; or a payment in cash or other assets for amounts that are based on the value of the equity instruments of the entity.

Payments in equity instruments are called 'equity-settled share-based payments'; payments in cash or other assets that are based on the value of the equity instruments of the entity are called 'cash-settled share-based payments'.

Why does an entity choose to pay in equity instruments or to pay amounts based on the value of an equity instrument, rather than a fixed cash amount? There are several reasons, including those set out below.

### 1.2.10 Principal-agent theory

One of the major reasons for granting share-based payments is based on the principal-agent theory<sup>1</sup>. This theory focuses on the conflict of interests between the shareholders (principals) and management or other employees (agents). According to this theory, the agents pursue not only the interests of the shareholders (to maximise enterprise value) but also their own interests, which may not necessarily be the same.

1. See *Michael C Jensen and William H Meckling: 'Theory of the Firm, Managerial Behaviour, Agency Costs, and Ownership Structure'*, in *Journal of Financial Economics* 3 (October 1976), pages 305–360.

To align the interests of principal and agent, or shareholders and employees (including management), and to mitigate the conflict, employees are granted share-based payments as part of their remuneration package. In this way, both the employees and the shareholders participate in value increases.

Based on the principal-agent theory, share-based payments are often granted to employees under the condition that the employees provide future services and that one or more specified service or performance targets are met. Therefore, the employees are motivated to make an effort to achieve the target in order to benefit from the share-based payment.

In these cases, the employee becomes unconditionally entitled to the share-based payment if and when the conditions are met – i.e. if the employee provides their service to the entity and any performance target is met.

To achieve this alignment of interests, the form of settlement does not matter because share-based payments settled either in equity instruments or in cash that is based on the value of the equity instruments have the same motivational effect. In our experience, whether entities prefer equity-settled or cash-settled share-based payments may depend on various items, including entity-specific circumstances (e.g. whether the entity is listed) and jurisdiction-specific circumstances (e.g. tax deductibility and transferability of shares).

### 1.2.20 Reward for past services

Share-based payments are also granted for past services – e.g. to acknowledge good services of an employee by giving them a participation in the entity (e.g. free or discounted shares). In this case, the share-based payment would be granted without the condition to provide future services – i.e. the share-based payment vests immediately.

### 1.2.30 Other reasons

Another important reason for granting equity-settled share-based payments is to receive goods or services without affecting the entity's liquidity. This form of remuneration is often found in high-growth industries – e.g. the hi-tech area. It is also used to preserve cash.

## 1.3 Key terms and abbreviations

### 1.3.10 Abbreviations

The following abbreviations are used in this publication.

BSM	Black-Scholes-Merton
DCF	Discounted cash flows
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
ESPP	Employee share purchase plan
IPO	Initial public offering
SARs	Share appreciation rights

References in the left-hand column identify the relevant paragraphs of the IFRS Accounting Standards or other literature (e.g. 'IFRS 2.IG5' is paragraph 5 of IFRS 2 illustrative guidance). References to Interpretations Committee decisions are also indicated (e.g. 'IU 11-06' is *IFRIC Update* November 2006).

### 1.3.20 Key terms

IFRS 2 uses numerous technical terms, most of which are defined in Appendix A of the accounting standard. Please see [Appendix I](#) for a list of key terms that are used in the handbook.

# 2 Overview

## 2.1 IFRS 2 at a glance

Handbook reference	Key points	Chapter reference
<b>Section 3</b>	<ul style="list-style-type: none"> <li>In a share-based payment transaction, an entity receives goods or services in exchange for consideration in the form of equity instruments, or cash or other assets for amounts that are based on the price (or value) of equity instruments.</li> <li>Goods or services received in a share-based payment transaction are measured at fair value. Goods are recognised when they are obtained and services are recognised over the period over which they are received.</li> </ul>	2.2.10
<b>Section 4</b>	<ul style="list-style-type: none"> <li>Share-based payments are classified based on whether the entity's obligation is to deliver its own equity instruments (equity-settled) or cash or other assets (cash-settled).</li> </ul>	2.2.20
<b>Section 5</b>	<ul style="list-style-type: none"> <li>Conditions that determine whether and/or when the entity receives the required services are classified as vesting or non-vesting conditions.</li> <li>Vesting conditions are subdivided into service, market and non-market performance conditions.</li> <li>Non-vesting conditions are also subdivided into several categories.</li> </ul>	2.2.30
<b>Section 6</b>	<ul style="list-style-type: none"> <li>For equity-settled transactions, an entity recognises a cost and a corresponding entry in equity.</li> <li>Measurement is based on the grant-date fair value of the equity instruments granted.</li> <li>Market and non-vesting conditions are reflected in the initial measurement of fair value, with no subsequent true-up for differences between expected and actual outcome.</li> <li>The estimate of the number of equity instruments for which the service and non-market performance conditions are expected to be satisfied is revised during the vesting period such that the cumulative amount recognised is based on the number of equity instruments for which the service and non-market conditions are ultimately satisfied.</li> </ul>	2.2.40
<b>Section 7</b>	<ul style="list-style-type: none"> <li>For cash-settled transactions, an entity recognises a cost and a corresponding liability.</li> <li>The liability is remeasured, until settlement date, for subsequent changes in fair value.</li> </ul>	2.2.50
<b>Section 8</b>	<ul style="list-style-type: none"> <li>Grants in which the counterparty has a choice of settlement are accounted for as compound instruments. Grants in which the entity has a choice of settlement are classified as either equity-settled share-based payments or cash-settled share-based payments, depending on the entity's ability and intent to settle in shares.</li> </ul>	2.2.60

Handbook reference	Key points	Chapter reference
<b>Section 9</b>	<ul style="list-style-type: none"> <li>Modification of a share-based payment results in the recognition of any incremental fair value but not any reduction in fair value. Replacements are accounted for as modifications. Cancellation of a share-based payment results in acceleration of vesting.</li> </ul>	2.2.70
<b>Section 10</b>	<ul style="list-style-type: none"> <li>A share-based payment in which the receiving entity and the settling entity are in the same group from the perspective of the ultimate parent and which is settled either by an entity in that group or by an external shareholder of any entity in that group is a group share-based payment and is accounted for as such by both the receiving and the settling entities.</li> </ul>	2.2.80
<b>Section 11</b>	<ul style="list-style-type: none"> <li>Equity-settled transactions with non-employees are generally measured based on the fair value of the goods or services received.</li> </ul>	2.2.90
<b>Section 12</b>	<ul style="list-style-type: none"> <li>IFRS 3 <i>Business Combinations</i> provides guidance about the accounting for replacement of awards held by the acquiree's employees.</li> </ul>	2.2.100
<b>Section 13</b>	<ul style="list-style-type: none"> <li>Accounting for share-based payments can have interactions with income taxes, EPS calculation, hedging and events after the reporting period.</li> </ul>	2.2.110
<b>Section 14</b>	<ul style="list-style-type: none"> <li>There are specific transition requirements for existing users of IFRS Accounting Standards.</li> </ul>	2.2.120
<b>Section 15</b>	<ul style="list-style-type: none"> <li>There are specific transition requirements for first-time adopters of IFRS Accounting Standards.</li> </ul>	2.2.120

## 2.2 General principles

### 2.2.10 Scope and basic principles

In share-based payment transactions, an entity receives goods or services from a counterparty and grants equity instruments (equity-settled share-based payment transactions) or incurs a liability to deliver cash or other assets for amounts that are based on the price (or value) of equity instruments (cash-settled share-based payment transactions) as consideration.

The following transactions are not in the scope of IFRS 2 *Share-based Payment*:

- transactions with counterparties acting as shareholders rather than as suppliers of goods or services;
- transactions in which a share-based payment is made in exchange for control of a business; and
- transactions in which contracts to acquire non-financial items in exchange for a share-based payment are in the scope of the financial instruments standards.

For further discussion of scope issues, see [Section 3](#).

A 'counterparty' can be an employee or any other party (see [2.2.90](#)).

The term 'equity instrument' is defined in IFRS 2 without reference to IAS 32 *Financial Instruments: Presentation*, and it appears that classification under IAS 32 is not relevant (see [3.5.20](#)).

Goods or services received in a share-based payment transaction are measured at fair value.

Goods are recognised when they are obtained and services are recognised over the period over which they are received.

## 2.2.20 Classification of share-based payment transactions

Share-based payment transactions are classified based on whether the entity's obligation is to deliver its own equity instruments (equity-settled) or cash or other assets (cash-settled). An intention or requirement to buy own equity instruments in order to settle a share-based payment does not affect classification.

Awards requiring settlement in a variable number of equity instruments to a specified value are classified as equity-settled.

Grants of equity instruments that are redeemable mandatorily or at the counterparty's option are classified as cash-settled, without consideration of intent or probability. Grants of equity instruments that are redeemable at the entity's option are classified based on the entity's intent and past practice of settling in shares or cash.

For further discussion of classification of share-based payment transactions as either equity-settled or cash-settled, see [Section 4](#).

## 2.2.30 Classification of conditions

Share-based payment transactions, in particular those with employees, are often conditional on the achievement of conditions. IFRS 2 distinguishes between vesting conditions and non-vesting conditions as follows.

<b>Vesting condition</b>	A condition that determines whether an entity receives services that entitle the counterparty to receive cash, other assets or equity instruments of the entity. A vesting condition is either a service condition or a performance condition.	
	<b>Service condition</b>	<b>Performance condition</b>
	<p>Vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity.</p> <p>If the counterparty, regardless of the reason, ceases to provide services during the vesting period, then it has failed to satisfy the condition.</p> <p>The service requirement can be explicit or implicit.</p>	<p>Vesting condition that requires the counterparty to complete a specified period of service and specified performance target(s) to be met while services are rendered.</p> <p>A performance target can be one of the following conditions.</p> <ul style="list-style-type: none"> <li>• <i>Market condition</i>: If it is based on the price (or value) of the entity's equity instruments – e.g. achieving a certain share price target.</li> <li>• <i>Non-market performance condition</i>: If it is based on the entity's operations or activities – e.g. achieving a certain profit target.</li> </ul>
<b>Non-vesting condition</b>	A condition other than a vesting condition that determines whether a counterparty receives the share-based payment – e.g. counterparty's choice of participation in a share purchase programme by paying monthly contributions.	

For further discussion of classification of conditions, see [Section 5](#).

## 2.2.40 Equity-settled share-based payments with employees

Equity-settled share-based payment transactions with employees require indirect measurement and each equity instrument granted is measured on its grant date. The impacts of any market conditions and non-vesting conditions are reflected in the grant-date fair value of each equity instrument. Any service or non-market performance condition is not reflected in the grant-date fair value of the share-based payment. Instead, an estimate is made of the number of equity instruments for which the service and non-market performance conditions are expected to be satisfied. The product of this estimate – i.e. grant-date fair value per equity instrument multiplied by the number of equity instruments for which the service and non-market performance conditions are expected to be satisfied – is the estimate of the total share-based payment cost. This cost is recognised over the vesting period, with a corresponding entry in equity. The cost is recognised as an expense or capitalised as an asset if the general asset recognition criteria in IFRS Accounting Standards are met. If the payment is not subject to a service condition, then it is recognised immediately.

Subsequent to initial recognition and measurement, the estimate of the number of equity instruments for which the service and non-market performance conditions are expected to be satisfied is revised during the vesting period. The cumulative amount recognised at each reporting date is based on the number of equity instruments for which the service and non-market performance conditions are expected to be satisfied. Ultimately, the share-based payment cost is based on the number of equity instruments for which these conditions are satisfied. No adjustments are made in respect of market conditions – i.e. neither the number of instruments nor the grant-date fair value is adjusted if the outcome of the market condition differs from the initial estimate.

Subsequent to initial recognition and measurement, the manner of adjustment for non-vesting conditions depends on whether there is choice within the condition. Failure to satisfy the following conditions results in accelerated recognition of unrecognised cost:

- non-vesting conditions that the counterparty can choose to meet: e.g. paying contributions towards the purchase (or exercise) price on a monthly basis, or complying with transfer restrictions; and
- non-vesting conditions that the entity can choose to meet: e.g. continuing the plan.

A non-vesting condition that neither the entity nor the counterparty can choose to meet (e.g. a target based on a commodity index) has no impact on the accounting if it is not met – i.e. there is neither a reversal of the previously recognised cost nor an acceleration of recognition.

For further discussion on accounting for equity-settled share-based payments, see [Section 6](#).

## 2.2.50 Cash-settled share-based payments with employees

Cash-settled share-based payment transactions are measured initially at the fair value of the liability and are recognised as an expense or capitalised as an asset if the general asset recognition criteria in IFRS Accounting Standards are met. If the payment is subject to a vesting condition, then the amounts are recognised over the vesting period. At each reporting date until settlement date, the recognised liability is remeasured at fair value with changes recognised in profit or loss. Remeasurements during the vesting period are only recognised to the extent that services have been received – e.g. on a time-proportionate basis. If the payment is not subject to a vesting condition, then it is recognised immediately. For further details, see [Section 7](#).

## 2.2.60 Employee transactions with a choice of settlement

Some share-based payment transactions provide one party with the choice of settlement in cash or in equity instruments. If the entity has the choice of settlement, then the transaction is classified as an equity-settled or a cash-settled share-based payment transaction, depending on whether the entity has a present obligation to settle in cash. A 'present obligation to settle in cash' exists, for example, if the entity has a past practice or a stated policy of settling in cash. If the counterparty has the choice of settlement, then the entity has granted a compound instrument comprising a debt component and an equity component. For further details, see [Section 8](#).

### 2.2.70 **Modifications and cancellations of employee transactions**

Modifications of an equity-settled share-based payment arrangement are accounted for only if they are beneficial. If the fair value of the equity instruments granted has increased as a result of a modification to their terms and conditions, then the incremental fair value at the modification date is recognised in addition to the grant-date fair value. Modifications that are not beneficial to the counterparty do not affect the amount of the share-based payment cost recognised. However, reductions in the number of equity instruments granted are accounted for as cancellations.

Cancellations by the entity or by the counterparty are treated as an acceleration of vesting, requiring any unamortised compensation cost to be recognised immediately. If an entity grants new equity instruments to replace cancelled equity instruments, then this cancellation and replacement may be accounted for in the same way as a modification.

For further discussion on modifications and cancellations of employee transactions, see [Section 9](#).

### 2.2.80 **Group share-based payments**

A share-based payment in which the receiving entity, the settling entity and the reference entity are in the same group from the perspective of the ultimate parent is a group share-based payment transaction from the perspective of both the receiving and the settling entities. In a group share-based payment transaction in which the parent grants a share-based payment to the employees of its subsidiary, the share-based payment is recognised in the consolidated financial statements of the parent, in the separate financial statements of the parent and in the financial statements of the subsidiary. Recharge arrangements do not affect the classification of the share-based payment arrangement, but may be accounted for by analogy to share-based payments. For further details, see [Section 10](#).

### 2.2.90 **Share-based payments with non-employees**

Equity-settled share-based payment transactions with non-employees are generally measured at the fair value of the goods or services received (direct measurement), rather than at the fair value of the equity instruments granted at the time when the goods or services are received. If in rare cases the fair value of the goods or services received cannot be measured reliably, then the goods or services received are measured with reference to the fair value of the equity instruments granted (indirect measurement). For further details, see [Section 11](#).

### 2.2.100 **Replacement awards in a business combination**

IFRS 3 provides guidance about the accounting for replacements of awards held by the acquiree's employees (acquiree awards) in a business combination when the acquirer:

- is obliged to issue share-based payment replacement awards (replacement awards); or
- chooses to replace awards that expire as a result of the business combination.

To the extent that the replacement awards relate to past service, they are included in the consideration transferred; to the extent that they require future service, they are not part of the consideration transferred and instead are treated as post-combination remuneration cost. If they relate to both past and future service, then the market-based measure (see [Chapter 12.1](#)) of the replacement awards is allocated between consideration transferred and post-combination cost.

IFRS 3 also includes guidance for equity-settled acquiree awards that the acquirer chooses not to replace (unreplaced awards). Such unreplaced awards are part of the non-controlling interests in the acquiree at the date of acquisition.

For further discussion of replacement awards in a business combination, see [Section 12](#).

### **2.2.110 Other application issues**

The interaction between IFRS 2 and other accounting standards can be difficult. The interaction with some of those accounting standards – e.g. IFRS 3 – is addressed in IFRS 2. Some aspects of the interactions with IFRS 3 are covered in [Section 12](#). However, there are some other accounting standards that are not addressed specifically in IFRS 2 but which raise questions on the interaction with IFRS 2. These include IAS 12 *Income Taxes*, IAS 33 *Earnings per Share* and IAS 10 *Events after the Reporting Period*. The issue of whether hedge accounting can be applied is also a common question.

For further guidance on some common issues arising in practice, see [Section 13](#).

### **2.2.120 Transition requirements, unrecognised share-based payments and first-time adoption of IFRS Accounting Standards**

IFRS 2 has been effective since 1 January 2005. For a discussion of the general transition requirements, see [Section 14](#); and for a discussion of the transition requirements for first-time adopters of IFRS Accounting Standards, see [Section 15](#).

# 3 Scope

## Overview

- In a share-based payment transaction, an entity receives goods or services in exchange for consideration in equity instruments or in cash or other assets for amounts that are based on the price (or value) of equity instruments.
- If the fair value of the identifiable goods or services received appears to be less than the fair value of the share-based payment, then circumstances may indicate that unidentifiable goods or services have been received.
- Except in group arrangements, share-based payments are either in the form of equity instruments of the entity or in cash or other assets for amounts that are based on the price (or value) of the equity instruments of the entity.
- Certain group arrangements in which either another group entity or a shareholder of a group entity is involved are also considered share-based payment transactions (see [Section 10](#)).
- Equity instruments are defined in IFRS 2 *Share-based Payment*; the definition may be different from classification as equity under IAS 32 *Financial Instruments: Presentation*.
- The following transactions are not in the scope of IFRS 2:
  - transactions with counterparties acting as shareholders rather than as suppliers of goods or services;
  - transactions in which a share-based payment is made in exchange for control of a business; and
  - share-based payment transactions in which the entity receives or acquires goods or services under a contract in the scope of financial instruments standards.

## 3.1 Definition of a share-based payment

IFRS 2.2

A share-based payment is accounted for under IFRS 2 if it meets the definition of a share-based payment transaction and the transaction is not specifically scoped out of the accounting standard. For transactions that are outside the scope of IFRS 2, see [Chapter 3.4](#).

IFRS 2.A

The accounting standard does not contain a stand-alone definition of a share-based payment but provides a complex two-step definition using the terms ‘share-based payment arrangement’ and ‘share-based payment transaction’. The definitions are as follows.

A ‘share-based payment arrangement’ is an agreement between the entity (or another group entity or any shareholder of any group entity) and another party, including an employee, that entitles the other party to receive:

- a. cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity; or
- b. equity instruments (including shares or share options) of the entity or another group entity, provided that the specified vesting conditions are met.

A ‘share-based payment transaction’ is a transaction in which the entity:

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

IFRS 2.A, 10.A

In defining a share-based payment arrangement, a ‘group’ is defined as a parent and its subsidiaries as set out in IFRS 10 *Consolidated Financial Statements*. This determination is made from the perspective of the reporting entity’s ultimate parent. The requirement to treat transactions involving instruments of another entity as share-based payments applies only to transactions involving equity instruments of a group entity (see [10.1.30](#)).

IFRS 2.3A

These definitions are complex because they include not only share-based payments that involve the reporting entity and the supplier, but also those that involve other group entities or shareholders. This handbook distinguishes between the following types of share-based payment transactions:

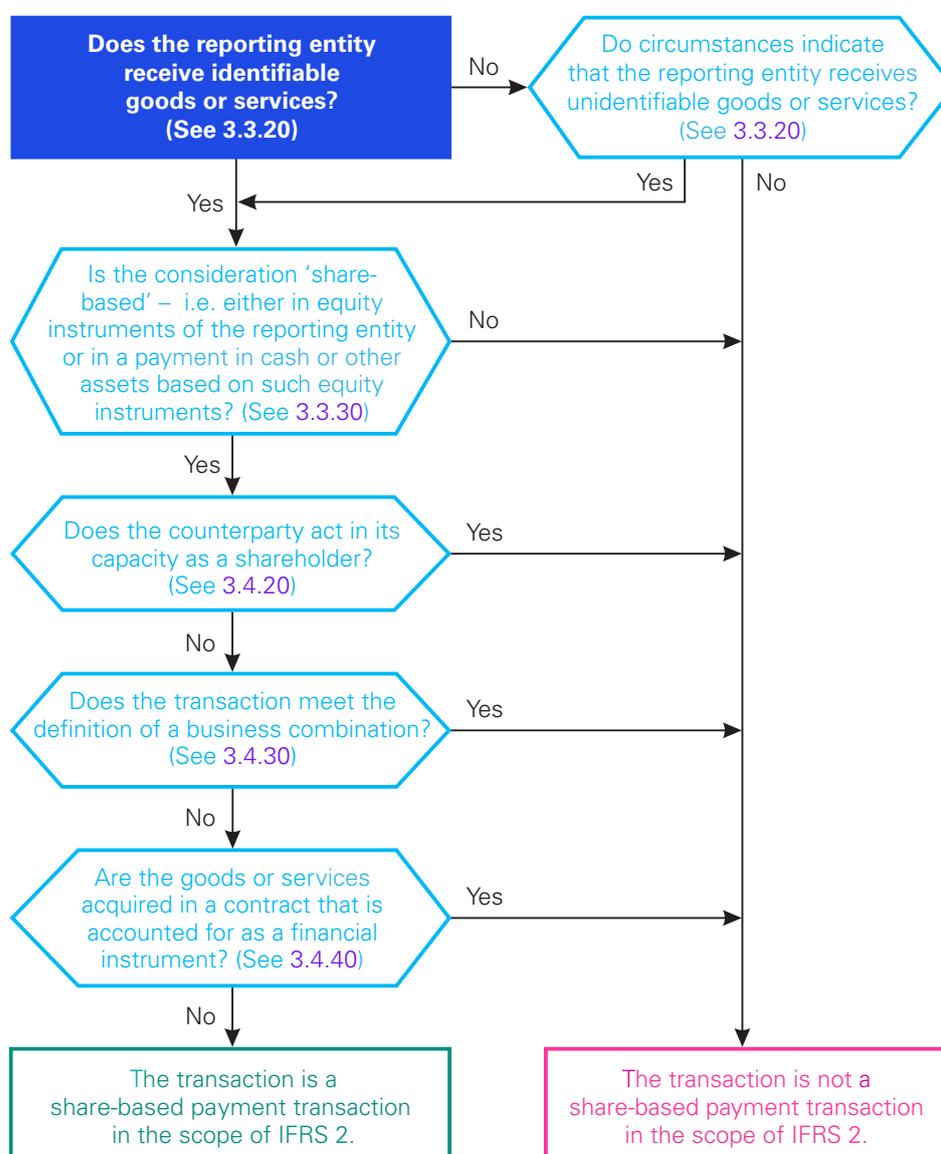
1. share-based payment transactions that involve only the supplier of goods or services and the reporting entity – i.e. the reporting entity receives the goods or services and settles the transaction in its own equity instruments or in a payment based on its own equity instruments; and
2. share-based payment transactions that involve the supplier, the reporting entity and at least one other group entity or a shareholder of any group entity (group share-based payment transactions).

Scope issues for the first type of share-based payment transactions are illustrated in this section; additional scope issues that arise in group share-based payment transactions are discussed in [Chapter 10.1](#).

For a discussion of the basic features of a share-based payment, see [Chapter 3.3](#), and for a consideration of the various scope exceptions see [Chapter 3.4](#). For the application of the definitions and exceptions in practice, see [Chapter 3.5](#).

## 3.2 Determining whether a transaction is a share-based payment transaction in scope of IFRS 2

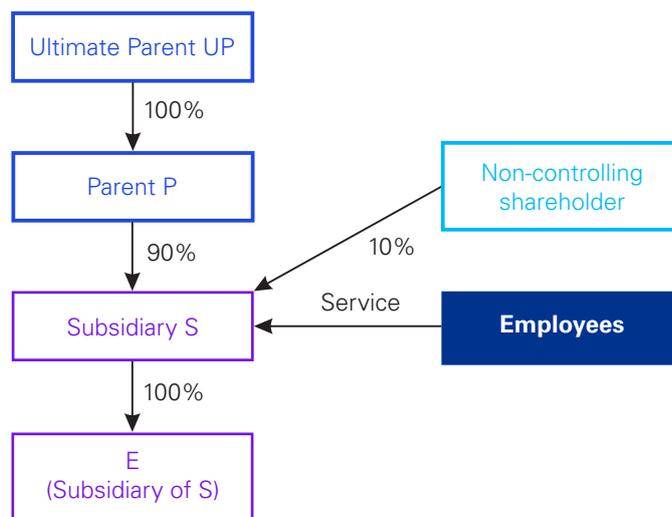
The following flowchart illustrates the steps to analyse whether a transaction is a share-based payment transaction in the scope of IFRS 2. This analysis covers transactions that involve only the supplier of goods and services and the reporting entity – i.e. the reporting entity receives the goods or services and settles the transaction in its own equity instruments or a payment based on its own equity instruments. The reporting entity can be a group or a separate legal entity. Scope issues in group arrangements are discussed in [Chapter 10.1](#).



If a transaction is a share-based payment transaction in the scope of IFRS 2, then the next step is to determine the classification of the transaction as either equity-settled, cash-settled or a transaction in which one party has the choice of settlement (see [Section 4](#)). Further steps include determining whether the counterparty is an employee or a non-employee (see [Chapter 11.1](#)).

If a transaction is in the scope of IFRS 2, then the requirements of the accounting standard specify both the initial and the subsequent accounting for the equity instruments issued or liability incurred, including requirements for planned and unplanned repurchases of vested shares. For the impact of the intent to repurchase on the classification of a share-based payment, see 4.5.30 and for accounting for the repurchase of a share-based payment see 9.3.20.

Sometimes arrangements involve entities that are outside the reporting entity.

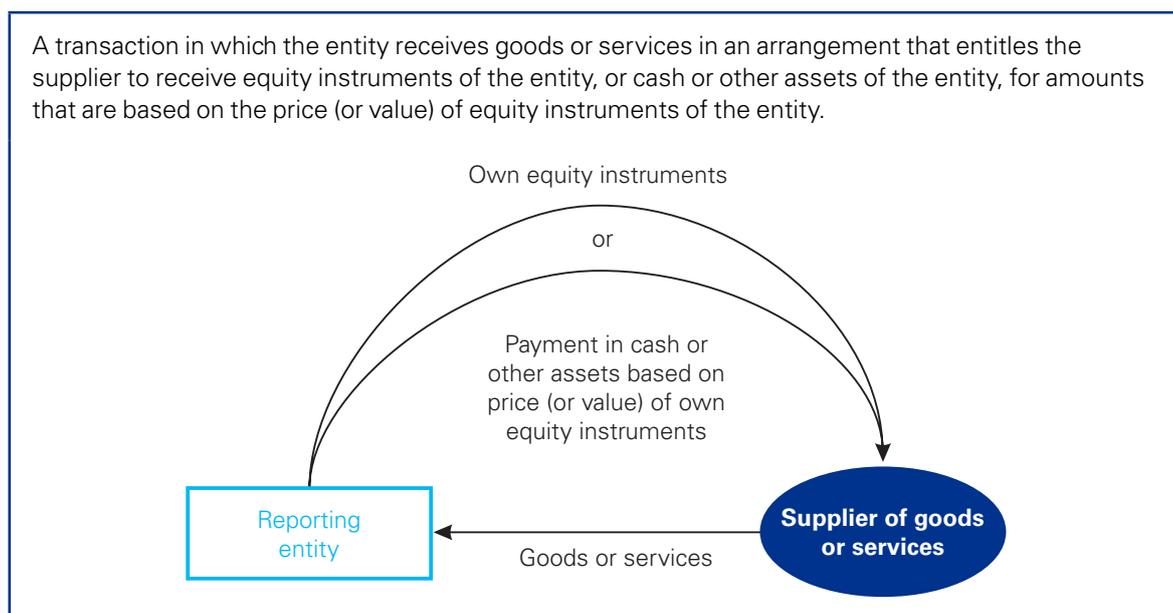


In this diagram, if Subsidiary S is the reporting entity and Parent P grants its own equity instruments to the employees of S or if S grants equity instruments of P to its own employees, then from the perspective of S's financial statements this is a share-based payment arrangement involving an entity outside the reporting entity. This is because P is not part of the reporting entity when S prepares its financial statements. Share-based payment arrangements that involve entities outside the reporting entity are referred to as 'group share-based payment arrangements' if the other entity is, from the perspective of Ultimate Parent UP, in the same group as the reporting entity. For guidance on these arrangements, see Section 10.

## 3.3 Basic features of share-based payment transactions

### 3.3.10 Introduction

This chapter addresses only scope issues that arise in share-based payment transactions that do not involve other group entities or shareholders. Therefore, all transactions discussed in this chapter can be described as follows.



### 3.3.20 Goods or services

#### Definition of goods or services

The most common goods or services received in exchange for a share-based payment are employee services. However, services received can be provided by parties other than employees – e.g. consultancy services. For a discussion of the definition of employees, see [Chapter 11.1](#).

*IFRS 2.5*

Goods can include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets.

#### Identification of goods or services

*IFRS 2.14–15*

Goods or services may be either received when a share-based payment is granted or expected to be received in the future.

*IFRS 2.2, 13A,  
BC18A–BC18D,  
IG5A–IG5D*

An entity may grant a share-based payment without any specifically identifiable goods or services being received in return. In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been received or will be received (see [11.2.40](#)).

*IFRS 2.IG5D.Ex1*

An example in which no goods or services are identifiable but unidentifiable goods or services are received are many share-based payments made to historically disadvantaged individuals under South Africa's Black Economic Empowerment (BEE) initiative.

**Example 3.3.1 – Unidentifiable goods or services in a share-based payment under a South African BEE scheme**

In response to the BEE government policy, Company S, a South African company, transfers shares to Company B, which is owned by historically disadvantaged individuals. The shares are issued for zero consideration.

S cannot identify any specific goods or services received in consideration for this transfer because B is not required to do anything in return for the shares. However, by meeting certain requirements of the BEE policy, S will benefit by improving its ability to tender for government contracts. IFRS 2 illustrates that these benefits represent unidentifiable goods or services received in exchange for the share-based payment and bring the arrangement into the scope of IFRS 2.

*IFRS 2.13A*

In other cases, there may be specifically identifiable goods or services received in exchange for the share-based payment. If the identifiable consideration received appears to be less than the fair value of the equity instruments granted or liability incurred, then typically this indicates that other consideration (i.e. unidentifiable goods or services) has also been (or will be) received (see 11.2.40). This issue is relevant in share-based payment transactions with non-employees when the goods or services are measured directly at their fair value.

*IU 07-14*

The IFRS Interpretations Committee discussed a scenario in which shares have been issued to retail and institutional investors at different prices in an IPO. In the scenario considered, to qualify for a listing the stock exchange's regulations require an issuer to achieve a minimum number of shareholders. To achieve this minimum number, the issuer offers shares to retail investors at a discount from the price at which shares are sold to institutional investors. The Committee noted that the entity issues shares at different prices to two different groups of investors (retail and institutional) for the purpose of raising funds and the only relationship between the issuer and investors is that of investee-investors. Therefore, IFRS 2 is not applicable because the difference between the retail price and the institutional price of the shares in the scenario relates to the existence of two different markets – i.e. one accessible to retail investors only and another one accessible to institutional investors only – rather than the receipt of unidentified goods or services.

**Goods or services from a supplier***IFRS 2.4*

The goods or services received or to be received by the entity need to be provided by the counterparty in its capacity as a supplier of goods or services. If the goods or services are provided by a counterparty in its capacity as a shareholder, then the transaction is not a share-based payment transaction (see 3.5.10).

**3.3.30****Consideration in form of share-based payment***IFRS 2.A*

In its basic form, a share-based payment transaction requires the entity to settle the transaction by either transferring its own equity instruments or making a payment in cash or other assets for amounts that are based on the price (or value) of its equity instruments.

*IFRS 2.A*

Depending on the type of consideration to be paid, the payment is referred to as either an equity-settled or a cash-settled share-based payment (see Section 4). Before classification is considered, it is necessary to consider what constitutes an equity instrument under IFRS 2 in order to decide if a transaction is in the scope of the accounting standard.

## Definition of equity instruments

IFRS 2.A

An 'equity instrument' is a contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. The most common examples of equity instruments used for share-based payments are ordinary shares and written call options, or warrants issued over ordinary shares (share options). An equity instrument for the purposes of IFRS 2 can include redeemable shares.

A share-based payment might involve granting preference shares or shares of one class of ordinary shares in circumstances in which there is more than one class of ordinary shares. In both of these cases, the instrument granted may be a right to a residual interest in an entity and therefore be equity.

IFRS 2.31,  
BC106–BC110,  
IAS 32.15, IFRIC 2

Although in most cases it will be clear whether an instrument meets the IFRS 2 definition of an equity instrument, in some cases this determination may require further consideration, because the instrument might be classified differently under IAS 32. Under IAS 32, some instruments issued in the legal form of shares may be classified as liabilities. However, these instruments might still be considered to be equity instruments in the context of a share-based payment. For example, IFRS 2 demonstrates that a grant of a redeemable equity instrument is viewed as a payment based on an equity instrument and in the scope of the accounting standard, although the redeemable equity instrument would in some cases be classified as a financial liability under IAS 32. For a more detailed discussion of this issue, see 3.5.20.

## Equity instruments of the entity

IFRS 2.A

The basic definition of a share-based payment arrangement refers to equity instruments *of the entity* (see Chapter 3.1).

IFRS 2.B50, 10.A

What constitutes an equity instrument 'of the entity' is an issue of particular interest in consolidated financial statements. In the consolidated financial statements, equity instruments of the entity comprise the equity instruments of any entity that is included in the group – i.e. the parent and its subsidiaries.

## Basis of cash payments

IFRS 2.A

If the entity does not settle in its own equity instruments but in a payment of cash or other assets, then the amount is a share-based payment if it is based on the price (or value) of its equity instruments (or the equity instruments of another entity in the same group).

IFRS 2.IG19

A common example of a cash payment based on the price (or value) of an equity instrument of the entity is when an entity grants SARs. SARs entitle the holder to receive a cash payment that equals the increase in value of the shares from a specified level over a specified period of time – e.g. from grant date to settlement date. In this case, the counterparty directly participates in changes of the value of the underlying equity instrument and, accordingly, the cash payment is based on the price (or value) of the equity instrument. Another common example of a cash-settled share-based payment is a payment based on the value of an equity instrument at a specific date – e.g. vesting date or settlement date – rather than on the increase in value.

Sometimes it is difficult to assess whether the cash payment is based on the price or value of the equity instrument. For a more detailed discussion of the distinction between a cash payment that 'depends on' vs one that 'is based on' the price or value of the equity instrument, see 3.5.20.

The following are basic scope examples that illustrate the analysis of the basic features of share-based payments in determining whether a transaction is in the scope of IFRS 2.

Scenario	In or out of scope of IFRS 2?	Rationale
Entity B grants 10 shares to its employees provided that they remain in service for the next 12 months.	In	This is an equity-settled share-based payment. The employees will receive the shares of B if they provide the required period of service to the entity.
Entity C grants employees a cash bonus equal to C's share price growth provided that they remain in service over the next 12 months.	In	This is a cash-settled share-based payment. C has an obligation to pay cash based on the change in share price to the employees who provide the required service; this award is also known as an SAR.
Entity E's share price is 120. E awards a cash bonus of 120 to employees, payable in one year to those who remain in service during the next 12 months.	Out	This is not a share-based payment. Although the payment to the employees is linked to the delivery of service from the employees, the payment is not based on the share price of E. For example, if the share price increases or decreases over the period, the employees would still receive the 120. The award is considered an employee benefit in the scope of IAS 19 <i>Employee Benefits</i> .
Entity D awards a cash bonus of 500 to employees, payable in one year to those who remain in service if D's share price exceeds a price of 10 per share during the next 12 months.	Out	This is not a share-based payment. Although D has an obligation if the share price-related target is met and the employees provide the required services, the amount of the payment is not based on the share price of D. The award is considered an employee benefit in the scope of IAS 19.

## 3.4 Transactions outside scope of IFRS 2

### 3.4.10 Introduction

IFRS 2.4–6

The following transactions are not share-based payment transactions in the scope of IFRS 2:

1. the counterparty acts in its capacity as a shareholder (see 3.4.20);
2. the reporting entity issues a share-based payment as consideration for the acquisition of a business (see 3.4.30); and
3. the reporting entity issues a share-based payment as consideration for a contract to acquire a non-financial item that is in the scope of the financial instruments standards (see 3.4.40).

Transactions under (1) do not meet the definition of a share-based payment transaction. Transactions under (2) and (3) do meet the definition of a share-based payment transaction, but are excluded from the scope of IFRS 2 by specific scope exceptions.

### 3.4.20 Counterparty acts in its capacity as shareholder

IFRS 2.4

Transactions with employees or other parties in their capacity as shareholders are outside the scope of IFRS 2.

IFRS 2.4

If employees or other parties who are also shareholders participate in a transaction with the entity, then it may be difficult to determine in which capacity they act: as suppliers of goods or services to the entity or as shareholders of the entity. If all shareholders have been offered the right to participate in a transaction, then this is an indication that the employees or other parties do not act as suppliers of goods or services but as shareholders.



### Example 3.4.1 – Shares at a discount/shareholder acts as an employee

As a reward for past services, Company B offers to sell shares at a discount of 10% of their market price to all of its employees, but not to shareholders who are not employees. There are no conditions attached to the shares other than paying the subscription price. Employee E, who is a shareholder of B, purchases such a share.

In this example, E is acting in its capacity as an employee, because the shares are not offered to all of B’s shareholders, but only to B’s employees. This transaction is in the scope of IFRS 2, because the share discount is granted to the employee in return for services.



### Example 3.4.2 – Shares at a discount/employee acts as a shareholder

Company C makes a rights issue to all of its shareholders in which shares are offered at a discount of 10% of their market price. There are no conditions attached to the shares other than paying the subscription price. Employee E, who is a shareholder of C, purchases such a share.

In contrast to [Example 3.4.1](#), in this example E is not acting as an employee but as a shareholder. This is because the benefit of the discount is offered to all of C’s shareholders. Therefore, the transaction is not a share-based payment transaction in the scope of IFRS 2.

## 3.4.30

IFRS 2.5

### Acquisition of a business

The following paragraphs illustrate the scope exception in IFRS 2 that addresses share-based payment transactions in which a business is acquired: in a business combination between third parties; in a transaction between entities under common control; and on the formation of a joint venture.

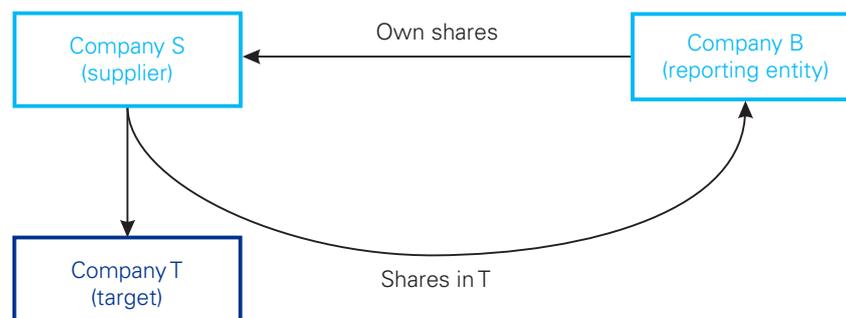
#### Business combinations between third parties

IFRS 2.5,  
BC23–BC24D, 3.A

Share-based payment transactions in which the entity acquires net assets in a business combination as defined in IFRS 3 *Business Combinations* are outside the scope of IFRS 2. This is because IFRS 3, which applies to the issue of shares in connection with a business combination, is the specific standard applicable to such transactions.



### Example 3.4.3 – Own shares in exchange for control (business combination)



Company B acquires a controlling interest in Company T from Company S by delivering its own shares in exchange for shares in T. T meets the definition of a business and B controls T from that point forward.

In this example, because the shares are issued in a business combination in exchange for control of the acquiree (T), the transaction is not in the scope of IFRS 2 but is instead in the scope of IFRS 3.

The conclusion would be the same if, instead of B acquiring all of the shares of T, B acquired all of the net assets of T constituting the business in return for delivering B's own shares to S.

*IFRS 2.5, 3.52(b)*

In a business combination, equity instruments are often issued to the previous owners of the acquiree in exchange for control. If equity instruments are issued to previous owners of the acquiree who are also employees of the combined entity, then a question arises about whether the transaction with the employees is in exchange for control or in exchange for continued employee services. If the shares issued are part of the consideration transferred in exchange for control, then they will be accounted for under IFRS 3. To the extent that the shares issued are granted to the employees in their capacity as employees – i.e. for continuing services – they are accounted for under IFRS 2. For further guidance on this issue, see [Section 12](#).

*IFRS 2.5*

The acquisition of a non-financial asset that does not constitute a business in exchange for equity instruments is in the scope of IFRS 2.



#### **Example 3.4.4 – Single asset (not a business) acquired in exchange for shares**

*IFRS 2.5*

Company C acquires a piece of vacant land from an unrelated party. C settles the purchase by issuing 1,000 new shares. The acquired asset – i.e. the vacant land – does not meet the definition of a business in IFRS 3. The transaction is in the scope of IFRS 2 and C accounts for the transaction as a share-based payment with non-employees.

*IFRS 2.13–13A*

If the presumption for share-based payments with non-employees is not rebutted and the fair value of the goods received – i.e. the vacant land – can be measured reliably, then the transaction is measured at the fair value of the land (see [11.2.30](#)). Otherwise, it is measured indirectly at the fair value of the equity instruments granted. If the fair value of the land appears to be less than the fair value of the equity instruments issued, then typically this situation indicates that other consideration – i.e. unidentifiable goods or services – has been (or will be) received in addition to the land (see [11.2.30](#)).

### Business combinations under common control

IFRS 2.5

IFRS 2's scope excludes all business combination transactions, whether or not those transactions are in the scope of IFRS 3.

**Example 3.4.5 – Combination of entities under common control**

The diagram illustrates a business combination under common control. At the top is the Ultimate Parent (UP). Below it are two entities: Company S1 (supplier) and Company S2 (reporting entity). Both S1 and S2 are subsidiaries of the UP, as indicated by the 'Own shares' label and arrows pointing from UP to both S1 and S2. Company S1 is shown to be a supplier to Company T (target). Company S2 acquires a controlling interest in Company T from Company S1. This acquisition is represented by an arrow from S1 to T labeled 'Shares in T', and another arrow from S2 to T. A curved arrow labeled 'Own shares' points from S2 back to S1, indicating that S2 provides its own shares to S1 in exchange for the shares of T.

Company S2 acquires a controlling interest in Company T from Company S1, by delivering its own shares in exchange for shares of T. S1 and S2 are both subsidiaries of Ultimate Parent UP – i.e. they are under common control. T meets the definition of a business.

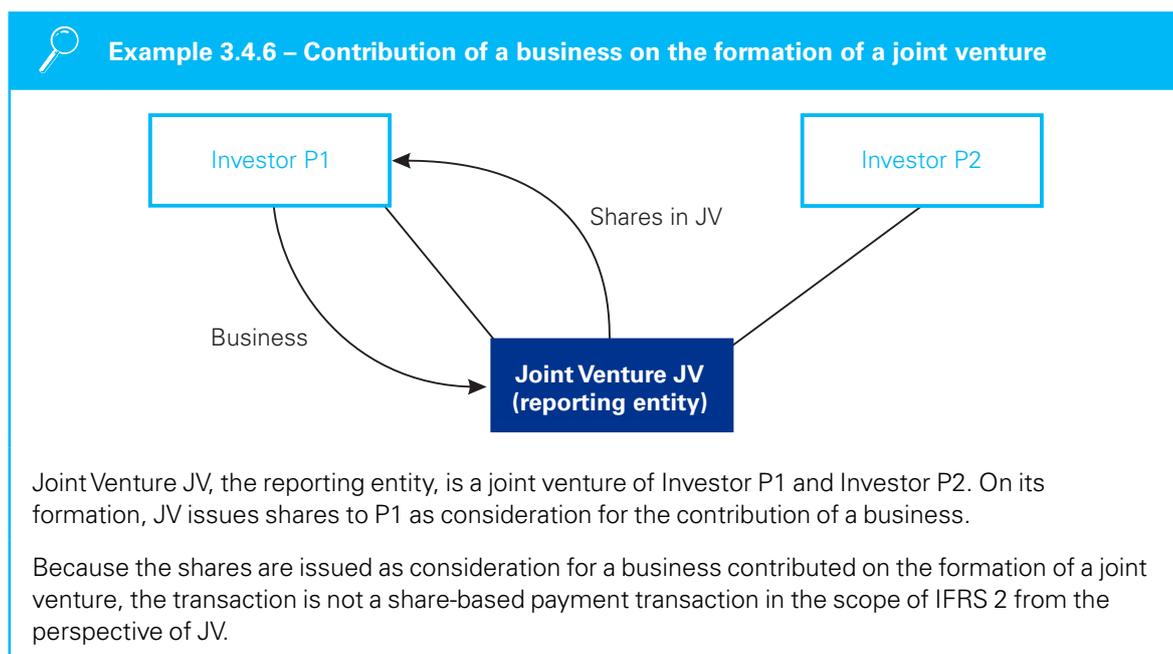
Because both T and S2 are ultimately controlled by UP both before and after the business combination, the transaction is neither in the scope of IFRS 2 nor in the scope of IFRS 3.

IFRS 2.5

IFRS 2.5,  
BC24A–BC24D,  
3.2(a)

### Contribution of business on formation of joint venture

A transaction in which an investor contributes a business as part of the formation of a joint venture in the scope of IFRS 11 *Joint Arrangements* in return for shares in an entity is not in the scope of IFRS 2. Like business combinations under common control, these transactions are excluded from the scope of IFRS 3 and they are also outside the scope of IFRS 2.



If, instead, the net assets contributed by an investor do not constitute a business, then the scope exception in IFRS 2 does not apply. As a result, such transactions are in the scope of IFRS 2.

### Other transactions outside the scope of IFRS 2

In our view, the exclusion from IFRS 2 for business combinations extends beyond business combination transactions as defined in IFRS 3, and we believe that the following transactions are also outside the scope of IFRS 2:

- acquisition of non-controlling interests after control is obtained, because IFRS 10 is generally the specific accounting standard applicable to the transaction;
- acquisition of associates, because IAS 28 *Investments in Associates and Joint Ventures* is the specific accounting standard applicable to the transaction; and
- acquisition of a joint controlling interest in a joint venture, because IAS 28 is the specific accounting standard applicable to the transaction.

#### 3.4.40

IFRS 2.6, BC25–BC28,  
9.2.4

### Commodity contracts

IFRS 2 includes a scope exception for contracts to acquire non-financial items that are in the scope of the financial instruments standards. Under the financial instruments standards, contracts to acquire non-financial items are required to be accounted for as financial instruments in some circumstances even if the contract is settled with a share-based payment. These contracts include those that fall directly in the scope of IFRS 9 *Financial Instruments* and those that meet the own-use exemption but are designated as at fair value through profit or loss. For a more detailed discussion of this issue, see Chapter 7.1 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#).

**Example 3.4.7 – Commodity contracts for own use**

On 23 July Year 1, Company B purchases 100 tonnes of cocoa beans in exchange for 100 shares of B. Both delivery and exchange will occur on 28 February Year 2. As a chocolate producer, B enters into the contract for the purpose of receiving delivery in order to process the cocoa beans; its purpose does not change and ultimately B receives the cocoa beans for its own use.

B expects to receive the delivery for its own use, so the contract is not in the scope of IFRS 9 (unless it is designated as at fair value through profit or loss) and therefore the scope exception in IFRS 2 does not apply. Therefore, the transaction is in the scope of IFRS 2, because B receives goods (i.e. cocoa beans) in exchange for a share-based payment.

Conversely, if B's purpose in entering into the contract were not for its own use (e.g. B intends to resell the cocoa beans to earn a dealer's profit), then the transaction would be accounted for under IFRS 9 and the scope exception in paragraph 6 of IFRS 2 would apply.

**3.4.50***IFRS 2.3A, BC22***Share-based payments that are not payments for goods or services**

IFRS 2 excludes from its scope those transactions that are clearly for a purpose other than payment for goods or services supplied to the entity receiving them. In our view, the requirement for the transfer of, or a cash payment based on, equity instruments for another purpose is a high threshold. We believe that any requirement for continued employment should be considered persuasive evidence that transfers of, or cash payments based on, equity instruments to employees are not clearly for another purpose and are share-based payments in the scope of IFRS 2.

**Example 3.4.8 – Grants by a shareholder clearly for a purpose other than payment for goods or services supplied to the entity**

Company B has a shareholder S. S transfers 100 shares in B to his child, who is employed by B, as part of S's advance planning for inheritance of S's investments. There are no service or other conditions attached to the grant.

The share grant is not classified as a share-based payment transaction in the scope of IFRS 2 from B's perspective because the grant of shares is not consideration for services supplied to the entity. The transfer would have taken place irrespective of whether S's child was employed by B.

**3.5 Scope issues in practice****3.5.10****Share-based payment vs shareholder transaction**

In some transactions, it will be clear that the counterparties are acting in their capacity as shareholders. An example is when the entity grants all existing shareholders of a particular class of equity instruments the right to acquire additional equity instruments at a discount (see [Example 3.4.2](#)).

*IFRS 2.4*

IFRS 2 does not limit situations in which the counterparty acts in its capacity as a shareholder to transactions in which all existing shareholders are granted the same rights and restrictions. In particular, if the counterparty buys the equity instruments at fair value, then it can appear as if the counterparty has paid the same amount as any other (new) shareholder would have paid. Distinguishing a share-based payment from a shareholder transaction can be difficult if the counterparty buys the equity instruments at the same amount as other shareholders (see [Example 3.5.9](#) and [A2.100](#) 'Complex capital structures').

*IFRS 2.IG17*

The implementation guidance to IFRS 2 discusses ESPPs and illustrates the application of the accounting standard to those transactions in which there is a discount on purchase or that contain option features. If an ESPP does not appear to fall under this guidance, then it may be difficult to determine whether the employee acts in the capacity of a shareholder or of a supplier of goods or services. For further discussion of ESPPs, see [3.5.40](#).

Factors that in our view may be relevant in determining whether a purchase of shares is in the scope of IFRS 2 include the following:

- the plan specifies that the realisation of a benefit is subject to future services; and
- the plan includes buy-back terms that do not apply to non-employee shareholders.

For example, an employee may buy a share at a price that appears to be fair value, but may be required to sell the share back at the lower of fair value at the date of sale and the amount paid if they leave before a specified date.

In another example, senior management of entities owned by private equity funds sometimes buy equity instruments with vesting being conditional on an exit event (e.g. an IPO or a sale of the entity).

The following analysis considers each of the indicators above in relation to such transactions.

- The arrangement contains a benefit that is subject to future services, because the employee can benefit from future increases in the value of the shares only by providing services for the specified period or by being employed when a specified (e.g. exit) event occurs.
- There is an apparent inconsistency in these arrangements between the proposition that the purchase of the shares is at fair value and the inclusion of a requirement to sell the shares back at the lower of fair value and purchase price. This requirement is, in effect, a right that allows the entity to reacquire the shares in a transaction that has a positive value to the entity and has a negative value to the employee. If the amount paid was the fair value of a share without this condition, then the employee appears to have overpaid in buying the share; the amount of the potential overpayment is the negative value of the entity's right to reacquire the shares. If the requirement to sell back was not imposed on non-employee shareholders, then this may call into question the validity of the assertion that the purchase was at fair value in the first place.

If applying these indicators results in the conclusion that a share purchase is a share-based payment, then a second issue is whether there is any cost to recognise if the transaction appears to be at fair value. Even if there is no cost to recognise – e.g. because the purchase price is equal to the grant-date fair value of the equity instruments granted – then in our view the disclosure requirements of IFRS 2 still apply.

However, in certain cases it may be difficult to determine that the purchase price is equal to the grant-date fair value of the equity instruments. This is particularly challenging if the shares purchased by the employee are issued by an unlisted entity with a complex capital structure – e.g. in some private equity transactions.

An entity may have multiple classes of shares. Sometimes the evidence that the employee's share purchase is at fair value is with reference to purchases of other shares by non-employee shareholders. Difficulties can arise in allocating the fair value of an entity between classes of equity instruments if the non-employee shareholder transaction used as a reference involves more than one class (e.g. ordinary and preference shares) but the employee only buys one class (e.g. ordinary shares). This is because the buyers of more than one class of equity instrument benefit from their investment differently from buyers of a single class. If there are multiple classes of shares, then the complex capital structure valuation guidance in [A2.100](#) may be relevant in deciding if the amount paid by the employee is below fair value.

## IFRS 2.4

Sometimes a privately held entity, such as a wholly employee-owned entity, may require employees (e.g. by virtue of the entity's articles of association) to sell shares back to the entity if they cease to be employees. This might be required even if these shares were previously purchased at fair value in a transaction that was a transaction with shareholders and not a share-based payment transaction. In our view, if in such circumstances the obligation to resell the shares requires the entity to pay fair value at the time of repurchase and the acquisition of the shares did not involve a share-based payment, then the repurchase/resale requirement does not result in the transaction being a share-based payment because there is no consideration received/paid beyond the shareholder transaction. However, the requirement to repurchase may affect the classification and measurement of these shares.

**Example 3.5.1 – Sponsor shares in the scope of IFRS 2**

A special-purpose acquisition company (SPAC) is formed by the sponsors with a nominal investment of 25,000 for shares (sponsor shares), sometimes also referred to as founder shares. The purpose of the SPAC is to raise money via an IPO and use that money to complete an acquisition of an operating company within two years. The sponsor provides significant support to the SPAC in its activities – i.e. raising capital through an IPO, identifying acquisition targets and completing the acquisition. The sponsor has significant expertise in undertaking SPAC IPOs, finding operating company targets and completing merger transactions. The sponsor is a director of the SPAC.

The sponsor shares:

- give the sponsor the sole right to elect directors to the SPAC's board of directors;
- give the sponsor voting and dividend rights in the SPAC;
- give the sponsor the right to a 20% interest in the SPAC after an IPO, conditional on completion of an acquisition;
- convert into public shares upon successful completion of an acquisition; and
- are subject to lock-up and transfer conditions for 180 days from the successful completion of an acquisition.

If no suitable target is found within a two-year period, then the SPAC is liquidated, while the sponsor shares are not redeemable and receive no proceeds on liquidation.

The sponsor does not receive any other compensation for its services to the SPAC.

The sponsor determines that the consideration paid for the sponsor shares is less than their fair value based on the assessed likelihood of a subsequent IPO and successful acquisition.

In this example, the sponsor shares are in the scope of IFRS 2. They are not a shareholder transaction because the sponsor considers them to be issued as compensation for their services to the SPAC, and the consideration paid for the shares is less than their fair value.

For further discussion on the accounting for SPACs, see [3.5.70](#).

**3.5.20**

## IFRS 2.A

**Share-based payment vs employee benefit**

Cash payments to employees for services rendered are generally accounted for under IAS 19 *Employee Benefits* unless the cash payment is a share-based payment, in which case it is accounted for under IFRS 2. Although some of the accounting consequences are similar under both accounting standards, there are some differences. A cash payment is a share-based payment if the payment is in cash or other assets for amounts that are based on the price (or value) of the equity instruments of the entity. In determining whether a payment to employees is a share-based payment, several issues may arise.

### Cash payments based on approximations of price (or value)

Sometimes a payment is not based on the price or value of the entity's equity instruments, but on an approximation of that measure. For example, employees of an entity receive a cash payment based on the increase in the *net asset value* of an unlisted entity (i.e. the change in shareholders' equity). The accounting for such an arrangement will depend on whether it is a profit-sharing arrangement or a share-based payment arrangement. In our view, if the net asset value of the entity does not reflect the fair value of its equity instruments (e.g. the change in net assets represents primarily the profit or loss from operations and does not include fair value changes of assets and liabilities), then the transaction is, in substance, a profit-sharing arrangement that should be accounted for as an employee benefit. In our experience, this is the more typical situation.

In some cases, the changes in net assets include substantially all changes in the fair value of the net assets of the entity. In these cases, the net asset value reflects the fair value of the equity instruments and this represents, in substance, the fair value of an equity instrument. Accordingly, in our view the transaction should be accounted for as a share-based payment. Judgement is needed on a case-by-case basis and we believe that only in limited circumstances will the change in net assets be substantially the same as the change in the value of an entity's shares.



#### Example 3.5.2 – Cash payment based on change in net assets of an investment vehicle

Company B, a mutual fund with only financial assets and financial liabilities, measures all of these recognised assets and liabilities at fair value. The equity instruments of the entity are priced based on the reported net asset value of the fund.

On 1 January Year 1, B grants a cash payment to an employee, determined as the positive difference between the net asset value at 31 December Year 1 and the net asset value at 1 January Year 3. The employee has to stay in service with B until that date.

In this example, we believe that it is appropriate to treat the cash payment as a cash-settled share-based payment because the cash payment is based on the entity's net asset value and the price of the equity instruments of the entity is based on the same measure. It follows that the payment is also based on the price (or value) of the underlying equity instruments.

Modifying the example, suppose that Financial Institution C is not a mutual fund, but an investment vehicle that also provides investment banking advisory services. The price of its equity instruments is not based solely on the reported net asset value. C also measures all of its financial assets and financial liabilities at fair value, but it has other unrecognised assets, in particular internally generated goodwill arising from the skills and experience of its workforce. Therefore, neither the price nor the value of its equity instruments is limited to the reported net assets. Accordingly, it is unlikely that a payment based on the change in the reported net asset value is the same as a payment based on the value of the equity instruments and it would not be appropriate to treat the payment as a share-based payment.

#### IFRS 2.B30

Sometimes newly listed or unlisted entities use an earnings basis for estimating the fair value of the entity's equity instruments. If such a measure uses a *predetermined* formula – e.g. a fixed multiple of EBITDA – to specify how the cash payment at settlement will be determined, then in our view such a payment is unlikely to be based on the price or value of the entity's equity instrument. This is because a market multiple will generally change over time. Accordingly, such payments should not be considered to be share-based payments, unless in limited cases the facts and circumstances provide evidence that the payment amount is based on the price or value of the entity's equity instruments. If the payment to an employee is not a share-based payment, then it would be considered an employee benefit in the scope of IAS 19.

## Date of determination of cash payments and link to services

IFRS 2.A

To meet the definition of a share-based payment, a payment needs to be based on the price (or value) of the equity instrument of the entity (see [Chapter 3.1](#)) and paid in return for goods or services provided to the entity (see [3.3.20](#)).

IFRS 2 does not specify the date that is relevant for the assessment of whether the payment is based on the price (or value) of the equity instruments of the entity. In principle, an arrangement could be designed with the payment being based on the price (or value) of the equity instrument at grant date, vesting date, settlement date or any other date.

IFRS 2.IG15.Ex9,  
IG17.Ex11

The implementation guidance illustrates that a payment based on the price (or value) of an equity instrument on the date of settlement or on vesting date is regarded as share-based. It is less clear whether a payment based on the price (or value) of the equity instrument at grant date also meets the definition of share-based, because it is a fixed amount.

IFRS 2.A

Even if a payment is based on the price (or value) of an equity instrument, to establish that it is a share-based payment in the scope of IFRS 2 the payment should be in return for goods or services. As discussed in [3.5.30](#), this issue can be difficult – e.g. if an employee buys a share at fair value and is required to sell back the share on termination of employment.

If an equity instrument is bought at fair value on grant date and is redeemable only at the amount paid for it, then there is no net payment to the buyer. However, in our view if the payment on settlement date changes from being based on the value of an entity's equity instruments on the date when the equity instruments are granted to being based on the value of the entity's equity instruments on settlement date, then the payment meets the definition of a share-based payment.



### Example 3.5.3 – Redemption amount with a change from grant date to settlement date

Company C grants a share to its employees in exchange for a cash payment at fair value. The employer is required to redeem the share at the end of employment. If the redemption occurs within the first three years after grant date, then the redemption amount equals the value of the share at grant date. If the redemption occurs after the three-year period, then the redemption amount becomes the current value of the share on redemption – i.e. on settlement date.

We believe that the transaction is a share-based payment because the redemption amount is based on the value of the equity instrument and the net payment is in return for services, because the employees can participate in value increases only if they stay employed for a period of three years.

## Cash payments depending on share price vs being based on share price

A cash payment may depend on, but not be based on, the share price. For example, an employee is entitled to a cash payment of 100 if the share price remains at least at the current share price of 8 over the next year. If the share price falls below 8, then the employee is not entitled to the payment. In our view, although this cash payment depends on the share price, it is not based on the share price. Therefore, we believe that the cash payment is not a share-based payment, but is likely to be an employee benefit in the scope of IAS 19.

If, in contrast, an employee is entitled to a payment equal to the share price at vesting date, then the employee participates one-to-one in the share price increases. In our view, a payment determined as a linear function of the share price or its movements is based on the share price, and is therefore a share-based payment.

We believe that payments that entitle the employee to a percentage of the share price – e.g. to 60 percent of the share price or to 200 percent of the share price – also meet the definition of being based on the value of the equity instruments and therefore are share-based payments.

If the mechanism to determine the amount of the cash payment is designed as something in between these extremes, then judgement is required to determine whether the mechanism is sufficiently linked to the price or value of the equity instruments. Therefore, judgement is required to define the border between ‘depending on’ and ‘being based on’, as illustrated in [Example 3.5.4](#).



#### Example 3.5.4 – Cash payment based on step function not share-based

Company B grants a cash bonus to its employees. The amount of the bonus depends on the share price achieved at the end of the year, as follows.

- Level 1: if the share price is below 10, then the bonus amount is zero.
- Level 2: if the share price is between 10 and 12, then the bonus amount is 1,000.
- Level 3: if the share price is above 12, then the bonus amount is 1,500.

Changes in the share price within a band (e.g. between 10 and 12) will not result in a change in the bonus amount. We believe that the cash payment is not share-based because the size of the gaps between share price levels means that there is not sufficient linkage between the two. Therefore, the bonus would not be a share-based payment in the scope of IFRS 2.

### Capped payments

An arrangement may provide for a payment to be made that is based on the share price of an entity, but is subject to a cap. In our view, the arrangement should be accounted for as a cash-settled share-based payment if the payment is expected to be based largely on the share price.

To determine whether the payment is expected to be based largely on the share price, in our view the level of the cap and the expected volatility should be compared with the share price at grant date. If, at grant date, the cap is well in excess of the expected growth in share price in light of expected volatility, then we believe that the payment at grant date is based largely on the share price. In our view, the assessment of whether the payment is expected to be based largely on an entity’s share price (i.e. the significance of the cap relative to the expected volatility) should be made at each grant date of a new grant and should be reassessed subsequently only if the grant is modified.



#### Example 3.5.5 – Cash payment based on the share price with a cap

On 1 January Year 1, Company E grants a cash bonus to its employees. The current share price at grant date is 100. The amount of the bonus is a payment of 30% of the share price at 31 December Year 1, which is the vesting date. However, if the share price exceeds 150, then the bonus is capped at a maximum of 45 (150 x 30%). In E’s history, the share price has never been outside a range of 68 to 117. The expected volatility at grant date is 20%, which means, assuming a rate of return of 10%, that the probability for the share falling within a range of 90 ( $100 \times e^{(10\% - 20\%)}$ ) to 135 ( $100 \times e^{(10\% + 20\%)}$ ) at the end of the year is 67%, assuming no dividends. For more details of expected volatility, see [A2.40](#).

In the absence of evidence to the contrary, E considers that the share price is not likely to exceed 150. Therefore, the cash payment is classified as share-based.

IFRS 2.31, A,  
BC106–BC110, IAS  
32.11, 96C

## Relevance of classification under IAS 32 of instruments granted

One characteristic of a share-based payment transaction is that it is based on the price (or value) of the equity instruments of the entity. An 'equity instrument' is a contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Under the financial instruments standards, some instruments issued in the legal form of shares may be classified as liabilities. Some potential share-based payment arrangements require payments based on the change in the price of an instrument that evidences a residual interest in an entity, but which would be classified as a liability under the financial instruments standards.

The term 'equity instrument' is defined in IFRS 2 without reference to IAS 32, and it appears that classification under IAS 32 is not relevant. For example, IFRS 2 includes as an illustration of a cash-settled share-based payment a grant of puttable or redeemable shares or options over them. Such instruments would generally be classified as financial liabilities under IAS 32. Under IFRS 2, payment based on the value of a puttable or redeemable share is a cash-settled share-based payment.

## Deemed equity

IFRS 3.A

An arrangement may require a cash payment to be made based on the price of a deemed share or a synthetic instrument. For example, a cash award may be based on the price (or value) of an amount that is a measure of equity of a business division that is not a separate legal entity. In our view, if the deemed equity or synthetic instrument is consistent with the definition of equity under IFRS Accounting Standards, then the arrangement meets the definition of a cash-settled share-based payment. We believe that the reference to equity instruments in IFRS 2 does not require the instruments to be in the legal form of shares or other equity instruments. This view is based, in part, on the definition of a business in IFRS 3, which does not require there to be a separate legal entity.

## Non-share-based elements

### Separable non-share-based cash element

In our view, an award that contains both an employee benefit and a share-based payment should be separated and each component should be accounted for separately.



#### Example 3.5.6 – Payment with combined share-based payment and employee benefit feature

Company B grants a bonus payment to an employee that has both a cash and a share component. The terms of the bonus plan require settlement of 75% of the award in a fixed amount of cash and 25% in shares; the total value of the bonus payment is 1,000, to be settled by 750 in cash and the remaining amount of 250 in a variable number of shares at their current share price at settlement date.

We believe that the 25% that is paid in shares is a share-based payment in the scope of IFRS 2, and the cash bonus is an employee benefit in the scope of IAS 19.

### Non-share-based cash alternative

If a single arrangement provides a choice of two settlement alternatives that are mutually exclusive and at the discretion of the employee, in which only one of the alternatives would be accounted for under IFRS 2, then in our view the entire arrangement should be accounted for as a share-based payment applying the requirements for compound instruments by analogy (see 8.2.50). This is because such an arrangement is neither clearly in the scope of IAS 19 nor clearly in the scope of IFRS 2, but the requirements in IFRS 2 for compound instruments seem applicable by analogy.

**Example 3.5.7A – Share-based payment with non-share-based cash alternative:  
At employee’s discretion**

Company B grants a bonus payment to its employees, subject to a three-year service condition. At the end of the service period, the employees will receive a bonus based on a predetermined percentage of the excess of the profit of B above 5.2 million. Each employee can choose to be paid in cash or to receive equity instruments of the entity to a value of 150% of the cash payment provided that they work for a further three years.

We believe that the entire arrangement should be accounted for as a share-based payment and that the profit-sharing component should be separated using the guidance in IFRS 2 for compound instruments.

**Non-share-based cash alternative at discretion of entity**

IU 05-06

Some share-based payment arrangements provide the entity with a choice of settlement, but the amount of the cash settlement does not vary with changes in the share price of the entity.

**Example 3.5.7B – Share-based payment with non-share-based cash alternative:  
At entity’s discretion**

Company B grants its employees a fixed bonus that B may choose to settle in shares or cash. Because the cash settlement alternative does not vary with the value of B’s shares or other equity instruments of B, the question arises about whether the arrangement is in the scope of IFRS 2.

The IFRS Interpretations Committee discussed similar scenarios and noted that because consideration may be equity instruments of the entity and because plans that give the entity a choice of settlement are specifically addressed by IFRS 2, such plans are in the scope of the accounting standard.

In contrast to [Example 3.5.7A](#), in this case B would not account for two components separately, but for the entire arrangement either as equity-settled or as a cash-settled liability, depending on B’s past practice or stated policy to settle in equity or cash.

**3.5.30****Share-based payment vs financial instrument**

Some share-based payment arrangements may be in the form of financial instruments that appear to be outside the scope of IFRS 2. Although the classification and subsequent measurement requirements of IFRS 2 are similar to those of the financial instruments standards, some differences exist and it is therefore important to determine the applicable accounting standard.

**Shares as legal mechanism**

Sometimes the share transaction in itself is not the share-based payment. In our view, if the issuance of shares represents only a legal mechanism to effect an arrangement, then it is not itself a share-based payment.

**Example 3.5.8 – Share transaction as legal mechanism**

Company S sells redeemable preference shares to its senior executives for a nominal amount. The preference shares are redeemable by the entity at the nominal amount if the executives leave the company. Redeemable preference shareholders are entitled to dividends, which are paid in the form of ordinary shares. The amount of the dividends payable is determined as 1% of S's profit for the year. The ordinary shares themselves do not contain vesting conditions.

We believe that the redeemable preference shares represent only a legal mechanism to effect a share-based payment, being the issue of equity instruments in the form of ordinary shares, and the preference shares are not themselves share-based payments. The identified share-based payment, being the issue of dividends in the form of ordinary shares, should be accounted for under IFRS 2 as an equity-settled share-based payment.

**Forfeiture payment based on the lower of subscription price and fair value**

A share purchase at fair value may contain a share-based payment.

**Example 3.5.9 – Shares bought at fair value being a share-based payment**

Company T sells ordinary shares to employees for cash consideration (subscription price) that appears to be equal to the fair value of the shares. The following facts are relevant for this example.

- The shares are subject to a condition that allows T to reacquire the shares when employment terminates.
- For the purpose of determining the reacquisition right exercise price, notionally the shares vest after five years of service.
- The reacquisition right exercise price of *vested* shares (i.e. after five years) is the fair value of the shares on the date of exercise. The exercise price of the reacquisition right for *unvested* shares (i.e. before five years) is the lower of the original subscription price plus 6% annual interest (not compounded) for each year from the purchase of the shares to exercise date of the reacquisition right, and the fair value at the exercise date.
- The subscription price of the ordinary shares is 50.
- The share price at the end of three years is 67.
- The share price at the end of five years is 70.

If an employee were to leave T at the end of three years, then T could acquire each of the employee's shares for 59 (50 x 118%), rather than for 67. However, if the employee were to leave T at the end of five years, then T could acquire each of the employee's shares for 70, not 65 (50 x 130%).

In this example, the exercise price of the reacquisition right depends on whether the shares are considered vested or unvested. Shares vest – i.e. the reacquisition right exercise price varies – with employment. The exercise price for unvested shares limits the amount of fair value appreciation in which the employee can participate, but exposes the employee to all of the downside risk; and the ability to participate in fair value increases is dependent on future service. Therefore, in our view a share-based payment exists because, for the reacquisition right exercise price to equal fair value and the employee to benefit from increases in the share price, the employee is required to provide five years of services to T. Because the employees have written T a reacquisition right, this is an award in which T has a choice of settlement (see [Chapter 8.3](#)). For a more detailed discussion of indicators to be considered whether or not the entity receives goods or services in a share purchase at fair value, see [3.5.10](#).

### Requirement to buy and hold shares

An employee may be required to buy shares to participate in a share-based payment arrangement. If the employee pays fair value for the shares and the shares do not contain vesting conditions, then in our view the acquisition of shares by the employee does not form part of the share-based payment transaction; instead, it should be accounted for as an equity transaction in accordance with the financial instruments standards. However, it is often difficult to determine whether shares are issued at fair value and entities should consider all of the facts and circumstances in determining whether the purchase of shares by employees is outside the scope of IFRS 2. The requirement to hold shares may be a non-vesting condition (see [Chapter 5.4](#) for further details).



#### Example 3.5.10 – Participation shares bought at fair value

Company B grants a share-based payment in the form of share options to its employees. To receive the share options, an employee is required to buy a specified number of participation shares at fair value and hold the participation shares throughout the vesting period of the share-based payment. The employees are free to sell the participation shares during the vesting period; however, if the employees sell the shares, then the share options are forfeited.

The requirement to hold the participation shares in order to exercise the share-based payment is treated as a non-vesting condition of the share-based payment arrangement (see [Chapter 5.4](#)).

## 3.5.40

### Tax payments related to share-based payments

In some countries, a share-based payment arrangement may be subject to a tax payment related either to the employee's own tax obligations or to employee-based taxes levied on the employer. The tax is often based on the difference between the share price and the exercise price, measured at the exercise date. Alternatively, the tax may be calculated based on the grant-date fair value of the grant.

#### Tax payments when employee has primary liability

In many cases, the tax obligation is a liability of the employee and not the employer, although the employer may have an obligation to collect it or withhold it. If the employer has an obligation to collect or withhold employee taxes, then the employer is either acting as an agent for the tax authorities by collecting the taxes or acting as an agent for the employee by paying the tax authorities on the employee's behalf. In such situations, the guidance in [4.4.40](#) applies.

#### IFRS 2.1

The employer may pay employees an amount of cash to cover social taxes and/or income taxes related to a share-based payment in addition to the share-based payment arrangement. In our view, if the cash payment is not based on the price (or value) of the entity's shares, then this portion of the plan should be treated as an employee benefit under IAS 19. If the cash payment is based on the value of the entity's shares, then it may be appropriate to treat this portion of the plan as a cash-settled share-based payment transaction (see [3.5.20](#) for further details).

**Example 3.5.11 – Grant of share options with additional payment to cover employee's income taxes**

On 1 January Year 1, Company B grants one share option each to 100 employees, subject to a two-year service condition. The share options will be exercisable at any date in Year 3.

The employees will be subject to income taxes at 20% of the intrinsic value of the options based on the difference between the exercise price and the then-current share price, at the date of exercise. All employees are expected to and ultimately do stay in service with B. The share price increases and all employees exercise the share options on the last day in Year 3.

In addition to the grant of share options, B grants a payment to the employees to cover the employees' income tax that results from the exercise of the share options. B's decision to compensate the employees for the income tax consequences to them of the share-based payment is an additional benefit that B recognises as the services are provided.

B is not required to withhold amounts for the tax liability from the employees.

B accounts for the grant of share options as an equity-settled share-based payment transaction and for payment for the employees' income tax as a cash-settled share-based payment.

The value per share option is as follows.

	Fair value	Intrinsic value
1 January Year 1	20	-
31 December Year 1	15	4
31 December Year 2	12	8
31 December Year 3	10	10

Because the additional 20% payment is accounted for as a cash-settled share-based payment transaction (i.e. the employee services received are measured initially based on the grant-date fair value of the share options, and then at each reporting date, and ultimately at settlement date, the fair value of the recognised liability is remeasured), the expenses over time are as follows.

End of	Instruments for which it is expected that the service condition will be satisfied	Current fair value at end of period	Expected total tax expense (instruments x fair value x 0.2)	Cumulative tax expense at the end of period	Tax expense in current period
Year 1	100	15	300	150 <sup>1</sup>	150
Year 2	100	12	240	240 <sup>2</sup>	90
Year 3	100	10	200	200	(40)
Totals					200

**Notes**

1.  $300 \times 1/2$ .
2.  $240 \times 2/2$ .

Assume that B's share-based payment expense is not deductible for tax purposes<sup>1</sup> and that all of the share options are exercised on 31 December Year 3. In addition, the tax payment due to the tax authority is required to be paid after the options have been exercised. B accounts for the transactions as follows.

	<i>Debit</i>	<i>Credit</i>
<b>31 December Year 1</b>		
Expenses	1,000 <sup>2</sup>	
Equity		1,000
<i>To recognise share-based payment expense in Year 1</i>		
Expenses	150	
Liability for employees' income tax		150
<i>To recognise associated payroll tax for share-based payments in Year 1</i>		
<b>31 December Year 2</b>		
Expenses	1,000	
Equity		1,000
<i>To recognise share-based payment expense in Year 2</i>		
Expenses	90	
Liability for employees' income tax		90
<i>To recognise associated payroll tax for share-based payments in Year 2</i>		
<b>31 December Year 3</b>		
Liability for employees' income tax	40	
Expenses		40
<i>To recognise remeasurement of payroll tax associated with share-based payments</i>		
Cash	2,000 <sup>3</sup>	
Equity		2,000
Liability for employees' income tax	200 <sup>4</sup>	
Payable to tax authority		200
<i>To recognise exercise of options and liability to tax authority</i>		
<b>Notes</b>		
1. For the accounting for the additional tax effects if the share-based payment is tax deductible based on the intrinsic value at the exercise date, see <a href="#">13.2.20</a> .		
2. 100 x 20 x 1/2.		
3. 100 x 20 (assumes exercise price of 20).		
4. Liability to the tax authority is accounted for in accordance with IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> and not IFRS 2.		

**IFRS 2.33**

This example illustrates that the tax liability is measured based on the fair value of the options during the vesting period, although the future payment will be based on the intrinsic value of the options. For more details, see [7.2.20](#).

**Tax payments when employer has primary liability**

In some jurisdictions, the employer rather than the employee may have the legal obligation to pay taxes on employee awards. If the employer is the obligor for the tax, then the employer recognises the cost and liability. In our view, an entity should choose an accounting policy, to be applied consistently, to treat the employer's obligation to pay the taxes either under IFRS 2 or as a provision in accordance with IAS 37.

IFRS 2.1

We believe that treatment as a provision would be appropriate if the obligation is of uncertain timing or amount, because this tax is not an income tax and therefore is not in the scope of IAS 12 *Income Taxes*.

The other alternative is to account for the tax obligation according to IFRS 2. Under this alternative, if the amount of the tax is based on the price (or value) of the equity instruments of the entity (see 3.5.20), then we believe that it should be accounted for as a cash-settled share-based payment. However, if the amount is not based on the value of an equity instrument, then it may be appropriate to consider the tax as an incidental expense associated with granting the share-based payment; the objective of IFRS 2 notes that the accounting standard addresses share-based payments including associated expenses.

The following example illustrates the treatment as a cash-settled share-based payment.



#### Example 3.5.12 – Tax payments with employer being obligor

On 1 January Year 1, Company C grants one share option each to 100 employees, subject to a two-year service condition. The share options will be exercisable at any date in Year 3.

C will pay payroll taxes at 20% of the intrinsic value of the options at the date of exercise. All employees are expected to and ultimately do stay in service with C. The share price increases and all of the employees exercise the share options on the last day in Year 3.

The accounting treatment for the payment of the payroll taxes is the same as the accounting in Example 3.5.11 – i.e. the fair value of the liability is estimated at grant date, spread over the vesting period and remeasured at each reporting date until settlement. Consistent with the accounting for cash-settled share-based payments, the measurement is based on the fair value of the options, although the payment is based on the intrinsic value of the share options.

IFRS 2.BC72

The employer may be able to require the employee to reimburse the employer for tax paid by the employer. In our view, if the employer elects to collect the tax from the employee, then the entity should choose an accounting policy, to be applied consistently, to account for this agreement with the employee using one of the following approaches.

- *Approach 1:* As a reimbursement right under IAS 37.
- *Approach 2:* As an adjustment to the exercise price because from the entity's perspective it is a cash inflow from the employee, assuming that it is conditional on exercise of the share-based payment.

If an entity follows Approach 2, then the estimation of the actual exercise price would affect the determination of the grant-date fair value. Differences between the estimated and actual exercise price would not be 'trued up' (adjusted). If an entity follows Approach 1, then the estimated recovery would be trued up to the actual amount recovered.

In our view, the accounting policy choice regarding the treatment of the reimbursement right is independent of the accounting policy choice regarding accounting for the employer's obligation.

The following examples illustrate the treatments described above.



### Example 3.5.13 – Reimbursement right for tax payments treated as adjustment to exercise price

The facts are the same as in [Examples 3.5.11](#) and [12](#), but the employer has a legal right (either from the arrangement or by law) to require reimbursement for the tax payment from the employee on exercise date and chooses to do so.

C elects to treat the reimbursement right as an additional exercise price in the underlying share-based payment transaction with the employee – i.e. the share option grant.

The additional exercise price reduces the grant-date fair value of the equity instruments granted. For example, the fair value of the share options before the adjustment at grant date is 20 (see [Example 3.5.11](#)). The grant-date fair value of the tax reimbursement would be 4 (20% of 20). Taking the additional exercise price into account, the adjusted grant-date fair value would be 16 (20 - 4) – i.e. the expenses recognised under the share-based payment transaction are reduced.

Assume that C's share-based payment expense is not deductible for tax purposes<sup>1</sup> and that all of the share options are exercised as at 31 December Year 3. C accounts for the transactions as follows.

	<i>Debit</i>	<i>Credit</i>
<b>31 December Year 1</b>		
Expenses	800 <sup>2</sup>	
Equity		800
<i>To recognise share-based payment expense in Year 1</i>		
<b>31 December Year 2</b>		
Expenses	800	
Equity		800
<i>To recognise share-based payment expense in Year 2</i>		
<b>31 December Year 3</b>		
Cash	2,200 <sup>3</sup>	
Equity		2,200
Expenses	200 <sup>5</sup>	
Payable to the tax authority		200
<i>To recognise exercise of options, liability to tax authority and reimbursement from employees<sup>4</sup></i>		

#### Notes

- For the accounting for the additional tax effects if the share-based payment is tax deductible based on the intrinsic value at the exercise date, see [13.2.20](#).
- $(100 \times (20 - 4)) \times 1/2$ .
- $(20 \times 100) + (10 \times 20\% \times 100)$ .
- This example assumes that the timing of the recognition of the reimbursement from employees coincides with that of the related tax effects. Therefore, no deferred income tax has been recognised in connection with the reimbursement.
- Liability to the tax authority is accounted for in accordance with IAS 37 and not IFRS 2.

The actual reimbursement received from the employee is recognised as the consideration for the issue of the share, like a normal exercise price: debit cash and credit equity.

If the intrinsic value at the date of exercise equals the grant-date fair value – i.e. it actually is 20 – then the reduced expenses for the equity-settled share-based payment of 4 and the expenses for the tax payment of 4 (20% of 20) result in a net effect on profit or loss of zero.

If, as is likely, the intrinsic value subsequently differs from 20, then these changes are not considered in the accounting for the share-based payment – i.e. there is no true-up – but the share-based payment expense related to the employee's tax liability will be adjusted when the options are exercised. For example, if the actual intrinsic value at date of exercise is 25, then 5 is the reimbursement to be received and credited to equity. In this case, the net effect on profit or loss would be an expense of 1 – i.e. a fixed reduction in share-based payment expense of 4 and variable tax cost of 5.



#### Example 3.5.14 – Reimbursement right for tax payments treated as a reimbursement right under IAS 37

The facts are the same as in [Example 3.5.13](#), but C elects to treat its right to recover tax as a reimbursement right under IAS 37.

The amount of income recognised will be equal to the actual payment. Together with the expenses recognised for the tax payment under the cash-settled share-based payment transaction or under the provision in accordance with IAS 37, the total net effect on profit or loss of the payment to the tax authorities and the tax reimbursement from the employee is zero.

There is no effect on the accounting for the share-based payment.

### 3.5.50 Employee share purchase plans

Often, broad-based share-based payment arrangements are designed as ESPPs.

*IFRS 2.IG17.Ex11*

Sometimes the shares are granted to the employees subject to a payment at a value below fair value. In this case, the entity receives past or future services in return for granting a discount and accordingly the transaction is a share-based payment (see [Example 3.4.1](#)).

*IFRS 2.IG17.Ex11*

If the terms appear to include a requirement for the employee to pay full fair value on grant date, then an example in the implementation guidance to IFRS 2 shows that there may be features in the terms and conditions that are required to be considered in determining the accounting.

It is not uncommon for such arrangements to contain some form of protection against any decline in value of the share between grant date and the date on which the employee is unconditionally entitled to the share. If this protection exists, then the arrangement is not the purchase of a share but instead is the granting of a share option. The exercise price of the share option is the amount paid on grant date. Because a share option with a prepaid exercise price has a positive value, there will be a cost to recognise for the employee services in such an arrangement.

**Example 3.5.15 – Examples of protection against falls in value**

Company X sells a share at fair value to an employee, but allows the employee to delay payment for the share for three years. After three years, the employee can settle the liability for the payment in cash or by returning the share.

Company Y sells a share at fair value to an employee. The employee is also given a put option to sell the share back to Y for the purchase price at any time for three years.

Company Z sells a share at fair value to an employee under an agreement containing clauses explaining what happens if the employee leaves. The 'bad leaver' clause includes the right for the employee to return the share for the amount they paid for it when they leave employment with Z for no reason.

If the shares are issued to employees in return for a payment at fair value without downside protection, then other factors may suggest that the transaction is in the scope of IFRS 2 (see 3.5.10).

**3.5.60****Reverse acquisition**

A 'reverse acquisition' is a business combination in which the legal acquirer – i.e. the entity that issues the securities – becomes the acquiree for accounting purposes and the legal acquiree becomes the acquirer for accounting purposes.

For example, an unlisted operating entity that meets the definition of a business may wish to obtain a stock exchange listing but want to avoid a public offering. The unlisted entity arranges for a listed entity (that does not meet the definition of a business) to acquire its equity interests in exchange for the equity interests of the listed entity. In this example, the listed entity is the legal acquirer because it issued its equity interests, and the unlisted entity is the legal acquiree because its equity interests were acquired.

*IU 03-13*

The IFRS Interpretations Committee discussed similar scenarios and noted that in such a case, the guidance in IFRS 3 on identifying the acquirer applies by analogy and would result in identifying the listed entity as the accounting acquiree and the unlisted entity as the accounting acquirer (see Chapter 2.6 in the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#) for further discussion of identifying the acquirer). However, because the listed entity is not a business, once the acquirer has been identified, the transaction is outside the scope of IFRS 3.

An issue arises about how to account for any difference between the fair value of the shares deemed to have been issued by the accounting acquirer (the unlisted operating entity) and the fair value of the accounting acquiree's (the non-operating listed entity's) identifiable net assets received. The Committee noted that the payment does not meet the definition of an intangible asset because it is not separable and that the difference should be treated in its entirety as a payment for a stock exchange listing and expensed. The stock exchange listing service is accounted for as a share-based payment transaction under IFRS 2 from the unlisted entity's perspective.

*IFRS 3.B21, IU 03-13*

Consolidated financial statements prepared following a reverse acquisition are legally those of the legal acquirer but are described in the notes as a continuation of the amounts from the (consolidated) financial statements of the legal acquiree. Consequently, the reverse acquisition is reflected in the consolidated financial statements of the legal acquirer, but not in any consolidated financial statements of the legal acquiree.



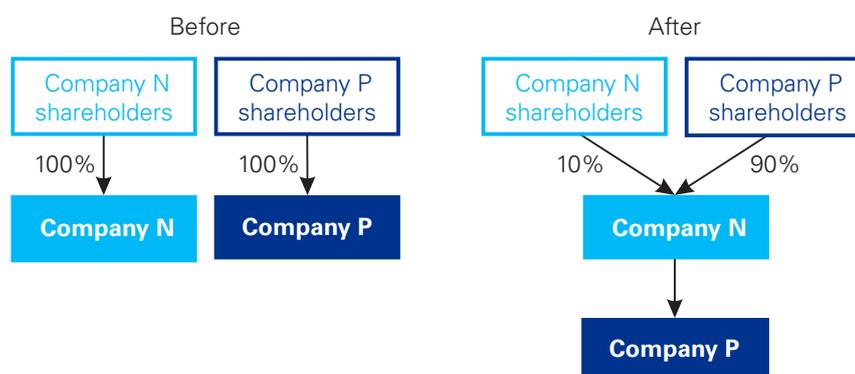
### Example 3.5.16 – Reverse acquisition into non-operating listed company

Company P is an unlisted operating company. Company N is a non-operating listed company that does not meet the definition of a business – i.e. N is a shell company. To obtain a stock exchange listing, P arranges for N to acquire all of P's shares by issuing its own shares to the shareholders of P.

The following facts are also relevant for this example.

- The fair value and book value of N's identifiable net assets (cash only) is 50.
- At the date of acquisition, the fair value of one share in P is 12.
- P has 90 ordinary shares.

After the transaction, the shareholders of P own 90% of the combined listed Company N, with the remaining 10% owned by the initial shareholders of N.



In this example, the substance of the transaction is that P has acquired N for its listing status. As noted in 3.5.60, because N is not a business the transaction is outside the scope of IFRS 3. The stock exchange listing service is instead accounted for as a share-based payment transaction from the perspective of P.

As such, P is deemed to have issued its own shares to acquire control of N. After the transaction, P's shareholders have a 90% interest in the combined entity – i.e. the shareholders have given up a 10% interest in P for a 90% interest in N. P would have to issue 10 shares to N's shareholders for interests after the transaction to be held 90% (90 / 100) by P's shareholders and 10% by N's shareholders (10 / 100). Therefore, the fair value of the shares issued to N's shareholders is 120 (10 shares x 12).

In the consolidated financial statements of N, the following entry is recorded in respect of the transaction. As noted in 3.5.60, the difference between the fair value of the shares deemed to have been issued and the fair value of the identifiable net assets acquired is recognised as a listing expense.

	Debit	Credit
Cash	50	
Listing expense (profit or loss)	70	
Equity (deemed issue of shares) <sup>1</sup>		120
<i>To recognise acquisition of N</i>		

#### Note

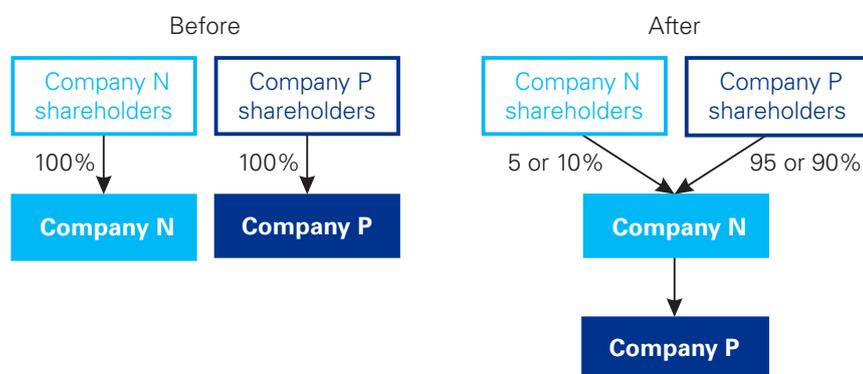
- As per the September 2022 IFRIC agenda decision *Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition*:
  - any instruments issued to acquire cash held by a SPAC are in the scope of IAS 32, as these instruments were not issued to acquire goods or services; and
  - any instruments issued for the stock exchange listing service are in the scope of IFRS 2.



### Example 3.5.17 – Reverse acquisition of non-operating listed company involving a variable number of shares

Assume the same facts as in [Example 3.5.16](#) except that under the terms of the agreement P's shareholders may be given additional N shares representing up to 5% of the total N shares outstanding after the end of the next financial year depending on the extent to which the group EBITDA exceeds a stated threshold in the next financial year.

None of the P or N shareholders provides services to the combined business. All P shareholders as at the transaction date will share proportionately in the additional N shares, regardless of whether they still hold the N shares in the future.



Similar to [Example 3.5.16](#), the substance of the transaction is that P has acquired N for its listing status. The stock exchange listing service is accounted for as a share-based payment transaction from the perspective of P because N is not a business.

The value of the listing expense is measured on the date on which the service was received (i.e. the transaction date).

In measuring the share-based payment, the EBITDA hurdle is a non-vesting condition because the period of achieving the performance target extends beyond the transaction date and consequently it does not demonstrate whether the listing 'service' was received. As such, the probability of the EBITDA hurdle being met is taken into account when estimating the fair value of the equity instruments granted. See [5.3.40](#) for further discussion.

On the assumption of 100% likelihood of achieving the EBITDA hurdle, the value of the equity (deemed issue of P shares to N shareholders) is calculated on the basis of P shareholders giving up a 5% interest in P for a 95% interest in N. Therefore, the fair value of the shares issued to N is 60 (five shares x 12), rather than 120 (10 shares x 12).

Because the EBITDA hurdle is a non-vesting condition, it is reflected in the measurement of the grant-date fair value of the share-based payment and there is no true-up for differences between the expected and actual outcome of non-vesting conditions – i.e. any subsequent difference in the number of N shares actually issued and the initially estimated outcome would not change the listing expense because it is the settlement of a non-vesting condition.

In the consolidated financial statements of N, the following entry is recorded in respect of the transaction. The difference between the fair value of the shares deemed to have been issued at the transaction date and the fair value of the identifiable net assets acquired is recognised as an expense.

	<i>Debit</i>	<i>Credit</i>
Cash	50	
Listing expense (profit or loss)	10	
Equity (deemed issue of shares) <sup>1</sup>		60
<i>To recognise acquisition of N</i>		

**Note**

- As per the September 2022 IFRIC agenda decision *Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition*:
  - any instruments issued to acquire cash held by a SPAC are in the scope of IAS 32, as these instruments were not issued to acquire goods or services; and
  - any instruments issued for the stock exchange listing service are in the scope of IFRS 2.



### Example 3.5.18 – Merger of two listed entities that do not meet the definition of a business

Companies L and G are listed companies engaged in mining exploration activities. Both companies are in the early stages of exploration and do not meet the definition of a business. L arranges for G to acquire all of L's shares by issuing its own shares to the shareholders of L.

Because both companies are not businesses, the transaction is outside the scope of IFRS 3. Similar to [Examples 3.5.16–17](#), the stock exchange listing service is instead accounted for as a share-based payment transaction and IFRS 3 may be applied by analogy to determine which entity to identify as the 'acquirer' (or the 'grantor') in the share-based payment transaction.

Assuming that L was identified as the acquirer, the transaction is accounted for as a share-based payment transaction from the perspective of L. As such, L is deemed to have issued its own shares to acquire control of G.

If the fair value of the net assets of G is reliably measurable and there is no indication that L has also received unidentifiable goods or services in the transaction, then the transaction is measured at this amount. If the fair value of the net assets of G are not reliably measurable or there is an indication that L has also received unidentifiable goods or services, then the transaction is measured indirectly with reference to the equity instruments deemed to be issued by L, which is the approach described in [Examples 3.5.16–17](#). See [11.2.30](#) for further discussion on measuring equity-settled share-based payment transactions with non-employees. See paragraph 2.6.30 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#) for further guidance on accounting for an asset or a group of assets that does not constitute a business.

## 3.5.70

### Special-purpose acquisition company – Accounting for warrants at acquisition

*IU 09-22*

The IFRS Interpretations Committee discussed the accounting for outstanding warrants of a SPAC by an entity acquiring a listed SPAC in a transaction that is not a business combination.

*IU 09-22*

In the scenario considered by the Committee, the entity issues new ordinary shares and new warrants to the SPAC's founder shareholders and public investors in exchange for the SPAC's ordinary shares and the legal cancellation of the SPAC warrants. The entity acquires cash and a stock exchange listing service in the transaction (see [3.5.60](#)).

- IU 09-22* The Committee noted that, when outstanding SPAC warrants exist, an entity is required to assess whether such warrants are part of liabilities assumed in the transaction. In assessing whether it assumes the SPAC warrants as part of the acquisition, the entity considers the specific facts and circumstances of the transaction, including the terms and conditions of all agreements associated with the acquisition. For example, it considers the legal structure of the transaction, as well as the terms and conditions of the SPAC warrants and the new warrants it issues.
- IU 09-22* If an entity concludes that the SPAC warrants are assumed as part of the acquisition, then it issues only ordinary shares to acquire cash and a stock exchange listing service, and assumes any liability related to the SPAC warrants. The entity applies IFRS 9 to account for the replacement of the SPAC warrants with new warrants. However, because the entity negotiated the replacement of the SPAC warrants as part of the acquisition, it determines whether it accounts for any of the new warrants it issues as part of that acquisition.
- IU 09-22* If the entity concludes that SPAC warrants are not assumed as part of the acquisition, then it issues both ordinary shares and new warrants to acquire cash and a stock exchange listing service. Because IFRS 2 applies only to the instruments issued for the stock exchange listing service and IAS 32 applies to those instruments issued for the cash, an entity determines to what extent it issued each type of instrument to acquire:
- the cash; and
  - the stock exchange listing service.
- IU 09-22* No IFRS accounting standard specifically applies to determining to what extent an entity issued each type of instrument to acquire the cash and the stock exchange listing service. Therefore, an entity develops and applies an accounting policy that results in relevant, reliable information.
- IU 09-22* The Committee also noted that an entity could:
- allocate the shares and new warrants to the acquisition of cash and the stock exchange listing service on the basis of the relative fair values of the instruments issued (i.e. in the same proportion as the fair value of each type of instrument to the total fair value of all issued instruments). For example, if 80 percent of the total fair value of the instruments issued comprises ordinary shares, then the entity could conclude that 80 percent of the fair value of instruments issued to acquire cash also comprises ordinary shares; or
  - use other allocation methods if they meet the requirements in paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, an accounting policy that results in the entity allocating all the new warrants issued to the acquisition of the stock exchange listing service solely to avoid the new warrants being classified as financial liabilities applying IAS 32 would not meet these requirements.



### Example 3.5.19 – Acquisition involving a Newco, a SPAC (which is not a business) and an Opco

Operating company Opco is an unlisted operating company. SPAC is a listed company that does not meet the definition of a business. To acquire SPAC and achieve the listing of Opco, Opco shareholders set up a new public company (Newco) which sits on top of Opco to facilitate the transaction. Together Newco and Opco are referred to as ‘the Entity’.

As part of the acquisition arrangement, the Entity registers and issues new shares and warrants to SPAC shareholders in exchange for the SPAC shares and warrants they hold. As part of the arrangement, Newco’s shares and warrants replace the existing SPAC shares and warrants as the listed instruments on the stock exchange and the SPAC shares and warrants are delisted and deregistered with the SPAC becoming a wholly owned subsidiary of Newco.

The following facts are relevant for this example.

- At the date of acquisition, the fair value of one share in SPAC is 1.
- SPAC has 120 shares on issue.
- SPAC has 100 warrants on issue which are classified as liabilities because the terms include a net settlement feature.
- The fair value and book value of SPAC's identifiable net assets is 75, which is made up of cash of 95 and a derivative liability for SPAC warrants of 20.
- At the date of acquisition, the fair value of one share in Newco is 12.
- Newco has 90 ordinary shares.
- Newco issues new warrants to the holders of SPAC warrants in exchange for the SPAC warrants. The SPAC warrants are immediately delisted and deregistered. The new warrants are issued on identical terms to the SPAC warrants.

After the transaction, the shareholders of Opco own 90% of the Entity, with the remaining 10% owned by the SPAC shareholders.

In this example, the Entity has acquired SPAC for its listing status. Because SPAC is not a business, the transaction is outside the scope of IFRS 3, so instead the Entity identifies and recognises the individual assets acquired and liabilities assumed in the transaction.

The identifiable assets and liabilities of the SPAC at the transaction date are cash of 95 and a derivative liability of 20 for the SPAC warrants. In assessing the transaction, the Entity views the SPAC warrants as being assumed in the transaction – i.e. the warrants are part of the identifiable assets acquired and liabilities assumed in the acquisition. As the SPAC warrants are viewed as assumed in the transaction, the fair value of the instruments issued by the Entity to acquire the SPAC is 120 (10 shares x 12).

The difference of 45 between fair value of the shares issued of 120 and the net identifiable assets acquired of 75 (cash of 95 less derivative liability of 20) is treated as a stock exchange listing expense and expensed immediately to profit or loss.

In the consolidated financial statements of the Entity, the following entry is recorded for the transaction.

	<i>Debit</i>	<i>Credit</i>
Cash	95	
Listing expense (profit or loss)	45	
Warrant liability <sup>1</sup>		20
Equity <sup>2</sup>		120

#### Notes

1. As per the September 2022 IFRIC agenda decision *Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition*, the liabilities assumed in the transaction are in the scope of IAS 32.
2. As per the September 2022 IFRIC agenda decision *Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition*:
  - any instruments issued to acquire cash held by a SPAC are in the scope of IAS 32, as these instruments were not issued to acquire goods or services; and
  - any instruments issued for the stock exchange listing service are in the scope of IFRS 2.

**Example 3.5.20 – Allocating warrants issued as part of consideration paid**

Modifying [Example 3.5.19](#), if the Entity instead concluded that the SPAC warrants are not assumed as part of the acquisition arrangement (i.e. the SPAC warrants are not part of the identifiable assets acquired and liabilities assumed in the acquisition). In this case, the new warrants form part of the instruments issued by the Entity in exchange for the cash acquired and the stock exchange listing service.

IFRS 2 applies to the instruments issued for the stock exchange listing service and IAS 32 applies to the instruments issued to acquire the cash. The Entity needs to allocate the shares and warrants issued between the cash acquired and the stock exchange listing service.

The Entity determines that it is appropriate to allocate the shares and new warrants between the cash acquired and the stock exchange listing service on a relative fair value basis.

Under IAS 32, the shares meet the definition of equity but the new warrants are classified as financial liabilities because the terms include a net settlement feature. Under IFRS 2, both the shares and warrants issued meet the definition of equity-settled share-based payments.

The following table sets out the allocation on a relative fair value basis. Refer to [Example 3.5.19](#) for information on the amounts included in the table below.

	Fair value	Relative %
Shares issued	120	85.7%
Warrants issued	20	14.3%
Total consideration	140	

Allocation of shares and warrants issued by the Entity between those issued to acquire the cash and those issued for the stock exchange listing service

Scope	Item	Amount	Shares	Warrants
IAS 32	Cash	95	81.4 <sup>1</sup>	13.6 <sup>2</sup>
IFRS 2	Listing service	45	38.6 <sup>3</sup>	6.4 <sup>4</sup>
			120.0	20.0

**Notes**

1.  $95 \times 85.7\%$ .
2.  $95 \times 14.3\%$ .
3.  $45 \times 85.7\%$ .
4.  $45 \times 14.3\%$ .

In the consolidated financial statements of the Entity, the following entry is recorded for the transaction.

	Debit	Credit
Cash	95	
Listing expense (profit or loss)	45	
Warrant liability		13.6
Equity: Shares		120.0
Equity: Warrants		6.4

# 4 Classification of share-based payment transactions

## Overview

- Share-based payment transactions are classified based on whether the entity's obligation is to deliver its own equity instruments (equity-settled) or cash or other assets (cash-settled).
- An intention or requirement to buy own equity instruments in order to settle a share-based payment does not affect classification.
- Awards requiring settlement in a variable number of equity instruments to a specified value are classified as equity-settled.
- Grants of equity instruments that are redeemable mandatorily or at the employee's option are classified as cash-settled, without consideration of intent or probability.
- Grants of equity instruments that are redeemable at the entity's option are classified based on the entity's intent and past practice of settling in shares or cash.

## 4.1 Scope of this section

This section addresses issues related to the classification of share-based payments as either equity-settled or cash-settled.

This section covers only share-based payments that involve the reporting entity settling in the reporting entity's shares or a cash payment based on its shares with a counterparty in exchange for goods or services provided directly to the reporting entity. All other arrangements – i.e. those that are settled by another group entity or shareholder or in which shares of another group entity are granted – are dealt with in [Section 10](#) (for classification issues in respect of group share-based payments, see [Chapter 10.2](#)). For a discussion of transactions in which the counterparty has a choice of settlement, see [Section 8](#).

IFRS 2.31

Transactions in which equity instruments are redeemable either mandatorily or at the counterparty's option are addressed in [4.5.20–30](#) respectively, because in these cases IFRS 2 *Share-based Payment* provides specific accounting requirements.

## 4.2 Principles of classification as either equity-settled or cash-settled

A share-based payment transaction that is in the scope of IFRS 2 (see [Section 3](#)) is classified as either an equity-settled or a cash-settled share-based payment transaction. The accounting requirements for each type of transaction differ significantly; for the accounting for equity-settled share-based payments see [Section 6](#), and for the accounting for cash-settled share-based payments see [Section 7](#). If the counterparty has a choice of settlement, then the transaction is accounted for in two components (see [Chapter 8.2](#)).

### IFRS 2.A

IFRS 2 defines equity-settled and cash-settled share-based payment transactions as follows.

An 'equity-settled share-based payment transaction' is a share-based payment transaction in which the entity:

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

A 'cash-settled share-based payment transaction' is a share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity.

In our experience, users of IFRS 2 work with simplified definitions of equity-settled and cash-settled share-based payment transactions that ignore group and shareholder aspects for an initial assessment of classification. Group and shareholder aspects can then be considered separately if necessary. One example of such a simplified definition could be as follows: A share-based payment transaction is classified as either equity-settled or cash-settled according to whether the entity is obliged to settle the transaction (a) either in its own equity instruments or (b) in cash or other assets based on the value of its own equity instruments.

### IFRS 2.B49

The classification of a share-based payment transaction is not affected by how an entity obtains the equity instruments that it will use to settle its obligations. For example, to settle an obligation to transfer shares to the counterparty, an entity may expect to buy its own shares in the market, either because it is prohibited from issuing new shares or because it wishes to avoid dilution. However, this expectation is not taken into consideration when assessing the classification of the share-based payment transaction. The classification of a share-based payment as either equity-settled or cash-settled is based on the nature of the entity's obligation to the counterparty. If the transaction is settled in equity instruments, then the transaction is classified as equity-settled.

The following issues raise questions in practice and the impact on classification is considered further in this section.

Issues in practice	Handbook reference
Grants of equity instruments 'to the value of'	<a href="#">Chapter 4.3</a>
Arrangements to transfer value to the employees on settlement date – e.g. when settlement is arranged in cash from the market (e.g. broker-dealer arrangements) or net of cash to be received from the counterparty	<a href="#">Chapter 4.4</a>

Issues in practice	Handbook reference
Grants of equity instruments that include redemption features – e.g. equity instruments that are redeemable at the employee’s option	Chapter 4.5
Contingently cash-settleable equity instruments – e.g. an event outside the control of the entity and the counterparty determines the type of settlement	Chapter 4.6
Arrangements denominated in a currency other than the issuing entity’s functional currency	Chapter 4.7

IFRS 2.34

Some share-based payment transactions contain a grant of equity instruments with a cash alternative. The cash alternative may be the result of a contingent event (see Chapter 4.6) or be subject to a choice of one of the parties:

- if the entity has the choice of settlement, then classification generally depends on the entity’s intention (see Chapter 8.3); or
- if the counterparty has the choice of settlement, then classification as equity-settled is precluded (see Chapter 8.2).

In other cases, the type of settlement depends on the occurrence of an event that neither party can control (see Chapter 4.6).

## 4.3 Grants of equity instruments ‘to the value of’

IFRS 2.BC106–BC110,  
IAS 32.16(b)(iii)

An ‘equity-settled transaction’ is defined as a transaction in which the entity receives goods or services as consideration for equity instruments of the entity. Therefore, a transaction that is settled in a variable number of shares is generally classified as an equity-settled share-based payment transaction, even though this classification may differ from the debt vs equity classification under the financial instruments standards.



### Example 4.3.1 – Grant of equity instruments to the value of a fixed amount

Company B, a listed entity, grants shares with a value equal to a fixed amount of 1,000 to each of the members of the management board, subject to a one-year service condition. The number of shares to be delivered depends on the share price on vesting date.

Because services are received, the transaction in this example is in the scope of IFRS 2 and is classified as equity-settled because the only consideration is B’s own equity instruments.

In contrast, an arrangement in which no services are received but a variable number of shares is exchanged for a fixed amount of cash would be classified as a liability under the financial instruments standards, which might suggest classification as cash-settled.

For a discussion of the measurement aspects of equity instruments to the value of a fixed amount, see 6.7.10.

In our view, classification as equity-settled applies even if the amount of cash itself is variable.

**Example 4.3.2 – Grant of equity instruments to the value of a variable amount**

Company C, a listed entity, grants shares to its CEO, subject to a one-year service condition. The value of the grant depends on the share price level achieved at the year end and the share price on vesting date.

- If the share price is above 100 at the end of the year, then the CEO receives 1,000 settled in shares.
- If the share price is above 120 at the end of the year, then the CEO receives 2,000 settled in shares.

We believe that C should classify the arrangement as equity-settled because equity instruments are issued in exchange for services. For a discussion of the measurement aspects of grants with a variable number of equity instruments, see [6.7.40](#).

**Example 4.3.3 – Cash bonus that is required to be used for buying shares in the entity**

On 1 January Year 1, listed Company D grants a bonus of 10,000 to an employee that is payable if the employee remains in service on 31 December Year 1 and D achieves a specified EBIT target for the year.

Under the terms of the arrangement, the employee will receive:

- 50% of the bonus in cash with no restrictions on its use; and
- 50% of the bonus in cash with a contractual requirement that the employee uses the cash to purchase shares in D within 30 days. The employee is required to hold the shares for three years but has no service requirement beyond Year 1.

During the three-year hold period, the employee:

- is required to confirm annually that they still hold the shares;
- can pledge but not sell the shares; and
- is obligated to return to D the cash bonus received to purchase the shares if they breach the terms of the arrangement – i.e. they do not purchase shares to the value of 5,000 or sell the shares before the end of three years.

The unrestricted cash bonus is in the scope of IAS 19.

The bonus received in cash and required to be used to buy and hold shares is a share-based payment transaction. This is because under the terms of the arrangement, the employee is entitled to receive D's equity instruments in exchange for services. D's obligation to transfer cash and the employee's obligation to use that cash to buy shares to the value of 5,000 are considered together. The share-based payment is classified as equity-settled because a variable number of shares to the value of 5,000 is granted to the employee.

For a discussion of how to account for a share-based payment in which the number of shares is variable ('shares to the value of'), see [6.7.10](#).

## 4.4 Arrangements to transfer value to the employees on settlement date

### 4.4.10 Introduction

IFRS 2.A, 41, 43

In some share-based payment arrangements, the entity's obligation is to deliver equity instruments, but the entity facilitates the sale of the shares on the market when employees want cash after settlement. In other arrangements, cash payments to be received from the counterparty – e.g. the exercise price of options or withholding taxes – are netted with the entity's obligation to deliver equity instruments. In these circumstances, the question arises whether such arrangements influence the classification of the share-based payment. Generally, if the counterparty has no ability to require a cash payment from the entity for its services, then the transaction is classified as equity-settled. This assessment does not change if the entity is required to make a cash payment as an agent on behalf of the counterparty (see 4.4.30).

### 4.4.20 Cashless exercise in a variable number of shares

IFRS 2.BC106

As illustrated in Chapter 4.3, a transaction that is settled in a variable number of shares is generally classified as an equity-settled share-based payment transaction, even though this classification may differ from the debt vs equity classification under the financial instruments standards. In our view, an award that is net share settled, sometimes referred to in practice as 'cashless exercise', would be viewed as equity-settled if the recipient has no ability to require a cash payment for the equity instruments tendered.



#### Example 4.4.1 – Cashless exercise of share options classified as equity-settled

Company B grants an employee 1,000 options at an exercise price of 100, subject to a three-year service condition. At the exercise date, the share price is 200. The exercise arrangement permits the employee to either:

- pay an exercise price of 100,000 and receive 1,000 shares worth 200,000 (i.e. net value of 100,000); or
- receive 500 shares worth 100,000 for no cash consideration (i.e. cashless exercise) by tendering all 1,000 options. The exercise price of 50,000 on these 500 shares is 'paid' by tendering unexercised options with an intrinsic value of 50,000  $((200 - 100) \times 500)$ .

We believe that the arrangement should be classified as equity-settled because the entity will not pay cash under either alternative.

### 4.4.30 Entity facilitates sale of equity instruments

An entity may facilitate the sale of shares or other equity instruments granted. For example, an entity might act as an agent for its employees. In our view, if the employer bears no risk in respect of the sale of the shares (e.g. share price fluctuations, credit risks etc), then classification of the transaction as an equity-settled share-based payment transaction is not precluded.

Determining whether the entity is settling the transaction in cash or acting as an agent requires an analysis of all of the terms and conditions. We believe that the following conditions are indicators of an agency relationship (i.e. that the equity instruments are sold on behalf of the recipient of the shares):

- the shares are sold to the market via an independent, third party brokerage firm;
- the entity has not agreed (explicitly or constructively) to buy the underlying shares from the brokerage firm;

- the entity does not guarantee, or underwrite in any way, the arrangement between the owner and the brokerage firm; and
- the entity is obliged to remit only the payments received from the broker and cannot be obliged to pay if the shares are not sold (e.g. in the event of unexpected market suspensions).



#### Example 4.4.2 – Entity facilitates the sale of equity instruments

Company C grants share options to its employees, subject to a one-year service condition.

Under the terms of the arrangement between C and the employees, employees may ask C to sell shares to the market via a third party brokerage firm. Some employees will opt for this type of settlement because it eases the realisation of the value of the shares in cash. In addition, a slightly better price and lower costs can be achieved on the market by aggregating the transactions of multiple employees. Under this option, C settles the transaction by transferring the shares to a third party brokerage firm in accordance with all of the conditions listed above, and C is obliged to transfer the cash received from the brokerage firm to the employee.

Although C can be required to transfer cash to the employees, we believe that this transaction should be classified as an equity-settled share-based payment transaction because C is acting as the agent of the employee in transferring cash from the broker's sale of the shares on the market.

#### 4.4.40

*IFRS 2.33E–33H*

#### Settling net of withheld taxes

In some countries, an employee may be subject to taxes on the receipt of a share-based payment arrangement. In some cases, the tax obligation is a liability of the employee and not the employer, although the employer may be obliged to collect or withhold the tax payable by the employee and transfer it to the tax authority. This type of transaction is classified as equity-settled in its entirety if the entire share-based payment would otherwise be classified as equity-settled without the net settlement feature. This may be referred to as 'an exception' to the general requirements in IFRS 2. For a discussion of when tax payments are share-based payments, see also [3.5.40](#).

In our view, the amount that the entity is obliged to withhold under tax laws or regulations does not need to be a fixed amount but does need to reflect the employee's tax obligation related to the share-based payment. Any amounts withheld in excess of the employee's tax obligation associated with the share-based payment should be accounted for as cash-settled in accordance with [Section 7](#).

The exception noted above does not apply to arrangements in which the entity is not required under tax laws or regulation to withhold an employee's tax obligation associated with the share-based payment or any equity instruments that an entity withholds in excess of the employee's tax obligation associated with the share-based payment.



#### Example 4.4.3 – Share-based payment settled net of tax: Statutory rate

Company F grants its employees options that entitle them to buy shares after three years at an exercise price of 100. The arrangement includes a three-year service condition.

Local tax law requires F to withhold an amount equal to 10% of the taxable gain on the share-based payment to settle the employee's tax obligation associated with share-based payments and transfer that amount in cash to the tax authority.

F accounts for the arrangement in its entirety as an equity-settled share-based payments because it withholds the amount under local tax law and the arrangement would be classified as equity-settled in its entirety in the absence of the net settlement feature.



#### Example 4.4.4 – Share-based payment settled net of tax: Employee’s marginal tax rate

Modifying Example 4.4.3, local tax law requires Company F to withhold tax at a minimum rate of 10% of the taxable gain to settle the employee’s tax obligation associated with the share-based payment and transfer that amount in cash to the tax authority.

The employee is required to pay tax on their income from the share-based payment arrangement at their marginal rate (i.e. the tax obligation is not limited to the minimum statutory withholding). Any difference between the amount withheld by F to meet the employee’s tax obligation and the employee’s final tax obligation is settled directly between the employee and the tax authority.

F’s current practice is to settle the share-based payment arrangement net at the employee’s expected marginal tax rate of 35%.

We believe that F should account for the arrangement in its entirety as an equity-settled share-based payment because it withholds an amount under local tax law and the arrangement would be classified as equity-settled in its entirety in the absence of the net settlement feature (see 4.4.40).

Conversely, if F chose to withhold at a fixed rate of 40% for administrative ease, rather than at the minimum statutory rate of 10% or the employee’s expected marginal rate of 35%, then any excess over the employee’s tax obligation withheld – i.e. in this case over 35% – would generally be outside the scope of the exception discussed in 4.4.40, because the 40% is not withheld to settle the employee’s tax obligation related to the share-based payment. The excess would instead be accounted for as a cash-settled share-based payment.

## 4.5 Grants of equity instruments that include redemption features

### 4.5.10 Introduction

An entity may make a share-based payment using equity instruments that are redeemable, either mandatorily or at one party’s option. The label under which these arrangements are seen in practice varies and includes ‘buy-back arrangement’, ‘sell-back arrangement’, ‘put option’ or ‘call option’. Although the redemption features are sometimes included in the share-based payment agreement, they may also be part of the entity’s articles of association or a separate agreement. In our view, redemption features that are associated with the instrument granted as part of a share-based payment form part of the terms and conditions of the share-based payment arrangement.

Redemption features are generally observed in share-based payments of unlisted entities. Often, those grants are under the condition that the equity instruments are redeemable when the employee ceases employment with the entity. This is because the shareholders of unlisted entities often do not want to allow external parties other than employees to participate in their decisions or to receive the benefit of subsequent increases in the value of the entity. However, such a feature does not always preclude the classification of the transaction as equity-settled, as discussed below.

### 4.5.20 Mandatorily redeemable equity instruments

*IFRS 2.31*

Sometimes, share-based payments include both a grant of an equity instrument and an obligation to pay cash at a later date. Although such a share-based payment includes the grant of an equity instrument, classification as equity-settled is precluded if the instruments issued are redeemable mandatorily. This is because the entity is required to pay cash at some point in time – i.e. to settle the share-based payment in cash.

**Example 4.5.1 – Grant of equity instruments that are redeemable mandatorily**

Company B, an unlisted entity, grants share options to its employees, subject to a three-year service condition. On exercise of the options, B is obliged to deliver own shares. When the employee ceases employment with B, the shares are redeemable mandatorily at the then-current fair value.

In this example, the share-based payment is classified as cash-settled, because B will be required to pay cash at some point in time. For the accounting consequences of such an award, see [Chapter 7.5](#).

**4.5.30***IFRS 2.31, 34***Equity instruments redeemable at the employee's option**

Classification as equity-settled is also precluded if the share-based payment results in the issuance of equity instruments that are redeemable at the option of the employee. The probability of the entity being required to pay cash is not considered.

**Example 4.5.2 – Grant of equity instruments that are redeemable at employee's option (put option)**

Company C, an unlisted entity, grants share options to its employees, subject to a three-year service condition. On exercise of the options, C is obliged to deliver its own shares. The employee may require C to redeem the shares at any time within five years after exercise.

In this example, the share-based payment is classified as cash-settled, because C can be required to pay cash at some point within five years after vesting.

If, in contrast, the employee does not require redemption within five years of the exercise of the options, then the guidance in [8.2.30](#) applies.

*IFRS 2.31, 34*

The requirement to classify transactions involving puttable or redeemable shares as cash-settled share-based payment transactions is not limited to instruments with put or redemption terms that are exercisable immediately. Therefore, in our view instruments that require a minimum holding period before put rights are exercisable should be classified as cash-settled, regardless of the length of the minimum holding period.

*IFRS 2.33*

The fair value of a cash-settled share-based payment is remeasured at each reporting date and ultimately on settlement date. In our view, for a grant of options to acquire redeemable shares, the settlement of the share-based payment occurs only on redemption of the shares and not on exercise of the options. Therefore, we believe that an entity should recognise compensation cost and a corresponding cash-settled liability equal to the grant-date fair value of the options; this liability should be remeasured at each reporting date. On exercise of the options, the entity should continue to remeasure the cash-settled liability to fair value. The entity should remeasure the cash-settled liability through profit or loss until the shares are redeemed.

*IFRS 2.31, 35, 37, BC259*

The requirement to classify a grant of equity instruments that are redeemable at the employee's option as cash-settled in its entirety is consistent with the requirements for a share-based payment in which the employee has a choice of settlement. For an instrument that is redeemable at the holder's option, the entity first determines the value of the debt component. If the equity-settled alternative is for the same award (e.g. 100 shares or their cash value), then there is nothing left to assign to the equity component. For example, the equity element will be measured at zero if the price at which the employee can redeem the share is structured so that the fair value of the payment is always the same as the fair value of the equity instrument.

## 4.5.40

IFRS 2.41

IFRS 2.BC265

### Equity instruments redeemable at the entity's option

If the entity rather than the employee has the option to redeem the shares granted in a share-based payment, then the entity determines whether it has a present obligation to settle in cash and accounts for the share-based payment transaction accordingly.

Even if the equity instruments are not puttable or redeemable, in our view the entity should consider whether the overall effect of the arrangements is that, in substance, the employer has a substantive choice of cash or equity settlement. A question may arise if, for example, the employee is required to offer shares back on ceasing employment and, although it is not required, the employer has a stated policy or past practice of accepting the offer and buying them back.



#### Example 4.5.3 – Entity's option to buy back shares

Company D, an unlisted entity, grants shares to its employees at a discount. When an employee leaves, they are required to offer to sell the shares back to D at the then-current fair value. D is not required to buy back the shares.

Classification will depend on D's stated policy and/or its past practice of buying back shares under similar transactions. If D has a past practice of buying back the shares, then we believe that the share-based payment arrangement should be classified as cash-settled.

For further discussion of share-based payment transactions in which the entity has the choice of settlement, see [Chapter 8.3](#).

However, a past practice of buying back shares issued in an equity-settled share-based payment transaction does not automatically require future similar transactions to be classified as cash-settled because the significance of past practices can depend on the nature of the repurchase arrangements of each transaction. In our view, if there is no mandatory redemption feature and a repurchase arrangement is available to all shareholders, including non-employees, and is substantive, then in rare circumstances it may be appropriate to 'de-link' the repurchase arrangement from the share-based payment, because it is considered more a shareholder-related term and condition. If the repurchase arrangement is de-linked in this manner, then it is not considered in the classification of the share-based payment, which is classified as equity-settled from grant date.



#### Example 4.5.4 – Buy-back arrangement de-linked from share-based payment

Company B, an unlisted entity, has established a discretionary share buy-back arrangement. The following facts are relevant for this example.

- Each year a share-dealing window operates around the annual general meeting date. A letter is distributed to all shareholders that advises them of the procedures for buying and selling B's shares and the fixed price at which the shares will be bought back as determined by an independent third party.
- These buy-back arrangements are available to all shareholders. Employees can leave B's employment and keep the shares that they have obtained through the share-based payment arrangements. Shareholders include employees, former employees, descendants of former employees and a pool of individual shareholders – i.e. not related to employees.
- Notwithstanding the existence of the buy-back arrangement, B is not obliged to repurchase the shares.

In this example, we believe that B should classify the equity instruments issued to its employees under a share-based payment arrangement as equity-settled because the buy-back arrangement available to all other shareholders is substantive and B is not obliged to repurchase the shares from the employee – i.e. there is no mandatory redemption feature. B should also consider the terms of the buy-back arrangement to determine whether the offer to buy back shares is a written put in the scope of the financial instruments standards.



#### Example 4.5.5 – Buy-back arrangement not de-linked from share-based payment

Company C, an unlisted entity, plans to issue shares to its employees. The following facts are relevant for this example.

- These equity instruments will be subject to discretionary share buy-back arrangements; C plans to make this buy-back available to all shareholders, but has not yet done so.
- Notwithstanding the proposal to establish a broad-based buy-back arrangement, C is not obliged to repurchase the shares. However, unlike in [Example 4.5.4](#), C is owned currently by a single shareholder. Following the share issue, a small percentage of C's shares will be held by other shareholders – i.e. employees. If they leave C's employment, then employees must offer their shares for sale to other employees or C, but C is still not obliged to repurchase the shares. Therefore, a body of ex-employee shareholders may in due course develop.

In this example, we believe that there is not sufficient evidence to support a conclusion that it is appropriate to de-link the buy-back arrangement from the terms of the share-based payment arrangement. Therefore, we believe that considering the proposed buy-back arrangement as a shareholder arrangement (rather than a term of the employee share-based payment) is not appropriate because there is no body of existing shareholders outside the employee pool to demonstrate that the buy-back arrangement relates other than to employees who receive shares in their role as employees. In our view, the possible future development of a substantial external shareholding body should not be anticipated and the share-based payment should be classified following the requirements for share-based payment transactions in which the entity has the choice of settlement (see [Chapter 8.3](#)).

### 4.5.50

*IFRS 2.31*

#### Equity instruments redeemable at the option of both parties

If the equity instruments are redeemable at the option of either party, then a question arises about whether layering an entity's call option on top of an employee's put option changes the conclusion reached for the employee's put option (see [4.5.30](#)). Because the entity can still be required to pay cash based on the employee's choice, such a transaction would be classified as cash-settled.

### 4.5.60

#### Return of up-front payments on forfeiture of a share-based payment

The scenarios in [4.5.20–50](#) cover equity instruments that are subject to redemption features once the equity instruments are vested. These redemption features affect the classification assessment and may result in classification as cash-settled. If the redemption feature applies to unvested equity instruments on forfeiture only, then in our view the assessment of classification may be different if the buy-back is only a mechanism for repaying an initial purchase price.



### Example 4.5.6 – Buy-back arrangement for non-vested shares

The employees of Company G are eligible to buy shares from G at a discount from the market price and the employees become unconditionally entitled to the shares if they satisfy a service vesting condition. If an award is forfeited because employment terminates before the award is vested, then the employee is required to sell the shares back to G for an amount equal to the original purchase price.

The discount from the grant-date fair value of the shares with protection from a decline in value is a share-based payment that is recognised over the service period.

We believe that the requirement for the employee to sell the shares back to G at the original purchase price if the vesting condition is not satisfied does not result in the share-based payment being classified as cash-settled. In this case, we believe that the redemption feature is a mechanism to claw back unvested share-based payments.

Because the employee is not unconditionally entitled to the shares during the vesting period, in our view the entity should recognise the purchase price received as a deposit liability until the share-based payment vests – i.e. the entity should initially recognise a liability to refund the purchase price rather than reflecting this in equity as an issuance of shares.

## 4.6 Contingently cash-settleable equity instruments

### 4.6.10 Introduction

IFRS 2 provides guidance on the classification of share-based payments that contain a cash alternative that can be chosen by the entity or by the employee (see [Chapters 8.2](#) and [8.3](#)). However, it does not provide guidance on the classification of a share-based payment in which equity instruments are cash-settleable only on the occurrence or non-occurrence of a contingent event.

IAS 37.14, IU 01-10

In our view, if an entity issues a share-based payment that is contingently cash-settleable and the contingency is not within the control of the issuer or the counterparty, then it should determine whether to classify the share-based payment as cash-settled or equity-settled based on the liability recognition criteria of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This is because IFRS 2 does not base classification solely on the legal right to avoid cash payment; for example, the accounting standard also considers the intended manner of settlement. Therefore, in respect of contingently cash-settleable share-based payment transactions, we believe that an entity is not required to analogise to the guidance in IAS 32 *Financial Instruments: Presentation* on the classification of instruments as debt or equity.

Examples of contingent events outside the control of the issuer and the counterparty include IPOs and changes in control of the entity.

Based on the classification guidance in IAS 37, we believe that when determining whether a liability to the employee exists, the contingent feature would affect the classification only if the contingent event is probable – i.e. more likely than not. If the event's likelihood of occurrence is less than probable and the share-based payment would otherwise be classified as equity-settled, then we believe that it should be classified as equity-settled.

In our view, after initial classification the entity should reassess at each reporting date the probability of cash outflow to determine whether the share-based payment is equity-settled or cash-settled. This is because IAS 37 requires reassessment of probabilities and estimates of expected cash flows at each reporting date.

**Example 4.6.1 – Cash settlement contingent on an event outside the control of the entity or the employee**

On 1 January Year 1 Company B, a listed company, grants 10 share options each to its 100 employees, subject to a two-year service condition. B is obliged to settle the transaction in its own shares, unless an employee gets a long-term illness. In this case, the employee is entitled to receive cash equal to the intrinsic value of the options at vesting date for a pro rata amount of options and the remainder of the options lapses.

We believe that B should estimate the probability of the employees getting a long-term illness during the vesting period. If B concludes that this is unlikely, then the grant is initially classified as equity-settled for all options granted.

At the end of Year 1, one employee contracts a long-term illness. We believe that B should change the classification of the share-based payment from equity-settled to cash-settled for five of the share options granted to this employee because a cash outflow on a pro rata basis is now probable. The employee is entitled to a payment based on five out of 10 of the options because he falls ill halfway through the two years. Under the agreement, the other five share options lapse and are accounted for as a forfeiture.

If a change in the probability of cash outflows is such that the classification of the arrangement as either equity-settled or cash-settled changes, then in our view a switching approach should be followed to account for the change in classification, because there is one single grant with two possible outcomes from inception. This approach is the same as that for an award with multiple alternative performance conditions (see 6.8.30). We believe that it is not appropriate to account for the change in classification under the approach for changes in classification arising from modifications (see Chapter 9.2).

**Example 4.6.2 – Contingently cash-settleable equity instruments on non-occurrence of an IPO**

On 1 January Year 1, Company P grants its employees an award with the following characteristics:

- if there is an IPO before 31 December Year 5 and the employees are still in service, then P will settle the award in equity; and
- if there is no IPO before 31 December Year 5 and the employees are still in service, then P will settle the award in cash.

On 1 January Year 1, it is not considered probable that an IPO will occur before 31 December Year 5. Therefore, the award is initially classified as cash-settled. On 1 January Year 2, it becomes probable that an IPO will occur before 31 December Year 5.



Therefore, on 1 January Year 2, the award should be reclassified as an equity-settled award; the cash-settled liability is reversed through profit or loss, and an expense for services provided to date for the equity-settled award is recognised using the grant-date fair value with a credit to equity.

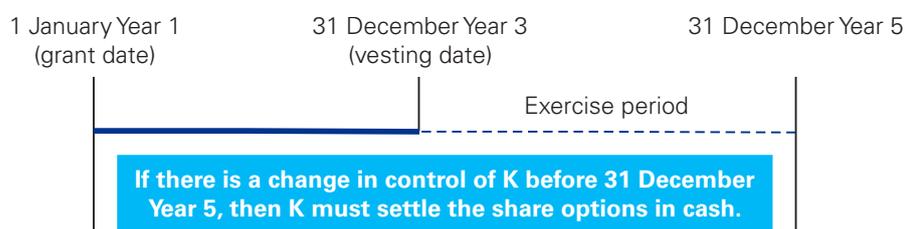
## 4.6.20 Change-in-control clauses

A further issue arises when the contingent event is a change in the control of the entity. Often, a change in control requires approval of the entity's board and/or the shareholders. Generally, IFRS 2 regards shareholders as part of the entity – e.g. when it requires attribution to the entity of equity-settled grants made directly by the shareholders (see 10.1.40). Therefore, the shareholders of an entity are generally regarded as part of the entity for the purposes of the accounting standard, unless it is clear that they are acting as an investor and not on behalf of the entity. In our view, in respect of a change in control, shareholders should be regarded as separate from the entity because they generally make decisions about whether to sell or retain their shares as investors based on the terms offered. Therefore, we believe that a change in control would not be regarded as an event within the control of the entity and should be considered a contingent event. This is consistent with our view on the impact of a change-in-control clause on the classification of a financial instrument as debt or equity under the financial instruments standards.



### Example 4.6.3 – Contingently cash-settleable equity instruments on change in control

On 1 January Year 1, Company K issues to employees share options that vest after three years of service; the options are exercisable until 31 December Year 5. If there is a change in control of K before 31 December Year 5, then K is required to settle the share options in cash at their fair value at that date.



Based on the approach described above, this share option is not cash-settleable at the option of the entity but is a contingently cash-settleable option that would be recognised as an equity-settled share-based payment unless it becomes probable that there will be a change in control of K before 31 December Year 5.

## 4.7 Arrangements denominated in a currency other than the issuing entity's functional currency

There is no specific guidance on the classification of share-based payment arrangements that are denominated in a currency other than the issuing entity's functional currency.

IFRS 2.BC106–BC110

Under IAS 32, contracts that will be settled by an entity by delivering a fixed number of its own equity instruments for a variable amount of cash are classified as financial liabilities. Delivering a fixed number of shares for a fixed amount of foreign currency is not equity-classified because the amount of cash in the entity's functional currency is variable. In the absence of specific guidance in IFRS 2, the question arises whether the classification of the share-based payment should be consistent with that which would be required under the financial instruments standards. In our view, classification under IFRS 2 should be based on what form of consideration the entity is providing to its employees. Because there are a number of identified differences between the share-based payments standard and the financial instruments standards, we do not believe that an analogy to the financial instruments standards is required for these arrangements.

**Example 4.7.1 – Exercise price in foreign currency**

Company C's shares are traded and quoted in euro, which is also C's functional currency. C issues options on its shares to employees of its US subsidiary with a fixed exercise price that is denominated in US dollars. Because the functional currency of C is the euro but the exercise price is denominated in US dollars, C will receive a variable amount of cash on exercise of the options for a fixed number of shares.

We believe that the arrangement should be classified as equity-settled, because C is providing equity instruments to employees in exchange for services. Because there are a number of identified differences between IFRS 2 and the financial instruments standards, we do not believe that an analogy to the financial instruments standards is required in respect of these arrangements.

In [Example 4.7.1](#) and similar scenarios, in our view, in determining the grant-date fair value of the foreign currency-denominated option, the entity should translate the exercise price into its functional currency at the exchange rate on that date and consider additional factors such as the volatility of the exchange rate, the correlation of the exchange rate and the share price, and the risk-free interest rates in both currencies. We believe that the grant-date fair value should not be remeasured for subsequent changes in exchange rates.

# 5 Classification of conditions

## Overview

- Conditions that determine whether and/or when the entity receives the required services are classified either as vesting conditions or as non-vesting conditions.
- 'Vesting conditions' determine whether the entity receives the required services from the counterparty.
- Vesting conditions are subdivided into service conditions and performance conditions.
- A 'service condition' is the requirement to complete a specified period of service.
- A 'performance condition' is the requirement to complete a specific period of service and to meet specified performance targets. Performance conditions are subdivided further into market conditions and non-market performance conditions.
- A 'market condition' contains a performance target that is related to the market price of the equity instruments of the entity.
- A 'non-market performance' condition contains a performance target that is not related to the market price of the equity instruments of the entity.
- 'Non-vesting conditions' do not determine whether the entity receives the required services but affect the counterparty's entitlement to receive the share-based payment.
- There are three types of non-vesting conditions: those that the entity can choose to meet; those that the counterparty can choose to meet; and those that neither the entity nor the counterparty can choose to meet.

## 5.1 Background

Share-based payments may be granted unconditionally. For example, an entity grants a share-based payment to its employees for services rendered in the past and the employees can retain the grant regardless of whether they leave the entity directly after the grant.

However, share-based payments are usually subject to one or more specified conditions. Often, these conditions are designed to motivate the employees, or other suppliers, to provide more or better services and align their personal goals and objectives with those of shareholders.

From the point of view of the counterparty, all conditions determine whether and/or when they become entitled to a share-based payment.

Different types of conditions affect the amount and timing of the entity's accounting differently, as illustrated below. The classification of conditions as discussed in this section is important because it may affect the consequential accounting.

An important aspect to consider is the distinction between vesting and non-vesting conditions. ‘Vesting conditions’ determine the vesting period over which the share-based payment cost is spread. ‘Non-vesting conditions’ are not relevant for determining the period over which the share-based payment cost is spread but they may have other implications – e.g. determining whether an employee receives a share-based payment or whether a share option is exercisable.

Conditions are either:

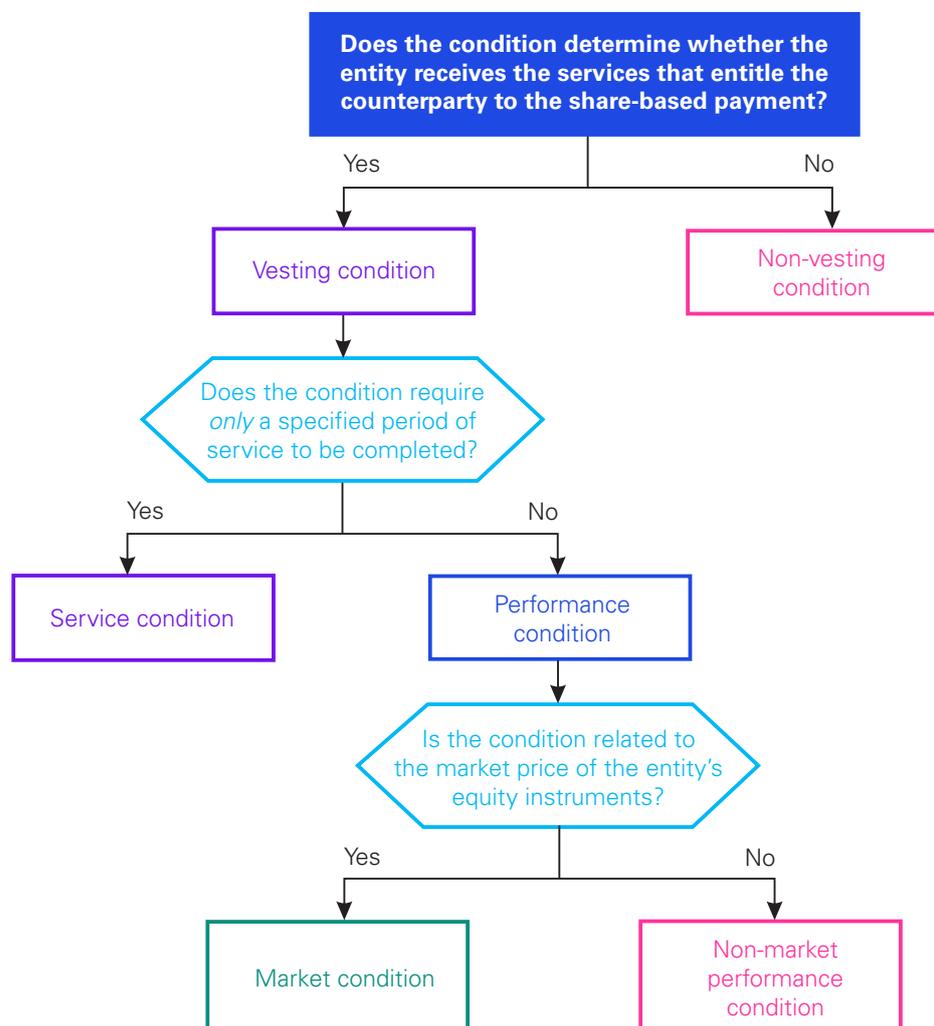
- reflected in the fair value of the awards granted: i.e. market conditions and all non-vesting conditions; or
- not reflected in the fair value of the awards granted, but reflected in an estimate of the number of awards that are expected to vest: i.e. service conditions and non-market performance conditions.

This section discusses the classification of such conditions. For a discussion of the impact of conditions on the recognition and measurement of share-based payments, see 6.2.10 (equity-settled share-based payments) and 7.2.10 (cash-settled share-based payments).

## 5.2 Determining the type of condition

IFRS 2.IG4A, IG24

The following flowchart, which is based on the implementation guidance to IFRS 2 *Share-based Payment*, illustrates how to determine the classification of a condition.



## 5.3 Vesting conditions

### 5.3.10 Introduction

IFRS 2.A

Important terms in classifying conditions are the terms 'vests' and 'vesting'. A share-based payment vests when the employee's right to receive the share-based payment is no longer conditional on the satisfaction of any vesting condition.

IFRS 2.A, IG4A

'Vesting conditions' are conditions that determine whether the entity receives the *services* that entitle the counterparty to the share-based payment. 'Non-vesting conditions' are all other conditions that determine whether the counterparty receives the share-based payment.

IFRS 2.BC171

Although determining whether a condition is a vesting condition can be complex (see [Chapter 5.5](#)), the basic meaning of 'vesting' is that an employee has paid for the share-based payment by having provided the required services to the entity. Once the share-based payment is vested, the employee can leave the entity without losing the entitlement to receive the share-based payment.

IFRS 2.IG24

However, the fact that the share-based payment vests does not necessarily mean that the employee *receives* the share-based payment. There may be other conditions, described as 'non-vesting conditions', that also need to be met for an employee to receive the share-based payment. For example, the requirement to hold shares for two years during the vesting period is a non-vesting condition.

IFRS 2.A

The definitions of 'vesting conditions' and 'market condition' in IFRS 2 were amended and the definitions of 'performance condition' and 'service condition' were added to IFRS 2 as part of the *Annual Improvements to IFRSs 2010–2012 Cycle*. These amendments are applied prospectively to share-based payment transactions for which grant date is on or after 1 July 2014 – i.e. they are currently effective requirements for entities with an annual reporting period ended on 31 December 2014. Earlier application is permitted.

For awards with a service condition (see [5.3.20](#)), the amendments clarify that if the counterparty, regardless of the reason, ceases to provide service during the vesting period, then it has failed to satisfy the service condition. Therefore, if an employer terminates the services of an employee and prevents the required service from being provided, then such a termination is accounted for as a forfeiture. As a result of this amendment, the accounting policy choice discussed in [6.9.10](#) cannot be applied to share-based payment transactions for which grant date is on or after 1 July 2014.

The amendments also address circumstances in which an award is conditional on both a service condition and a specified performance target. They clarify that the specified performance target must be met while the counterparty is rendering services – i.e. the performance target is a performance (vesting) condition only if the performance assessment period coincides with the service period. Specifically, the period of achieving the performance target cannot extend beyond the end of the service period but may start before the service period, provided that the commencement date of the performance target is not substantially before the service commencement date. For further discussion of the period for achieving a performance target and the impact on whether the condition is a performance (vesting) or non-vesting condition, see [5.3.40](#).

### 5.3.20 Service conditions

IFRS 2.A, BC171A,  
BC346

Service conditions require the counterparty to complete a specified period of service. For a discussion of an implicit service condition, see [5.5.20](#).

[Examples 5.3.1](#) and [2](#) illustrate the implications of a service condition.

**Example 5.3.1 – Share option without service condition**

On 1 January Year 1, Company C grants a share option to an employee. The share option can be exercised at any time within the next five years and has no conditions.

In this example, no future services are required; therefore, the share-based payment does not contain a vesting condition. The employee can leave C on 2 January Year 1 and still be entitled to exercise the option at any time until 31 December Year 5.

**Example 5.3.2 – Share option with service condition**

On 1 January Year 1, Company D grants a share option to an employee, subject to a two-year service condition. The share option can be exercised at any time in the period from 1 January Year 3 until 31 December Year 5.

In this example, the employee is required to provide future services – i.e. to satisfy a two-year service condition – before the share option vests and becomes exercisable.

If the condition is met at the vesting date – i.e. if the employee stays in service with D until 31 December Year 2 – then the employee is entitled to exercise the option at any time in the period from Year 3 to Year 5, regardless of whether they stay with D or leave.

If the condition is not met at the vesting date – i.e. if the employee's employment with D terminates before the vesting date – then the share option does not vest and the employee cannot exercise the share option.

The service condition is a vesting condition because it ensures that the employee provides two years of service before being entitled to the share-based payment.

**5.3.30***IFRS 2.A***Performance conditions**

Performance conditions are either market conditions or non-market performance conditions that require the counterparty to:

- complete a specified period of service: i.e. a service condition, which can be either explicit or implicit; and
- meet specified performance targets while the counterparty is rendering the services.

The performance target in a market condition relates to the share price of the equity instruments of the entity or the equity instrument of another entity in the same group.

The performance target in a non-market performance condition relates to operations or activities of the entity itself or another entity in the same group – i.e. it is not related to the share price of the equity instruments of the entity (or the equity instruments of another entity in the same group).

*IFRS 2.A*

'Market conditions' are conditions under which the vesting or exercisability of an equity instrument is related to the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group).

'Non-market performance conditions' are conditions under which vesting or exercisability of an equity instrument is related to specific performance targets associated with an entity's own operations or activities, or the operations or activities of another entity in the same group – e.g. a specified increase in profit or an EPS target. As such, non-market performance conditions are unrelated to the market price of the entity's equity instruments (or the equity instruments of another entity in the same group).

Examples 5.3.3 and 5.3.4 illustrate basic examples of performance market and non-market conditions. Examples 5.3.5–7 illustrate how to consider ESG-related conditions when identifying performance conditions.



#### Example 5.3.3 – Market condition

On 1 January Year 1, Company B grants a share option to an employee, subject to a three-year service condition and B's share price meeting a target of at least 120 at vesting date. The share option is exercisable for a period of five years after 31 December Year 3, regardless of whether the employee is still employed with B at that time.

The condition attached to the share-based payment is classified as a market condition, because it contains a service requirement and a performance target that relates to the share price of B's equity instrument.



#### Example 5.3.4 – Non-market performance condition

On 1 January Year 1, Company C grants a share option to an employee, subject to a three-year service condition and to C's profit being at least 10 million in Year 3. The share option is exercisable for a period of five years after 31 December Year 3, regardless of whether the employee is still employed with C at that time.

The condition attached to the share-based payment is classified as a non-market performance condition because it contains a service requirement and a performance target that is related to C's profit, and is not related to the share price of C's equity instrument.



#### Example 5.3.5 – Non-market performance condition: Scope 1 emissions target

On 1 January Year 1, Manufacturing Company X grants an award of free shares in X to senior executives.

X structures the arrangement such that the shares vest after a five-year service period if X's Scope 1 emissions for the year ended 31 December Year 5 are 30% less than those for the year ended 31 December Year 0. X has a formal process for measuring its annual Scope 1 emissions and the calculations are verified by a third party.

X's management is considering actions for reducing Scope 1 emissions, including:

- discontinuing products for which the production process produces emissions above a specified limit;
- changing production processes to reduce emissions;
- exploring opportunities to implement carbon-capture activities; and
- electrifying the vehicle fleet.

X determines that the emissions reduction target meets the definition of a non-market performance condition because:

- the assessment period aligns with the service period;
- the arrangement includes a specific target – i.e. a 30% reduction in emissions; and
- the target is associated with X's operations and actions because it relates to reducing greenhouse gases emitted by X.



#### Example 5.3.6 – Non-market performance conditions: Scope 3, Category 7 emissions target

On 1 January Year 1, Service Company Y grants options to senior executives.

As part of its net-zero strategy, Y structures the arrangement such that the options vest after a three-year service period if Y's Scope 3, Category 7 (employee commuting) emissions for the year ended 31 December Year 3 are 25% less than those for the year ended 31 December Year 0.

Y implements policies that encourage its employees to reduce commuting emissions, including:

- allowing employees to work from home when possible;
- carpooling incentives; and
- identifying lower emission travel options for those commuting by air or rail.

Assume that employee commuting emissions can be measured reliably.

Y determines that its Scope 3, Category 7 emissions are related to the activities of Y because it implements policies to incentivise its employees to reduce their commuting emissions.

As a result, Y concludes that the emissions reduction target meets the definition of a non-market performance condition because:

- the assessment period aligns with the service period; and
- the specified target relates to Y's activities.



#### Example 5.3.7 – Non-market performance conditions: Scope 3, Category 1 emissions target

On 1 January Year 1, Clothing Manufacturer X grants options to senior executives.

As part of its net-zero strategy, X structures the arrangement such that the options vest after a three-year service period if X's Scope 3, Category 1 (purchased goods and services) emissions for the year ended 31 December Year 3 are 25% less than those for the year ended 31 December Year 0.

X has a large number of suppliers to choose from and its size relative to its suppliers means that it has the ability to influence its suppliers. Throughout Years 1 and 2, X plans to evaluate its existing agreements with its fabric mills, garment manufacturers and other product and service suppliers. To evaluate its Scope 3, Category 1 emissions, X will request information about its suppliers' Scope 1 and 2 emissions through inquiries with their management, site inspections and reviews of available financial and sustainability reporting.

To reduce its Scope 3, Category 1 emissions, X plans to:

- renegotiate some supplier agreements to include emissions reduction commitments with penalties for non-performance;
- terminate certain agreements; and
- enter into agreements with new suppliers.

Assume that Scope 3, Category 1 emissions can be measured reliably.

X determines that the Scope 3, Category 1 emissions are related to the activities of X through its purchasing decisions because it can choose whether it purchases goods or services from a supplier, as well as the extent to which it purchases goods or services from a particular supplier.

As a result, X concludes that the emissions reduction target meets the definition of a non-market performance condition because:

- the assessment period aligns with the service period; and
- the specified target relates to X's activities.

The following conditions are further examples of market conditions and non-market performance conditions.

#### Examples of performance conditions (each condition also includes a service requirement)

##### Market conditions

The share price needs to increase by at least a specified percentage over a specified period of time.

The share price needs to meet a target on at least one day in a specified period.

The share price needs to meet a target for at least five consecutive days in a specified period.

The share price needs to increase by more than a share index over a specified period.

The total shareholder return (change in share price plus dividends) needs to meet a specified percentage increase over a specified period.

##### Non-market performance conditions

The entity needs to achieve a specified revenue, EBITDA, profit or EPS target, which can be an absolute amount or a percentage increase.

The entity needs to achieve a specified non-financial performance target – e.g. a specified market share.

The entity needs to decrease its error rate in a certain area.

The entity needs to achieve a specified greenhouse gas emissions reduction target and achieving that target is based on the entity's actions.

## 5.3.40

IFRS 2.A

### Period of achieving performance target

An award can require the counterparty to meet a performance target (market or non-market) in addition to a service condition, with a performance assessment period shorter or longer than the service period. Before the amendments introduced to IFRS 2 by the *Annual Improvements to IFRSs 2010–2012 Cycle*, it was not clear how the duration of a performance target should interact with the duration of the related service condition. The amendments confirmed that, in order for the target to be a vesting condition, the period of achieving the performance target:

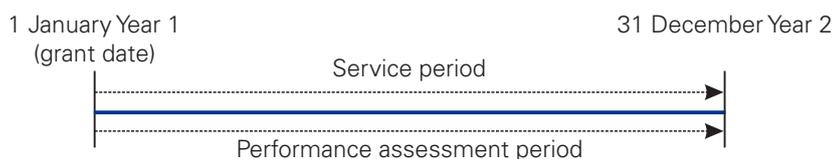
- cannot extend beyond the end of the service period: inclusive of any implicit service period; but
- may start before the service period on the condition that the commencement date of the performance target is not substantially before the commencement of the service period.

As such, the performance target is a performance (vesting) condition if the performance assessment period satisfies the requirements in 5.3.40. The performance target is a non-vesting condition if the performance assessment period extends beyond the end of the service period. This is because in the latter case the performance target does not determine whether the entity receives the services that entitle the counterparty to receive the share-based payment: the employee can leave the entity without losing entitlement to the award once the required service period has passed. For further discussion of this issue in the context of an IPO or other exit event as either a vesting condition or for exercisability, see 5.5.30.



#### Example 5.3.8 – Period of achieving performance target: Vesting condition (1)

Company S issued a share-based payment to its employees on 1 January Year 1, subject to the conditions that the employees remain in service for two years and that S achieves a cumulative revenue target of 10,000 over those two years.

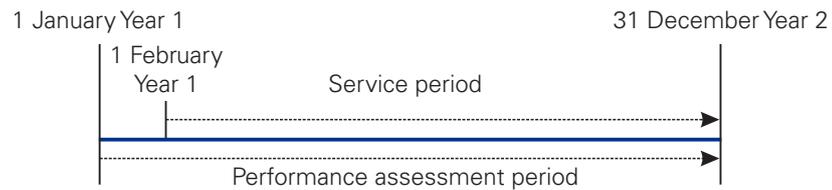


In this example, the performance assessment period – i.e. the two-year period to achieve the cumulative revenue target – coincides with the two-year service period, and therefore it is treated as a vesting condition (non-market performance condition).



**Example 5.3.9 – Period of achieving performance target: Vesting condition (2)**

Modifying [Example 5.3.8](#), Company S offers the same plan to employees who are hired on 1 February Year 1. These new employees are required to remain in service until the end of the original two-year service period – i.e. 31 December Year 2. The cumulative revenue target for the two years from 1 January Year 1 to 31 December Year 2, of 10,000, is unchanged.

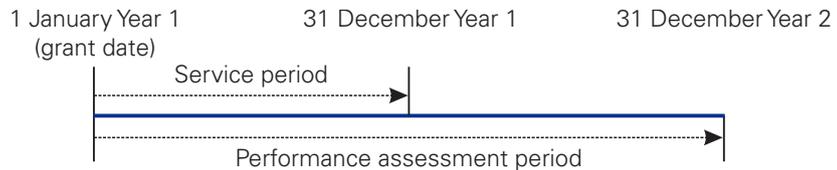


In this example, the performance assessment period – i.e. the two-year period to achieve the cumulative revenue target – starts before the service period, but not substantially before, and therefore it is treated as a vesting condition (non-market performance condition).



**Example 5.3.10 – Period of achieving performance target: Non-vesting condition (3)**

Modifying [Example 5.3.8](#), the plan has the same performance condition requiring Company S to meet a cumulative revenue target of 10,000 over the two years, but employees can leave S after one year without losing entitlement to the award – i.e. there is only a one-year service requirement.



In this example, the performance target is a non-vesting condition because the performance assessment period extends beyond the service period. The performance target does not determine whether S receives the services that entitle the employees to receive the share-based payment – i.e. the employees can leave S after one year without losing entitlement to the award.

## 5.4 Non-vesting conditions

*IFRS 2.BC364*

The term ‘non-vesting condition’ is not explicitly defined in IFRS 2 but is inferred to be any condition that does not meet the definition of a vesting condition.

*IFRS 2.IG4A, BC171B*

The following description of non-vesting conditions is derived from the implementation guidance to the accounting standard. Like vesting conditions, non-vesting conditions are conditions that determine whether the counterparty receives the share-based payment. Unlike vesting conditions, they do not determine whether the entity receives the services that entitle the counterparty to the share-based payment.

In other words, although non-vesting conditions are just as important as vesting conditions for the counterparty, they are unrelated to the requirement to deliver services to the entity. This means that, even when all vesting conditions have been satisfied and the share-based payment vests, the employee does not receive the benefit of the share-based payment if a non-vesting condition is not met.

*IFRS 2.IG24*

IFRS 2 does illustrate three types of non-vesting conditions, depending on who can choose to meet the condition:

- non-vesting conditions that neither the entity nor the counterparty can choose to meet;
- non-vesting conditions that the counterparty can choose to meet; and
- non-vesting conditions that the entity can choose to meet.

The following are basic examples of non-vesting conditions.

<b>Examples of non-vesting conditions</b>	
	<b>Non-vesting conditions that neither the entity nor the counterparty can choose to meet</b>
	The consumer price index in a specified year must not increase by more than a specified target.
	The price for a specific raw material, which is the entity’s main commodity, must not increase by more than a specified target (e.g. oil price or gold price).
	<b>Non-vesting conditions that the counterparty can choose to meet</b>
	The employee is required to hold a share after vesting date for a specified period (post-vesting transfer restrictions).
<i>IFRS 2.BC171B</i>	The employee is required not to be employed by a competitor within two years after vesting date (non-compete restrictions).
	The employee participates in an ESPP and is required to pay monthly contributions into a savings plan.
	<b>Non-vesting conditions that the entity can choose to meet</b>
	The entity is required to continue the plan under which the share-based payment was granted.

*IFRS 2.A*

Additionally, as discussed in [Example 5.3.10](#), a performance condition is a non-vesting condition if the performance assessment period extends beyond the service period.

## 5.5 Classification of conditions in practice

### 5.5.10 Leaver clauses

*IFRS 2.IG11.Ex1A*

Often, share-based payment arrangements specify the required period of service by stating that a share-based payment is forfeited or lapses if an employee leaves before a specified date.

*IFRS 2.BC214*

Share-based payment arrangements may contain good leaver and bad leaver clauses that distinguish reasons for the employee leaving employment. In our experience, the terms 'good' and 'bad' leavers are defined on an entity-specific basis and therefore may vary from entity to entity or even from agreement to agreement by the same entity for reasons such as jurisdictional tax reasons.

A 'good leaver' is often defined as an employee who leaves the entity before the vesting date for circumstances outside the control of the employee – e.g. mandatory redundancy, death, retirement or inability to work because of an accident, disability or long-term illness. A good leaver may be treated by the entity like an employee who has provided the required services in full or pro rata to service completed to date and may therefore be entitled to receive the share-based payment either in full or pro rata without completing the full service period. Accordingly, the specified service period for a good leaver will end on the date on which they are entitled to receive the share-based payment under the good leaver clause.

In contrast, a 'bad leaver' is often defined as an employee who leaves the entity before a specified date without meeting the definition of a good leaver. A good leaver might be someone who is injured and takes early retirement on disability. Someone who resigns to accept a new job would typically be a bad leaver. A bad leaver would not generally be entitled to receive the share-based payment. As explained above, typically a service condition may end on the expiry date of a bad leaver clause.



#### Example 5.5.1 – Good leaver clauses and different service periods

On 1 January Year 1, Company B grants a share option to its employees, subject to a three-year service condition. The share-based payment arrangement further contains a good leaver clause according to which any employees leaving the company because they are eligible for retirement before 31 December Year 3 are treated as if they had met the service condition.

If such options are granted to different employees whose employment is expected to end on different dates during the vesting period (e.g. on their respective retirement dates), then an additional complexity arises because it will be necessary for B to estimate different vesting periods for those employees. This is because share options granted to employees whose retirement date is before 31 December Year 3 have vesting periods that are shorter than the vesting period specified in the share-based payment arrangement. This will have accounting implications that are addressed in [6.8.30](#).

*IFRS 2.IG12.Ex2*

A share-based payment arrangement might not contain a specific date after which a leaver no longer forfeits a share-based payment but instead may contain a date that varies with when a performance target is satisfied. In these circumstances, the existence of a leaver clause indicates that there is also a service requirement.

**Example 5.5.2 – Leaver clause with determinable service requirement**

Company C grants a share option to an employee, subject to a specified EPS target being met within the next two years. The arrangement does not contain a fixed service requirement, but contains a leaver clause that the award lapses if the employee leaves before the EPS target is met.

The arrangement contains a service condition of variable length, because the employee can receive the share-based payment only if they remain in service but the length varies with the date of meeting the EPS target. For further details about share-based payments with a variable vesting period, see [6.4.40](#).

**5.5.20**

*IFRS 2.A,  
BC171A, BC346*

**Implicit service condition**

The definition of a service condition is that the employee is required to deliver a specified period of service. However, the service requirement can be implicit rather than explicit.

A share-based payment may include an implicit service condition even if it does not contain an explicit leaver clause (i.e. a clause that specifies whether the employee retains their entitlement after they leave the entity). All of the terms and conditions of a share-based payment arrangement are considered for an assessment of whether the arrangement contains an implicit service condition. If the employee can benefit from the fair value increases only by remaining employed, then in our view there is an implicit service condition embedded in the share-based payment. When awards with implicit service conditions also have performance conditions (market or non-market), the terms of the awards may support an assessment that the period of achieving the performance target does not extend beyond the service period (see [Chapter 5.4](#)).

**5.5.30**

*IFRS 2.IG12.Ex2*

**Requirement for IPO or other exit event**

Sometimes an award requires an IPO or other exit event – e.g. sale of the business – either as a vesting condition or for exercisability. For example, unlisted entities that are planning a listing in the future may issue a share-based payment that is conditional on a successful IPO.

*IFRS 2.BC171B*

The requirement for an exit event affects share-based payments in different ways depending on the timing of the condition. If the condition applies after the counterparty has become entitled to the share-based payment, then it would be a non-vesting condition. If the condition is required to occur during the service period, then it would be a non-market performance condition.

An award may have both vesting and other (non-vesting) conditions. An example is an award of options that has a three-year service condition, but which cannot be exercised until an exit event occurs. If employees leaving the entity after the service period but before the exit event retain the options, then the condition of an exit event is a non-vesting condition. If employees leaving the entity before an exit event are required to surrender the ‘vested’ options (or sell them back at a nominal amount), then in our view the exit condition is in substance a vesting condition.

*IFRS 2.BC171B*

In other situations, options do not vest until an exit event occurs and employees leaving before the exit event forfeit the options. We believe that this is an award that contains both a service condition and a non-market performance condition, assuming that there is no minimum price for the exit event. Such an arrangement should be accounted for as a grant with a variable vesting period (i.e. the length of the vesting period varies depending on when a performance condition is satisfied) based on a non-market performance condition. Because the exit event has no minimum price and is therefore not a market condition, the condition would not be reflected in the grant-date measurement of fair value and the cost would be recognised over the expected vesting period and trued up to the actual vesting period and the actual number of equity instruments granted. If the expected exit event condition influences the length of the estimated vesting period, then it might affect inputs in measuring the grant-date fair value – e.g. interest rate.



### Example 5.5.3 – IPO as non-vesting condition

Company U granted a share option to an employee on 1 January Year 1, subject to a three-year service condition. The option is exercisable only if an IPO occurs within the four years following the service period. If the employee leaves U after the service period but before the IPO, then the employee retains the option. There is no minimum IPO price required (see 5.5.30).



In this example, the IPO is a non-vesting condition because it applies after the employee has become entitled to the award (see 5.3.40), and therefore U considers it in measuring the grant-date fair value (see 6.2.10).



### Example 5.5.4 – IPO as non-market performance condition

Modifying Example 5.5.3, if the employee leaves Company U after the service period but before the IPO, then the employee is required to surrender the 'vested award' (or to sell it back at a nominal amount). In this case, the exit condition is in substance a vesting condition. Although the explicit service period is only three years, there is an implicit service period that runs until the exit event – i.e. the IPO – occurs. This is because if the IPO occurs after the explicit three-year period, then the employee is entitled to the award only if the employee is still in service when the IPO occurs.



In this example, the IPO is a non-market performance condition because it is required to occur during the service period and there is no minimum IPO price (see 5.5.30).

U accounts for this arrangement as a grant with a variable vesting period (see 6.4.40) depending on a non-market performance condition. Because the IPO has no minimum price and therefore is not a market condition (see 5.5.30), U does not consider it in measuring the grant-date fair value; instead, it recognises the cost over the expected vesting period with true-up for the actual vesting period and the actual number of equity instruments granted. However, because the expected IPO condition influences the length of the estimated vesting period, it might affect inputs in measuring the grant-date fair value – e.g. the interest rate.

If there is a minimum price for the exit event, then it is unclear whether there is just one market condition, because the pricing is considered integral to the exit event, or a non-market performance condition (the occurrence of an IPO) and a market condition (reaching the minimum price). In our view, determining which approach is appropriate depends on the facts and circumstances of the transaction. We believe that it is appropriate to consider that an award has two separate conditions only if the non-market condition is substantive as a separate condition – e.g. it is possible that the entity would pursue an exit event even at a lower price. If this is not the case, then we believe that the award should be viewed as having only one integrated market condition.

## 5.5.40 Cap in exercisability

IFRS 2.A

The exercisability of a share-based payment may be limited by a cap (e.g. the intrinsic value of the options exercised cannot exceed a certain percentage of an employee's annual salary). Such a condition may be structured as a limit on exercisability, but in substance it may be a vesting condition if it imposes further performance targets to receive the share-based payment.

In our view, if the cap reduces the number of exercisable options when the share price increases, then the cap meets the definition of a market condition rather than a non-vesting condition. This is because it is a condition on which the exercise price, vesting or the exercisability of an equity instrument depends that is related to the market price of the equity instrument, even though market conditions are usually designed to reward, rather than penalise, increases in share price.



### Example 5.5.5 – Cap in exercisability classified as market condition

Company N grants an employee 1,000 share options with an exercise price of 10 per option. The employee may exercise the options at the end of the year subject to a service condition and a cap that depends on the employee's salary and the profit realised per option. The objective of the cap is to ensure that the intrinsic value on exercise does not exceed the employee's annual salary. Therefore, if the share price at exercise date is 60 and the employee's salary is 10,000, then the cap limits the number of exercisable options to 200 (10,000 salary divided by a profit of 50 per option) and the remaining options lapse.

In this example, we believe that the cap meets the definition of a market condition rather than a non-vesting condition, because the share price affects the number of options that can be exercised and potentially results in a number of options lapsing.

# 6 Equity-settled share-based payment transactions with employees

## Overview

- Employee services are recognised as expenses, unless they qualify for recognition as assets, with a corresponding increase in equity.
- Employee service costs are recognised over the vesting period from the service commencement date until vesting date.
- Employee services are measured indirectly with reference to the fair value of the equity instruments granted; this is done by applying the modified grant-date method. If, in rare circumstances, the fair value of the equity instruments granted cannot be measured reliably, then the intrinsic value method is applied.
- Under the modified grant-date method, the grant-date fair value of the equity instruments granted is determined once at grant date, which may be after the service commencement date.
- If a market price is not available, then the grant-date fair value of the equity instruments granted is determined under a valuation technique.
- The grant-date fair value of the equity instruments granted takes into account the impact of any market conditions and non-vesting conditions and does not take into account service and/or non-market performance conditions.
- The grant-date fair value is not adjusted for subsequent changes in the fair value of the equity instruments and differences between the estimated and actual outcome of market or non-vesting conditions.
- Recognition is initially based on the number of instruments for which any required service and non-market performance conditions are expected to be met.
- Subsequently, recognition of the share-based payment cost is trued up for changes in estimates regarding the achievement of any service and non-market performance conditions, so that ultimately the share-based payment cost is based on the number of instruments for which any service and non-market performance conditions are met.
- Failure to meet a non-vesting condition that either the entity or the employee can choose to meet results in accelerated recognition of any unrecognised grant-date fair value of the equity instruments granted based on the amount that otherwise would have vested (cancellation accounting).
- Grants in the form of shares may be in substance grants of share options, which will affect the valuation of the equity instruments.

## 6.1 Who is an employee

This section addresses recognition and measurement requirements for equity-settled share-based payment transactions with employees.

*IFRS 2.A*

Employees and others providing similar services are defined as individuals who render personal services to the entity and either:

- are regarded as employees for legal or tax purposes;
- work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes; or
- render services similar to those rendered by employees.

The term ‘employee’ encompasses all management personnel – i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors.

*IFRS 2.11, A*

The requirements for transactions with employees are also applied to transactions with individuals who may not be employees but who provide personal services similar to services provided by an employee.

For further discussion of the definition of non-employees and for a discussion of equity-settled share-based payments with non-employees, see [Section 11](#).

For a discussion of additional aspects of equity-settled share-based payments in the context of group transactions, see [Section 10](#).

## 6.2 Basic principles of accounting for equity-settled share-based payment transactions with employees

### 6.2.10 Recognition

*IFRS 2.7*

Services received in an equity-settled share-based payment transaction with employees are recognised as the services are received.

*IFRS 2.8–9*

The cost of services received is recognised as an expense, unless the services qualify for recognition as an asset, with a corresponding credit to equity. As a consequence, we generally use the term ‘share-based payment cost’ throughout this handbook. In the examples, we generally refer to ‘share-based payment expense’ because we illustrate only employee services that do not qualify for recognition as an asset, unless noted otherwise.

*IFRS 2.14*

If the employee is not required to satisfy a vesting condition before becoming unconditionally entitled to the instruments granted, then the equity instruments vest immediately. Therefore, there is a presumption that the services rendered as consideration for these instruments have been received and the grant-date fair value of these instruments is recognised immediately with a corresponding credit to equity.

*IFRS 2.15*

If the equity instruments do not vest until the employee completes a period of service, then the entity presumes that services are to be provided in the future. The entity accounts for the services as they are received during the vesting period.

*IFRS 2.IG11.Ex1A*

The costs are recognised on a straight-line basis over the vesting period following the modified grant-date method (see next paragraphs). For a discussion of the recognition of expenses when the vesting period is variable, see [6.4.40](#); and [6.4.30](#) when the performance period is shorter than the service period. One grant may contain several vesting periods, in which case the principles of graded vesting apply (see [6.4.20](#)).

### Modified grant-date method, including true-up of the share-based payment cost

IFRS 2.10–12

The value of employee services is measured indirectly with reference to the fair value of the equity instruments granted, rather than directly at the fair value of the services. This is because there is a presumption that it is not possible to value employee services reliably; this presumption is non-rebuttable. If, in rare circumstances, the fair value of the equity instruments granted cannot be measured reliably, then the intrinsic value method is applied (see 6.2.10).

IFRS 2.BC96

The fair value of the equity instruments granted for services received from employees in an equity-settled share-based payment is determined at grant date rather than on every date on which services are received. IFRS 2 *Share-based Payment* presumes that the fair value of the services expected to be received is the same as the fair value of the equity instruments granted at grant date. Therefore, although the services are recognised over the service period, they are measured only once, at grant date, unless the arrangement is modified (see Chapter 9.2).

IFRS 2.BC180

Share-based payments may include conditions that determine whether the employee is entitled to receive the payment. Such conditions are reflected in the accounting for equity-settled share-based payments with employees by applying the modified grant-date method. Under this method, there are two different approaches for dealing with conditions, which depend on their classification. For further details on the definition and classification of conditions, see Chapters 5.3 and 5.4.

IFRS 2.19–23, IG9, BC216

Under the modified grant-date method (see also below), the share-based payment cost is generally determined by multiplying a value component and a number component.

- The *value component* reflects the fair value of the individual equity instruments granted (e.g. a share or a share option) at grant date. Starting from the fair value of the underlying equity instrument, downward adjustments are made to reflect the possibility of not meeting any market and/or non-vesting conditions. No adjustments are made for the likelihood of not meeting any service and/or non-market performance conditions. The resulting value is referred to as the 'grant-date fair value' of the equity instrument granted. The grant-date fair value is not adjusted subsequently for any changes in the fair value of the underlying equity instrument or any changes in the possibilities of not meeting any market and/or non-vesting conditions.
- The *number component* reflects the number of equity instruments for which the service and any non-market performance conditions are expected to be satisfied. Initially, the entity estimates the number of equity instruments for which the service and any non-market performance conditions are expected to be satisfied. The number can be anything between zero and the total number of equity instruments granted. At each reporting date, the entity revises the estimate if necessary. At vesting date, the estimate is adjusted to reflect the number of equity instruments for which the service and any non-market performance conditions actually are satisfied. This mechanism of modifying the initial estimate of the number of instruments for estimated and actual satisfaction of the service and any non-market performance conditions is referred to as 'trueing up' for forfeitures.

IFRS 2.21, 21A

In our experience, the downward adjustment made to the value component to reflect the possibility of not meeting a market condition cannot generally be calculated by multiplying the fair value of the equity instruments by the probability of not meeting the condition. Rather, the effect of a market condition is taken into account by incorporating the risk of not meeting such a condition into a valuation model. For a discussion of the choice of model for share-based payments with market conditions, see A2.40. In our experience, the probability of not meeting a non-vesting condition that is unrelated to possible future share prices does not generally need to be incorporated into a valuation model to be estimated (see also 6.6.10 and A2.40).

*IFRS 2.20, IG11.Ex1,  
IG13.Ex5*

The estimation of the number component is the best estimate of the number of equity instruments for which the service and non-market performance conditions are expected to be satisfied. In a grant to one employee that is subject to a service condition, this is effectively a yes/no decision, being the expected outcome for the entire number of instruments granted to that employee; it is not a probability-weighted number. In larger populations, a weighted-average probability of the number of employees expected to remain is typically used for service conditions.

Applying the modified grant-date method ultimately results in recognition of a share-based payment cost determined by multiplying the grant-date fair value of an individual equity instrument granted by the number of equity instruments for which the service and any non-market performance conditions ultimately are satisfied. Therefore, if a service or non-market performance condition is not met, then no share-based payment cost is recognised on a cumulative basis and any previously recognised cost is reversed. However, if a market or non-vesting condition is not met, then a share-based payment cost is nevertheless recognised, assuming that all other vesting conditions are met, even though the employee would neither become entitled to nor receive the share-based payment. This is different from the approach for cash-settled share-based payments (see [Chapter 7.2](#)).

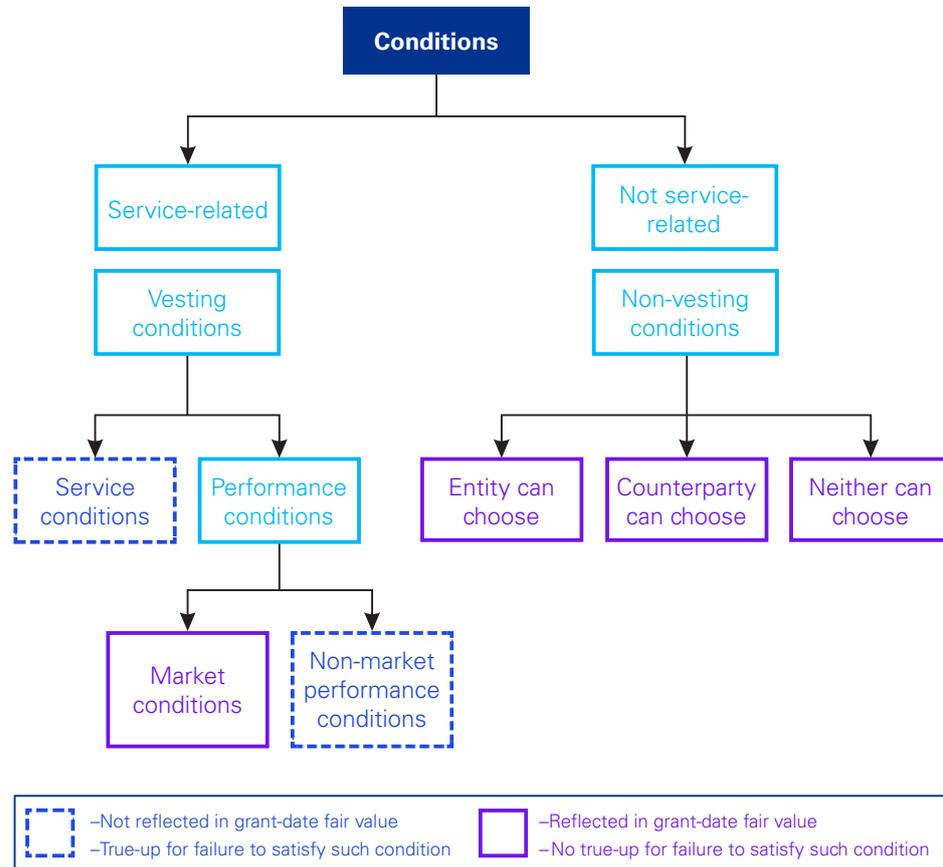
*IFRS 2.IG11.Ex1A*

Changing expectations for satisfaction of service or non-market vesting conditions is a change in estimate. However, the normal prospective treatment for changes in estimate is not used. Instead, the true-up for changes in estimates of the number of instruments expected to satisfy service and non-market performance conditions occurs as follows. In the period in which the change in estimate occurs, an amount is determined that would have been recognised cumulatively by the end of that period if the revised estimate had been used from the beginning of the vesting period. The difference between the cumulative cost taking into account the revised estimates at the reporting date and the cumulative cost recognised at the previous reporting date is recognised in the period of the change. Although this is usually an increase in cost because of recognising the cost over the vesting period, the amount can be negative – i.e. a reduction in expense. Prior periods are not adjusted. For an illustration of how to account for a revised estimation of expected forfeitures, see [Example 6.2.1](#).

*IFRS 2.23*

After vesting date, there is no adjustment to the total share-based payment cost recognised for an equity-settled share-based payment. For example, options that are exercisable during a specified period after vesting may not be exercised because the share price falls below the exercise price during that period and they become out-of-the-money. In this case the options lapse, but the cumulative share-based payment cost previously recognised is not adjusted.

The following flowchart provides a simplified overview of the treatment of different types of conditions under the modified grant-date method.



IFRS 2.19, IG13.Ex5

The manner in which IFRS 2 explains the modified grant-date method may initially be confusing. It uses the following sentence: "..., vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest." However, read in the context of the remainder of IFRS 2, we believe that the sentence should be read as meaning 'vesting conditions other than market conditions'.

The following examples illustrate the accounting for an equity-settled share-based payment with the following features:

- only a service condition (see [Example 6.2.1](#))
- a service condition and a non-market performance condition (see [Example 6.2.2](#)); and
- a service condition and a market performance condition (see [Example 6.2.3](#)).

**Example 6.2.1 – Equity-settled share-based payment transaction with a service condition**

On 1 January Year 1, Company B grants one share option to each of its 100 employees in a share-based payment transaction, subject to a three-year service condition. If the service condition is met, then the employees can exercise their option at any date in Year 4 at an exercise price of 50 per share.

On grant date and at the end of each year, B estimates the number of employees expected to have satisfied the service condition at 31 December Year 3 and the number of instruments expected to vest.

	Estimate of instruments expected to vest	Number of employees on date of estimate
1 January Year 1	90	100
31 December Year 1	80	92
31 December Year 2	75	77
31 December Year 3	70	70

All 70 employees who meet the service condition on 31 December Year 3 exercise their options in Year 4.

The fair value of a share option at grant date is 9.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	80	720 <sup>1</sup>	240 <sup>4</sup>	240
Year 2	75	675 <sup>2</sup>	450 <sup>5</sup>	210
Year 3	70	630 <sup>3</sup>	630 <sup>6</sup>	180

**Notes**

- 80 x 9.
- 75 x 9.
- 70 x 9.
- 720 x 1/3.
- 675 x 2/3.
- 630 x 3/3.

B accounts for the transaction as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses	240	
Equity		240
<i>To recognise share-based payment expense based on best estimate at reporting date of number of instruments for which service condition is expected to be met (80 x 9 x 1/3)</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Expenses	210	
Equity		210
<i>To recognise difference between cumulative amount taking into account revised estimate (75 x 9 x 2/3) and cumulative amount recognised in previous years (240)</i>		
<b>Year 3</b>		
Expenses	180	
Equity		180
<i>To recognise difference between cumulative amount taking into account revised estimate (70 x 9) and cumulative amount recognised in previous years (450)</i>		
<b>Year 4</b>		
Cash	3,500	
Equity		3,500
<i>To recognise exercise price received (70 x 50)</i>		
<b>Cumulative effects</b>		
Expenses	630	
Cash	3,500	
Equity		4,130

The total increase in equity of 4,130 comprises the exercise price paid in cash of 3,500 and the option premium of 630 paid in services provided. The increase in equity during the vesting period equals the grant-date fair value of the equity instruments granted (9) multiplied by the number of equity instruments that ultimately satisfy the service condition (70).

### Observations

- The grant-date fair value of the share options granted does not take into account the impact of the service condition.
- The change in the fair value of the share options after grant date has no effect on the accounting.
- The actual number of employees in employment during the service period is not relevant for the accounting for the share-based payment. Instead, the accounting is based on the number of instruments expected to vest based on the number of employees that are expected to meet the service condition at the end of the vesting period.

**Example 6.2.2 – Equity-settled share-based payment transaction with a non-market performance condition**

On 1 January Year 1, Company C grants one share option to each of its 100 employees in a share-based payment transaction, subject to a three-year service condition and cumulative profits being at least 10 million at vesting date. If the service condition and non-market performance condition are met, then the employees can exercise their option at any date in Year 4 at an exercise price of 50 per share.

On grant date and at the end of each year, C estimates the number of employees expected to have satisfied the service condition at 31 December Year 3 and the number of instruments expected to vest.

	Instruments for which it is expected that the service requirements will be satisfied	Estimate whether profit target will be met
1 January Year 1	90	Yes
31 December Year 1	80	Yes
31 December Year 2	75	Yes
31 December Year 3	70	No

The fair value of a share option at grant date is 9. At the end of Year 3, the profit target is not met.

End of	Instruments for which it is expected that the service requirements and NMP <sup>1</sup> target will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	80	720 <sup>2</sup>	240 <sup>5</sup>	240
Year 2	75	675 <sup>3</sup>	450 <sup>6</sup>	210
Year 3	-	- <sup>4</sup>	- <sup>7</sup>	(450)

**Notes**

1. Non-market performance.
2.  $80 \times 9$ .
3.  $75 \times 9$ .
4.  $0 \times 9$ .
5.  $720 \times 1/3$ .
6.  $675 \times 2/3$ .
7.  $0 \times 3/3$ .

C accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	240	
Equity		240
<i>To recognise share-based payment expense based on best estimate at reporting date of number of instruments for which service condition is expected to be met (80 x 9 x 1/3)</i>		
<b>Year 2</b>		
Expenses	210	
Equity		210
<i>To recognise difference between cumulative amount taking into account revised estimate (75 x 9 x 2/3) and cumulative amount recognised in previous years (240)</i>		
<b>Year 3</b>		
Equity	450	
Expenses		450
<i>To recognise true-up because non-market performance target was not met (0 - 450)</i>		

### Observations

If both a service and a non-market performance condition are required to be met, then failure to meet either results in a true-up to zero.



### Example 6.2.3 – Equity-settled share-based payment transaction with a market condition

On 1 January Year 1, Company D grants one share option to each of its 100 employees in a share-based payment transaction, subject to a three-year service condition and the underlying share price reaching a target of 80 at vesting date. If the service condition and market condition are met, then the employees can exercise their option at any date in Year 4 at an exercise price of 50 per share.

The valuation technique used by D to determine the grant-date fair value of the share options estimates the grant-date fair value of a share option granted as 6. This is a discount of 3 compared with the fair value of a share option without such a condition (i.e. 9 as calculated in [Example 6.2.1](#)).

On grant date and at the end of each year, D estimates the number of employees expected to have satisfied the service condition at 31 December Year 3.

	<b>Instruments for which it is expected that the service requirements will be satisfied</b>
1 January Year 1	90
31 December Year 1	80
31 December Year 2	75
31 December Year 3	70

At the end of Year 3, the share price target is not met.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	80	480 <sup>1</sup>	160 <sup>4</sup>	160
Year 2	75	450 <sup>2</sup>	300 <sup>5</sup>	140
Year 3	70	420 <sup>3</sup>	420 <sup>6</sup>	120

**Notes**

1. 80 x 6.
2. 75 x 6.
3. 70 x 6.
4. 480 x 1/3.
5. 450 x 2/3.
6. 420 x 3/3.

D accounts for the transaction as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses	160	
Equity		160
<i>To recognise share-based payment expense based on best estimate at reporting date of number of instruments for which service condition is expected to be met (80 x 6 x 1/3)</i>		
<b>Year 2</b>		
Expenses	140	
Equity		140
<i>To recognise difference between cumulative amount taking into account revised estimate (75 x 6 x 2/3) and cumulative amount recognised in previous years (160)</i>		
<b>Year 3</b>		
Expenses	120	
Equity		120
<i>To recognise difference between cumulative amount taking into account revised estimate (70 x 6) and cumulative amount recognised in previous years (300)</i>		

**Observations**

Although the final amount recognised takes account of the number of instruments for which the service requirement is satisfied, the actual failure to meet the share price target does not have any effect on the accounting.

## Non-vesting conditions

IFRS 2.21A, IG24

Like market conditions, non-vesting conditions are reflected in measuring the grant-date fair value of the share-based payment and there is no true-up in the measurement of the share-based payment for differences between the expected and the actual outcome of non-vesting conditions. Therefore, if all service and non-market performance conditions are met, then the entity will recognise the share-based payment cost even if the employee does not receive the share-based payment due to a failure to meet a non-vesting condition.

The failure to meet a non-vesting condition may have other effects on the recognition of the share-based payment, depending on whether any party (i.e. the entity or the employee) can choose not to meet a non-vesting condition in the vesting period.

IFRS 2.28(a), 28A

If either the entity or the employee can choose whether to meet a non-vesting condition and one chooses not to do so during the vesting period, then such a failure to meet the condition is treated as a cancellation. Under cancellation accounting, the amount of the cost that would otherwise have been recognised over the remainder of the vesting period is recognised immediately, generally in profit or loss. For a discussion of non-vesting conditions that one party can choose to meet, see 6.6.10.



### Example 6.2.4 – Not meeting a non-vesting condition that the counterparty can choose to meet

On 1 January Year 1, Company E grants 10 share options to each of its 100 employees, subject to a four-year service condition and the employees making monthly contributions towards the exercise price of 20. The grant-date fair value of the options is 10, taking into account the probability of employees not meeting the non-vesting condition (i.e. the saving requirement).

E expects all employees to remain employed. Although all 100 employees remain employed, one employee stops making monthly contributions in Year 3 – i.e. that employee chooses not to meet the non-vesting condition.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	1,000	10,000 <sup>1</sup>	2,500 <sup>2</sup>	2,500
Year 2	1,000	10,000 <sup>1</sup>	5,000 <sup>3</sup>	2,500
Year 3	1,000	10,000 <sup>1</sup>	7,525 <sup>4</sup>	2,525
Year 4	1,000	10,000 <sup>1</sup>	10,000 <sup>5</sup>	2,475

#### Notes

- 10 x 100 x 10.
- 10,000 x 1/4.
- 10,000 x 2/4.
- (10 x 99 x 10 x 3/4) + (10 x 1 x 10).
- 10,000 x 4/4.

Although not meeting the non-vesting condition does not change the total amount of the share-based payment expense recognised, recognition of share-based payment expense is accelerated for the employee that does not meet the non-vesting condition. In this case, the acceleration in Year 3 amounts to 25 (2,525 - 2,500) and can be determined as follows: (10 x 1 x 10) - (10 x 1 x 10 x 3/4).

Determining how to accelerate the recognition of unrecognised share-based payment expense is not always straightforward. For a discussion of how to determine the accelerated amount, see 9.3.20.

In [Example 6.2.4](#), the requirement to make contributions is a non-vesting condition that *either* the entity or the counterparty can choose to meet; more specifically, it is a non-vesting condition that the employee can choose to meet. Another example of such a non-vesting condition is the condition to buy shares and hold them for a specified period (see [3.5.30](#)).

*IFRS 2.21A, IG24*

However, if neither the entity nor the employee can choose whether to meet a non-vesting condition, then there is no change to the recognition if the non-vesting condition is not satisfied during the vesting period. The entity continues to recognise the cost over the vesting period.

### **Intrinsic value method**

*IFRS 2.24–25, IG16*

In rare circumstances, if the grant-date fair value of the equity instruments cannot be measured reliably, then an intrinsic value method is applied. The intrinsic value is remeasured at each reporting date and changes are recognised in profit or loss (to the extent that the cost is not eligible for capitalisation) until the instrument is settled (e.g. until an option is exercised). Example 10 in the implementation guidance to IFRS 2 provides an illustration of the intrinsic value method.

In our view, uncertainty about the future market price is not a reason for not being able to measure the fair value reliably. For example, in an ESPP in which employees pay a monthly contribution of 100 to buy shares at the end of the year at a discount of 20 percent of the then-current market price, there is uncertainty at grant date about what the future market price of those shares will be and accordingly how many shares the employees will be entitled to buy. However, this is not sufficient reason to conclude that the grant-date fair value cannot be measured reliably. For a discussion of the rare circumstances in which the application of the intrinsic value method may be required, see [6.6.10](#).

## **6.3 Determination of grant date**

### **6.3.10 Introduction**

*IFRS 2.11*

The determination of grant date is important because this is the date on which the fair value of equity instruments granted is measured. Usually, grant date is also the date on which recognition of the employee cost begins. However, this is not always the case (see [6.4.10](#)).

*IFRS 2.A*

‘Grant date’ is the date at which the entity and the employee agree to a share-based payment arrangement, and requires that the entity and the employee have a shared understanding of the terms and conditions of the arrangement.

*IFRS 2.IG2*

In order for the employer and the employee to ‘agree’ to a share-based payment transaction, there needs to be both an offer and an acceptance of that offer.

### **6.3.20 Approval and communication by the employer**

*IFRS 2.A, IG1*

If the agreement is subject to an approval process, then the grant date cannot be before the date on which that approval is obtained. If a grant is made subject to approval – e.g. by a board of directors – then the grant date is normally when that approval is obtained.

The arrangement also needs to be communicated to the employees to achieve grant date.

In a broad-based unilateral grant of a share-based payment, there is often a period of time between board approval and communication of the terms of the award to individual employees. In some entities, the terms and conditions of the awards are communicated to each employee by their direct supervisor. Because of the varying schedules of employees and employers, it is possible that different employees may be informed of their awards on different dates. In some circumstances, the number and geographic dispersion of employees results in communication spanning several days or weeks.

As a result, awards approved at a single board meeting may be subject to several different grant dates. However, using a single grant date for the purpose of valuing share-based payment transactions with the same terms that are granted at approximately the same date may not result in a material difference from the aggregate fair value that would otherwise be determined on the grant date of each individual award.



#### Example 6.3.1 – Grant date and communication of a plan to the employees

Each year on the first day of the year, multinational Company X issues share options to all employees who were employed by X for the three months before the end of the previous year. The number of options that each employee receives is based on their employee class and is a set amount each year. The exercise price of the share options is always 10% less than the market price on the day on which the share plan is approved by the board, which is on the first day of the year. X's human resources policy requires remuneration information to be communicated to employees by their immediate supervisors; once the share plan has been approved by the board, the immediate supervisor of each employee is responsible for communicating the grant to the employee. On the day after the share plan is approved, X places information about the share plan on the employee website.

We believe that grant date is the board approval date because the award is unilateral, communication to employees is purely administrative and soon after the board meeting X issues an entity-wide communication about the grant of the award, including the specific terms and conditions.

### 6.3.30

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#### Meaning of 'shared understanding'

A shared understanding may not require the finalisation of all terms and conditions. For example, an offer may not specify the actual exercise price, but instead may state the formula that determines how the actual exercise price will be established. In our view, if the outcome is based on *objective* factors and different knowledgeable parties, independently of each other, would be able to make consistent calculations, then there is a shared understanding without having specified the actual grant terms. If, for example, the exercise price is based on the market price at a specified later date but the outcome of all other factors is already known, then there is a shared understanding at the date of the agreement of the way in which the exercise price will be determined.



#### Example 6.3.2 – Grant date and determination of exercise price dependent on formula

On 1 January Year 1, Company B grants share options to its employees, subject to a one-year service condition. The share options can be exercised at any date in the three years following vesting. The exercise price is determined using a formula, which is based on the share price, as follows: the fixed exercise price equals the grant-date share price of 10 plus a variable exercise price of 20% of the difference between the share price at the date of exercise and 10.

In this example, we believe that there is a shared understanding at the date of the agreement of the way in which the exercise price will be determined. This is because even though the actual exercise price is known only at a later date, it is based on a formula that has only objective inputs.

**Example 6.3.3 – Processes to identify and measure performance against condition not yet finalised**

On 1 January Year 1, Financial Services Company X grants an award of free shares in X to senior executives.

X structures the arrangement such that the shares vest after a two-year service period if X's Scope 3, Category 7 (employee commuting) emissions for the year ended 31 December Year 2 are 20% less than those for the year ended 31 December Year 0 resulting from the entity's actions.

X has not yet implemented its process for identifying and measuring Scope 3, Category 7 emissions. X expects to complete the process by 31 December Year 2.

In this example, there is no shared understanding because there is insufficient information about how the entity plans to identify and measure its Scope 3, Category 7 (employee commuting) emissions. However, the entity is still required to recognise an expense from the date it starts to receive services. This expense is based on an estimate of the grant-date fair value of the award, which is remeasured up to the date that the grant date is achieved; see [6.4.10](#).

In our view, there will not generally be agreement on terms and conditions if the outcome is based primarily on *subjective* factors – e.g. if the number of shares to be awarded is a discretionary determination by a compensation committee at the end of the service period. Similarly, if the number of instruments issued to employees is determined based primarily on a *subjective* evaluation of the individual's performance over a period, then we believe that there is not a shared understanding until the number of instruments has been determined. The assessment of whether the evaluation of an individual's performance is primarily subjective may require judgement. For further details on discretion clauses that result in a shared understanding being delayed, see [6.3.60](#).

**6.3.40 Acceptance by the employee***IFRS 2.IG2*

Grant date is not reached until there is acceptance of the offer. The acceptance may be explicit (e.g. by signing a contract) or implicit (e.g. by commencing to render services).

*IFRS 2.IG2*

Some arrangements do not require explicit acceptance. This is the case when participation in the arrangement does not require any action by the employee other than providing the required services until vesting date.

*IFRS 2.IG2*

Other arrangements require explicit acceptance – e.g. signing a contract, paying an exercise price up-front, starting to pay monthly contributions towards the exercise price and buying participation shares.

For a discussion of the impact of different types of acceptance on ESPPs, see [6.5.10](#).

If an arrangement provides the opportunity to alter the extent of a previous acceptance, then it is necessary to conclude not only whether grant date has been reached, but also whether there are several grants with several grant dates. All of the facts and circumstances need to be considered and judgement may be required. Once the grant date has been reached, the opportunity to alter the extent of a previous acceptance may be considered to be a modification or cancellation (see [Section 9](#)).



### Example 6.3.4 – Annual acceptance and monthly reductions

Company Q establishes a three-year share-based payment arrangement in which an employee is required to specify a monthly deduction percentage from their salary for buying shares at the then-current fair value (participation shares). For each participation share, the employee will receive an additional free share (matching share). Employees can state their monthly deduction in January Year 1 for the entire three-year period – i.e. January Year 1 to December Year 3. They are required to make an explicit annual statement in January of each year in which they confirm the deduction percentage or amount. New joiners to the company can participate in the plan from the beginning of the next calendar year.

Employees also have the right to reduce the monthly deductions at any time. If, for example, an employee stops the deductions from May Year 1 onwards, then the employee will not lose entitlement to the matching shares previously received. Although the employee cannot subsequently increase the deduction amount during Year 1, the employee can rejoin in January Year 2 or January Year 3 by stating a new monthly deduction percentage.

In this example, we believe that the statement of the deduction or investment amount is a required explicit acceptance. Therefore, grant date for the share-based payment of the matching shares could not be earlier than January each year because that is the date on which both parties agree to the arrangement.

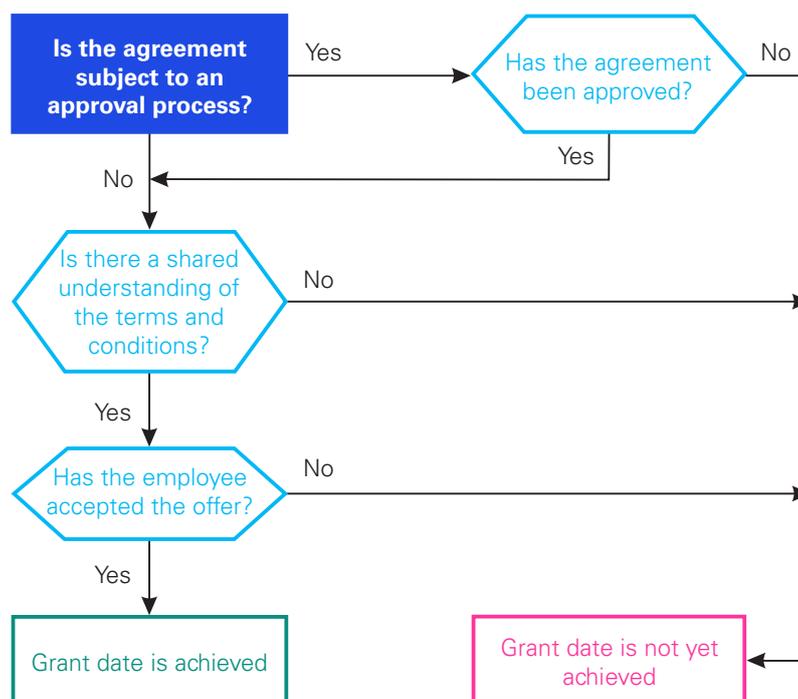
In our view, 1 January each year is a new grant date because employees may increase or decrease their contributions and new employees are permitted to join at that date.

In our view, in this example there is only one grant date per year because we believe that an ability to reduce but not increase contributions does not create new acceptance at each monthly purchase date of participation shares. This is because the absence of a reduction is not an implicit acceptance, and an explicit acceptance has already been made.

We believe that the ability to reduce or stop deductions entirely is a cancellation right rather than an indication of a separate grant date because it is a one-directional change. If a reduction does take place, then that would be accounted for as a cancellation, which accelerates recognition of the related cost (see [Section 9](#)).

### 6.3.50 Grant-date flowchart

The determination of grant date of a share-based payment that requires substantive approval can be illustrated as follows.



### 6.3.60 Discretion clauses

Some share-based payment arrangements may provide a remuneration committee (or an equivalent body) with differing degrees of discretion to amend the terms of awards. If a share-based payment arrangement contains a 'discretion clause', then it is necessary to consider the impact of the discretion clause:

- on the determination of grant date of the share-based payment (see 6.3.10–50); and
- whether modification accounting should be applied if discretion is exercised after grant date.

In our view, if the terms of a share-based payment arrangement provide the remuneration committee with discretion to amend the terms of an award, then a determination about whether there is a shared understanding with employees should be based on an analysis of the degree of subjectivity (i.e. discretion) afforded to the remuneration committee, as well as the factors over which the remuneration committee has discretion.

We believe that arrangements with discretion clauses should be categorised into the following three categories depending on the degree of discretion available to the remuneration committee.

#### Category 1 – No delay to grant date, no modification

Arrangements may contain clauses that are largely objective, such that these may give little, if any, discretion to either the employee or the remuneration committee. In our view, such clauses that are largely objective do not result in a delay in grant date. As discussed at 9.2.20, we believe that subsequent use of the clause does not result in modification accounting if the changes are for predetermined adjustments. We believe that adjustments made under a discretion clause are 'predetermined' if the following conditions are met:

- the arrangement clearly states the objective, method or outcome of the clause;
- both parties have a shared understanding of the clause at grant date; and
- the clause is invoked following a specified event.

Examples of predetermined adjustments are changes in the exercise price of options to reflect changes in capital structures – e.g. share splits or the recalculation of performance requirements. We believe that, in limited circumstances, a constructive obligation may exist if an entity, by its past practice or sufficiently specific communication to its employees, has created a valid expectation in the employees that it will exercise the discretion clause.



#### Example 6.3.5 – Category 1 discretion clause

Company B grants share options to its employees. The agreement contains an anti-dilution clause requiring B to restore the fair value of the employees' award following a change in the capital structure. B has discretion over the mechanism of restoring the fair value – e.g. by issuing additional share options or by lowering the exercise price. Both B and its employees have a shared understanding of the terms of the anti-dilution provision at grant date.

We believe that the anti-dilution provision in this example should be treated as a Category 1 discretion clause because the changes to the award are predetermined. In this case, both the event requiring the clause to be invoked and the objective of the clause are clearly defined in the agreement – i.e. B is required to invoke the clause to restore the fair value of the employees' award following a change in the capital structure.

However, if the fair value of the award increases rather than stays the same before and after changes in the capital structure, then B would treat this as a modification and recognise additional compensation cost (see 9.2.20).

#### Category 2 – No delay to grant date, modification

If the discretion clause does not result in a delay to grant date, then it is necessary to consider whether invocation of the clause would result in modification accounting. In our view, modification accounting should be applied if a discretion clause is invoked and results in changes other than predetermined adjustments.



#### Example 6.3.6 – Category 2 discretion clause

Company C grants share options to its employees. The agreement contains a discretionary anti-dilution clause that gives C discretion over whether to make an equitable adjustment to the employees' award following a change in capital structure.

We believe that the anti-dilution clause in this example should be treated as a Category 2 discretion clause, because the changes to the award are not predetermined. In this example, C has discretion over whether to invoke the clause.

When an entity exercises its discretion and modifies awards in conjunction with an equity restructuring, in our experience this often results in significant incremental compensation. This incremental compensation is measured as the difference between the fair value of the pre-modified award – considering how the equity restructuring would have affected the fair value of the award had it not been modified – and the fair value of the post-modified award. For further discussion of modification accounting, see [Section 9](#).

### Category 3 – Delayed grant date

If the discretion clause provides the remuneration committee with significant subjectivity (e.g. the ability to reduce or eliminate an award) such that there is no shared understanding of the terms and conditions before finalisation of the award, then grant date is not achieved until the period for exercising the discretion has passed. In our view, clauses that would be invoked only ‘with cause’ or in exceptional circumstances would not generally delay grant date. For example, a clause that is intended to be invoked with cause may be in relation to a specific employee action or an event that was not anticipated when the original performance condition was set – e.g. adjusting a revenue performance condition on the disposal of a significant business unit.

An example of a discretion clause with a significant degree of subjectivity is a discretion clause that allows the remuneration committee to review at the vesting date the total compensation of employees (including share-based compensation) to determine whether total compensation is appropriate. The clauses may be included in share-based payment arrangements to provide the remuneration committee with the discretion to reduce or eliminate an award.

A delayed grant date does not result in delaying recognition of the share-based payment (see [6.4.10](#)).

## 6.4 Determination of the vesting period

### 6.4.10 Service commencement date and grant date

*IFRS 2.A*

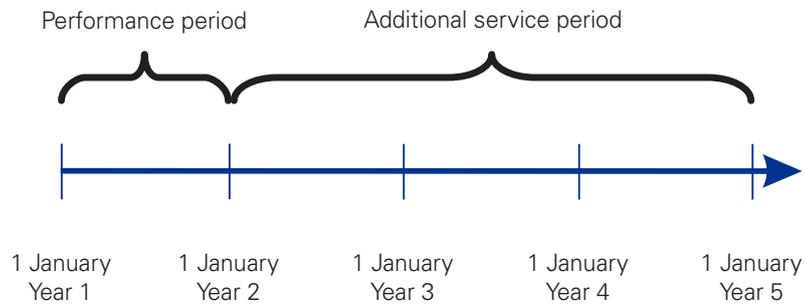
The ‘vesting period’ is the period during which all of the specified vesting conditions are to be satisfied in order for the employees to be entitled unconditionally to the equity instrument. Normally, this is the period between grant date and the vesting date.

*IFRS 2.IG4, IGE<sub>x</sub>1A,  
IGEx2*

However, services are recognised when they are received and grant date may occur after the employees have begun rendering services. Grant date is a measurement date only. If grant date occurs *after* the service commencement date, then the entity estimates the grant-date fair value of the equity instruments for the purpose of recognising the services from the service commencement date until grant date. A possible method of estimating the fair value of the equity instruments is by assuming that grant date is at the reporting date. Once grant date has been established, the entity revises the earlier estimates so that the amounts recognised for services received are based on the grant-date fair value of the equity instruments. In our view, this revision should be treated as a change in estimate.



**Example 6.4.1 – Service commencement date before grant date**



On 1 January Year 1, Company B sets up an arrangement in which the employees receive share options, subject to a four-year service condition. The total number of equity instruments granted will be determined objectively based on B's profit in Year 1. The total number of options will be allocated to employees who started service on or before 1 January Year 1. Significant subjective factors are involved in determining the number of instruments allocated to each individual employee and B concludes that grant date should be postponed until the outcome of the subjective evaluations is known in April Year 2 – i.e. subsequent to the approval of the financial statements for the reporting period ending 31 December Year 1.

Because the subjective factors are determined only in April Year 2, grant date cannot be before this date. However, in this case there is a clearly defined performance period, commencing on 1 January Year 1, which indicates that the employees have begun rendering their services before grant date. Accordingly, B recognises the cost of the services received from the date on which service commences – i.e. 1 January Year 1. The estimate used in the Year 1 financial statements is based on an estimate of the fair value, assuming that grant date is 31 December Year 1. This estimate will be revised in April Year 2 when the fair value at grant date is determined.

Assume that B estimates on 31 December Year 1 that the grant-date fair value of an equity instrument granted will be 10 and the actual fair value on grant date of April Year 2 is 9. Based on preliminary profit figures, B further estimates at 31 December Year 1 that the total number of equity instruments granted will be 100, which is confirmed by the final profit figure. If all instruments are expected to and actually do vest, then the accounting is as follows.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	100	1,000 <sup>1</sup>	250 <sup>3</sup>	250
Year 2	100	900 <sup>2</sup>	450 <sup>4</sup>	200
Year 3	100	900 <sup>2</sup>	675 <sup>5</sup>	225
Year 4	100	900 <sup>2</sup>	900 <sup>6</sup>	225

**Notes**

1. 100 x 10.
2. 100 x 9.
3. 1,000 x 1/4.
4. 900 x 2/4.
5. 900 x 3/4.
6. 900 x 4/4.

## 6.4.20

IFRS 2.IG11

### Graded vesting

In some situations, the equity instruments granted vest in instalments over the specified vesting period. Assuming that the only vesting condition is service from grant date to the vesting date of each tranche, each instalment is accounted for as a separate share-based payment. As a result, even though all grants are measured at the same grant date, there will be several fair values and the total cost recognised each year will be different because both the grant-date fair values and the vesting periods are different. In our experience, instalments are not always on a yearly basis, but can also be on a monthly or even daily basis, which creates significantly more data complexities.

Application of the graded-vesting method to grants that vest in instalments results in recognition of a higher proportion of cost in the early years of the overall plan. This is because Year 1 would bear the full cost for the instalment vesting in Year 1 *and* a proportion of the cost of the instalment vesting over the next number of years – e.g. 1/2 of the Year 2 instalment and 1/3 of the Year 3 instalment. This effect is sometimes referred to as ‘front-end loading’ and is illustrated in [Example 6.4.2](#).



#### Example 6.4.2 – Graded vesting

On 1 January Year 1, Company C grants 100 share options to 100 employees, subject to a four-year service condition. At each year end, 25% of the equity instruments granted vests – i.e. an employee leaving in Year 2 earns the entitlement to 25 share options. Once the share options vest, they can be exercised in the following two months. The exercise price equals the share price at grant date.

The fair values of the equity instruments granted differ due to their different option terms and are estimated as follows.

Equity instruments of tranche	Fair value on grant date
1 (vesting on 31 December Year 1)	4
2 (vesting on 31 December Year 2)	6
3 (vesting on 31 December Year 3)	8
4 (vesting on 31 December Year 4)	10

Assuming that C expects all employees to remain employed with C and that they ultimately do, the cost recognised for each of the share-based payment tranches in each period is determined as follows.

	Year 1	Year 2	Year 3	Year 4	Total
Tranche 1	10,000	-	-	-	10,000 <sup>1</sup>
Tranche 2	7,500	7,500	-	-	15,000 <sup>2</sup>
Tranche 3	6,667	6,667	6,666	-	20,000 <sup>3</sup>
Tranche 4	6,250	6,250	6,250	6,250	25,000 <sup>4</sup>
Total	30,417	20,417	12,916	6,250	70,000

#### Notes

1. 25 x 100 x 4.
2. 25 x 100 x 6.
3. 25 x 100 x 8.
4. 25 x 100 x 10.

## 6.4.30

IFRS 2.15, BC38

### Attribution to periods

When allocating the cost of share-based payment awards that require the achievement of both service and performance conditions, in our view no greater significance should generally be placed on either the service or the performance condition; and the share-based payment cost should be recognised on a straight-line basis over the vesting period. Similar to the observation that it is generally not possible to identify the services received in respect of the individual components of an employee's remuneration package (e.g. services received in respect of healthcare benefits vs a company car vs share-based payment), it is very difficult to determine whether more services were received in respect of any given performance period as compared with the service period.



#### Example 6.4.3 – Straight-line attribution and different reference periods

Company S issues to its employees share options that vest on the achievement of an EPS target after one year. In addition, the employees are required to remain employed with S for another three years after the EPS target is achieved.

We believe that S should recognise the share-based payment cost on a straight-line basis over the four-year period in the absence of compelling evidence that a different recognition pattern is appropriate.

We believe that, even if a grant is subject to a four-year service condition and a challenging one-year performance condition, both beginning at the same time, this is not sufficiently compelling evidence to apply a method other than the straight-line method over four years.



#### Example 6.4.4 – Straight-line attribution with challenging performance target

Company T issues to its employees a share-based payment that is subject to a four-year service condition and a one-year performance condition, both beginning at the same time. The performance condition is defined as an increase in revenue by 20% and revenues have not increased by more than 10% over the past five years.

Although the performance target is challenging, we believe that T should recognise the grant-date fair value over four years.

## 6.4.40

IFRS 2.15(b)

### Variable vesting period

In some share-based payments, the length of the vesting period varies depending on when a performance condition is satisfied. In this case, the length of the expected vesting period needs to be estimated.

#### Market condition with variable vesting period

IFRS 2.IG14.Ex6

If the performance condition in such transactions is a market condition, then the length of the expected vesting period is estimated consistently with the assumptions used in estimating the grant-date fair value of the equity instruments granted. The length of the vesting period is not revised subsequently.

**Example 6.4.5 – Market condition not met when expected**

Company U issues a share-based payment subject to the employee remaining in service until the share price achieves a certain target price at any time within the next five years. If the market condition is not met by the end of Year 5, then the employee is not entitled to the payment. U estimates that the market condition will be met at the end of Year 3. At the end of Year 3, the market condition has not yet been met, but it may still be met in the future.

In this example, the grant-date fair value is recognised over three years. Because the expected length of the vesting period is not revised if the performance condition is a market condition, the entire grant-date fair value of the equity instruments granted is recognised in Years 1 to 3, even though at the end of Year 3 the market condition is not met.

No adjustment is made if the employee leaves in Year 4 because the employee has already completed the expected vesting period of three years.

IFRS 2 does not provide guidance on the accounting for the reverse scenario – i.e. if the market condition is met earlier than expected. Continuing [Example 6.4.5](#), if the market condition is met in Year 2, then in theory all of the expected services have been provided. Therefore, it could be argued that no cost should be recognised subsequent to that date, and instead that recognition should accelerate at that date. In our view, IFRS 2's explicit prohibition of revising the length of the vesting period should prevail – i.e. cost should continue to be recognised in accordance with the original three-year estimate – even though we believe that accelerated recognition would better reflect the economics of the scenario.

**Example 6.4.6 – Market condition met earlier than expected**

Company V issues a share-based payment subject to the employee remaining in service until the share price achieves a certain target price at any time within the next five years. V estimates that the market condition will be met at the end of Year 3. At the end of Year 2, the market condition is already met.

Like in [Example 6.4.5](#), the grant-date fair value is recognised over three years. However, because the market condition is met in Year 2, in theory all of the expected services have been provided. We believe that the expense should continue to be recognised in accordance with the original three-year estimate.

**6.4.50***IFRS 2.15(b), IG12.Ex2***Non-market performance condition with variable vesting period**

In contrast to a variable vesting period with a market condition, if the length of the vesting period is dependent on achieving a non-market performance condition, then the entity makes an estimate of the length of the expected vesting period at grant date based on the most likely outcome of the performance condition. Subsequently, the entity revises the estimate of the length of the vesting period until the actual outcome is known.

*IFRS 2.15, 20*

If the arrangement is accounted for as a grant with a variable vesting period, then the entity estimates at grant date whether (a) the employees will complete the requisite service period and (b) the non-market performance condition will be satisfied. A common example of a non-market performance condition with a variable vesting period is a requirement for an exit event (e.g. IPO or sale) combined with a requirement that the employee be employed until the exit event occurs. The individual circumstances of each arrangement will have to be considered. The share-based payment cost is recognised if the exit event is more likely than not to be achieved; it is not necessary to be certain that the exit event will occur.

**Example 6.4.7 – Non-market performance condition not met when expected**

Company B grants 100 share options with a grant-date fair value of 6 to its CEO. The share-based payment is subject to the CEO remaining in service until C's market share, according to quarterly external surveys, is reported as exceeding 30% for a quarter, provided that this is achieved within the next five years. The share-based payment is exercisable on the sixth anniversary following grant date.

B estimates that the term of the share-based payment will be six years regardless of when the market share target is met. B estimates that the target will be met at the end of Year 3. In the early part of Year 3, it becomes clear that the target will not be met by the end of Year 3. B's revised estimate is that it will be met in Year 5, which ultimately is achieved.

End of	Instruments for which it is expected that service and NMP <sup>1</sup> conditions will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	100	600 <sup>2</sup>	200 <sup>3</sup>	200
Year 2	100	600 <sup>2</sup>	400 <sup>4</sup>	200
Year 3	100	600 <sup>2</sup>	360 <sup>5</sup>	(40)
Year 4	100	600 <sup>2</sup>	480 <sup>6</sup>	120
Year 5	100	600 <sup>2</sup>	600 <sup>7</sup>	120

**Notes**

1. Non-market performance.
2. 100 x 6.
3. 600 x 1/3.
4. 600 x 2/3.
5. 600 x 3/5.
6. 600 x 4/5.
7. 600 x 5/5.

Modifying this example, if it turns out in Year 5 that the market share target is not met, then forfeiture accounting applies – i.e. all previously recognised expense is reversed – because achieving a market share target is a non-market performance condition.

**Example 6.4.8 – Non-market performance condition met earlier than expected**

Company C grants 100 share options with a grant-date fair value of 6 to its CEO. The share-based payment is subject to the CEO remaining in service until C's market share has exceeded 30% at any time within the next five years. The entity estimates that it will be met at the end of Year 3. At the end of Year 2, the options vest because the market share is 32%.

End of	Instruments for which it is expected that service and NMP <sup>1</sup> condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	100	600 <sup>2</sup>	200 <sup>3</sup>	200
Year 2	100	600 <sup>2</sup>	600 <sup>4</sup>	400
Year 3	100	-	-	-
Year 4	100	-	-	-
Year 5	100	-	-	-

**Notes**

1. Non-market performance.
2. 100 x 6.
3. 600 x 1/3.
4. 600 x 2/2.

In our view, when accounting for a share-based payment award that contains multiple vesting alternatives and vesting depends on the interaction of a service condition and a performance condition, an entity should determine which vesting alternative to account for based on its assessment of which vesting alternative is the most likely outcome. This is because under IFRS 2 an entity generally accounts for the most likely outcome.

For example, an award of options is granted with a performance condition and a service condition, but the vesting period automatically accelerates if the performance condition is met during the period of required service; the award vests at the end of the service period regardless of whether the performance condition is met. The options are exercisable at the same fixed date regardless of when they vest. Such an award contains two vesting alternatives:

- *vesting alternative 1*: the period from grant date until the date on which the service condition is met. This would occur if the non-market performance condition is not met before the service condition is met; and
- *vesting alternative 2*: the period from grant date until the date on which the performance condition is met before the date on which the service period is completed. This is because vesting is automatically accelerated if the non-market performance condition is satisfied before the service condition.

In this situation, if an entity's initial assessment was that the most likely outcome was vesting alternative two, then it would estimate the expected vesting date for that vesting alternative. As long as the entity believes that the non-market performance condition will be met before the service condition, then it should base its accounting on its best estimate of the expected vesting period. If subsequent information indicates that the length of vesting alternative two differs from the previous estimate, then the length of the vesting period is revised and the entity adjusts the recognised share-based payment expense on a cumulative basis in the period in which the estimate is revised. See 6.4.40.

If an entity's assessment of the most likely outcome changes, then we believe that the accounting should switch to the alternative vesting period. The share-based payment cost recognised in the period of the change in estimate would adjust the cumulative cost recognised to the amount that would have been recognised if the new estimate had always been used. See 6.8.30.



#### Example 6.4.9 – Non-market performance condition with variable vesting period

Company D grants 100 share options with a grant-date fair value of 6 to its CEO. The share-based payment is subject to the CEO remaining in service for four years. However, vesting automatically accelerates if there is an IPO during the four-year service period.

The entity's assessment at the grant date is that there will be an IPO at the end of Year 2. At the end of Year 2, the entity's assessment is that an IPO will take place at the end of Year 3. At the end of Year 3, the entity's assessment is that the share options will vest at the end of the service period.

End of	Instruments for which it is expected that service and NMP <sup>1</sup> condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	100	600 <sup>2</sup>	300 <sup>3</sup>	300
Year 2	100	600 <sup>2</sup>	400 <sup>4</sup>	100
Year 3	100	600	450 <sup>5</sup>	50
Year 4	100	600	600 <sup>6</sup>	150

#### Notes

1. Non-market performance.
2. 100 x 6.
3. 600 x 1/2.
4. 600 x 2/3.
5. 600 x 3/4.
6. 600 x 4/4.

## 6.5 Determination of type of equity instruments granted

### 6.5.10 Employee share purchase plans

IFRS 2.IG17

In an ESPP, the employees are usually entitled to buy shares at a discounted price. The terms and conditions can vary significantly and some ESPPs include option features.

In our view, the predominant feature of the share-based payment arrangement determines the accounting for the entire fair value of the grant. That is, depending on the predominant features, a share purchase plan is either a true ESPP or an option plan. All of the terms and conditions of the arrangement should be considered when determining the type of equity instruments granted and judgement is required. The determination is important because the measurement and some aspects of the accounting for each are different (see below).

IFRS 2.B4–B41

Options are characterised by the *right*, but not the *obligation*, to buy a share at a fixed price. An option has a value (i.e. the option premium), because the option holder has the benefit of any future gains and has none of the risks of loss beyond any option premium paid. The value of an option is determined in part by its duration and by the expected volatility of the share price during the term of the option. In our view, the principal characteristic of an ESPP is the right to buy shares at a discount to current market

prices. ESPPs that grant short-term fixed purchase prices do not have significant option characteristics because they do not allow the grant holder to benefit from volatility. We believe that ESPPs that provide a longer-term option to buy shares at a specified price are, in substance, option plans, and should be accounted for as such.

IFRS 2.IG17

Examples of other option features that may be found in ESPPs are:

- ESPPs with look-back features, whereby the employees are able to buy shares at a discount, and choose whether the discount is applied to the entity's share price at the date of the grant or its share price at the date of purchase;
- ESPPs in which the employees are allowed to decide after a significant period of time whether to participate in the plan; and
- ESPPs in which employees are permitted to cancel their participation before or at the end of a specified period and obtain a refund of any amounts paid into the plan.

In all of these examples, the employees are protected from a decline in the value of the equity instrument. The implementation guidance to IFRS 2 indicates that the option features in these ESPP examples mean that they are, in effect, share option plans. See 3.5.40 for a discussion of share-based payments with protection against falls in value in the context of scope questions and 4.5.60 in the context of classification questions.



#### Example 6.5.1 – Share purchase plan at fixed price for longer period

Employees of Company B are entitled to buy shares at a fixed price from the date of communication of the plan until two years later.

Whether the predominant feature in this agreement is the option feature requires judgement based on all of the terms and conditions of the plan. In the absence of other indicators, we believe that this agreement is effectively an option and should be accounted for as an option plan and not as an ESPP. This is because the employees have no obligation to buy the shares, but only the right. If the share price falls below the fixed exercise price, then the employees would not buy any shares. Therefore, the employees are protected from a decline in the value of the shares.

The classification as a 'true' ESPP or as an option plan affects:

- the determination of grant date;
- the number of instruments to account for; and
- the measurement of the grant-date fair value.



#### Example 6.5.2 – Impact of classification as true ESPP or as option plan

On 1 January Year 1, Company T grants a right to its employees to buy shares at a 20% discount from its share price. This grant is made to 1,000 of its employees and 700 employees buy shares.

If the substance of the offer is an ESPP, then grant date is the date when the employees accept the offer and recognition is based on the number of employees that accept the offer (i.e. 700).

Conversely, if the substance of the offer is an option grant, then grant date is not dependent on the explicit acceptance by the employees and is therefore achieved on 1 January Year 1. Recognition is based on the options granted to the 1,000 employees, assuming that the award vests and not on the 700 employees that exercise their options.

## 6.5.20

### Share purchases funded through loans

The determination of whether a share purchase plan is in substance an option plan is affected when the employee receives a loan from the entity to fund the purchase of the shares. All of the terms and conditions should be analysed when determining the type of equity instruments granted. A share purchase funded through loans provided by or guaranteed by the granting entity may indicate that an ESPP is in substance an option plan.

In our view, if a share-based payment that is funded through a loan contains a put option feature over the shares such that it removes any risk for the employee of share price decreases while all rewards above the market rate of interest are retained, then this plan is, in substance, an option that should be accounted for as such. For an illustration of such a share-based payment, see [Example 6.5.3](#). In general, we believe that it is difficult to support recognition of shares and the loan as outstanding when the shares were paid for by a loan from the issuer to the buyer.

If the substance of a share purchase arrangement is an option, then neither the shares nor the loan are outstanding until either the options are exercised by paying the exercise price for the shares – i.e. by repaying the loan – or the options expire. Accordingly, until exercise of the options, the shares ‘issued’ to employees are treated as treasury shares and no financial asset for the loan receivable from the employees is recognised until this time.

Consider the following example of a share-based payment that is structured as a share purchase arrangement.



#### Example 6.5.3 – Share purchase funded through loan: Net settlement

An employee receives a right to and buys shares immediately and, at the same time, receives a loan for the amount of the exercise price. The loan accrues interest at a market rate. The employee receives a right to settle the loan in full by tendering the shares bought.

In this example, the put option feature over the shares removes any risk for the employee of share price decreases while all rewards above the market rate of interest are retained. We believe that this plan is, in substance, an option and the transaction should be accounted for as such.



#### Example 6.5.4 – Share purchase funded through loan: Gross settlement

Assume the same facts as in [Example 6.5.3](#), except that the loan and interest are settled in full in cash but the employee has the right to put the shares back to the entity at the original purchase price plus interest at a market interest rate, provided that the cash is used to settle the loan and interest. That is, compared with a right to settle by tendering shares, there is an equal and opposite cash outflow from the entity to the employee and a subsequent cash inflow to the entity from the employee when the employee chooses not to ‘exercise’ the option.

The key conclusion is the same as in [Example 6.5.3](#) – i.e. there is an option feature because the employee is protected from share price decreases by being able to sell back the shares at the original purchase price, while all rewards above the market rate of interest are retained if the employee chooses to ‘exercise’ the option by settling the loan and not selling back the shares.

IU 11-05

### Determining assets to which entity has recourse for loan repayment

In assessing whether shares paid for by a loan from the issuer are in substance a grant of options, an entity should consider whether it has full recourse to the employees in respect of the balance of the loan. For example, if the share price falls below the outstanding balance of the loan, then does the entity have recourse to the personal assets of the employee, and will it pursue collection of the full loan balance?

In our view, it is appropriate to account for the transaction as the issue of shares and a financial asset for the loan receivable only when it can be demonstrated clearly that the entity has and will pursue full recourse to the employee in respect of the loan.

Whether the entity has full recourse to the employee in respect of the loan should be assessed based on all of the terms and conditions of the arrangement. We believe that, for the loan to be considered full recourse, it should be documented as a full-recourse loan and there should not be evidence that would indicate otherwise – e.g. a past history of the entity waiving all or a portion of similar loans. The following are examples of indicators that may support the conclusion that a loan is full recourse.

- The loan is reported by the entity to a credit agency in the same manner as commercial loans.
- The entity requests financial information from the employees to assess their ability to repay the loans.
- The entity has an ongoing process for monitoring the collectability of the loan.
- If applicable, the entity has a past history of collection in full of other employee loans (e.g. housing loans).



#### Example 6.5.5 – Share purchase funded through loan with retrospective partial waiver: Full-recourse loan

Company W issues shares to its employees at the market price on the date of issue and the purchases are funded through a loan provided by W to its employees. W has recourse to all of the employees' assets and not just the shares bought with the loan. If W achieves a two-year cumulative EPS growth target of 15%, then 25% of the loan balance will be waived – i.e. the share purchase price will be reduced retrospectively by 25%. W has the intent and ability to pursue full collection of the outstanding loan balance and a past practice of collecting loans from employees.

In this example, we believe that the arrangement is an issue of shares and a financial asset (e.g. the loan is full recourse and therefore the arrangement is not in substance an option grant but rather should be treated as a share purchase). The employees may earn a discount to the share price subject to the achievement of a non-market performance condition – i.e. a waiver of 25% of the share price if a cumulative EPS target is met.

In our view, the potential retrospective adjustment to the share purchase price is a share-based payment and not an employee benefit under IAS 19 *Employee Benefits* because the payment is based on the share price (see 3.5.20). This is consistent with the example in IFRS 2 of a reduction in the exercise price of an option as a result of achieving a non-market performance condition – i.e. the shares ultimately can be bought by the employees at a discount from the purchase price specified originally (see 6.7.30).

We believe that, because the employees receive equity instruments (i.e. shares that may be bought at a discount) and do not receive a payment based on the price (or value) of the entity's shares or other equity instruments, the share-based payment should be classified as equity-settled.



### Example 6.5.6 – Share purchase funded through loan with retrospective partial waiver: Non-recourse loan

Company X issues shares to its employees at the market price on the date of issue. The fact pattern is the same as in [Example 6.5.5](#), except that X does not have the ability to pursue full collection of the outstanding loan balance. Instead, X only has the ability to require the employees to tender back the shares if either the share-based payment does not vest (i.e. the loan is not reduced or the employees leave) or the share-based payment vests but the employees choose not to settle the reduced loan balance on vesting.

In this example, we believe that the grant should not be classified as a share purchase plan, but as an option plan. This is because X does not have full recourse to the outstanding loan balance. If, for example, the performance target is not met and the share price has fallen compared with the date of purchase, then the employees only need to tender back the shares to X and the outstanding loan balance is waived. The employees are protected from any downside risk, because they received the shares and just tender them back without any payment made. This is in substance the same as not exercising a share option.

As a result, X should not recognise either the loan or the shares as outstanding.

See [Examples 6.5.8–9](#) for an illustration of the accounting for this type of arrangement.

In our view, if the structure is viewed as a share purchase, then the financial asset should be accounted for separately from the share-based payment and should be recognised and measured in accordance with the financial instruments standards. Under those accounting standards, the initial and subsequent measurement of the financial asset should reflect the likelihood of the employee receiving a discount as a result of the achievement of the non-market performance condition.

If the loan issued to the employee does not bear interest at a market rate, then in our view the low-interest loan is a benefit conveyed to the employee that could be accounted for under IFRS 2. In some cases, such a loan is available only for financing share purchases, which suggests that the loan is an integral part of the share-based payment arrangement and therefore we believe that it should be accounted for under IFRS 2. However, it might also be appropriate to account for the discount as an employee benefit separately from the share-based payment, particularly if similar loans are available for other purposes.

In other arrangements, a share purchase by employees may be funded only partially through a loan from the entity – e.g. the entity issues a loan to employees for 70 percent of the market price of its shares and the employee is required to pay in cash the remaining 30 percent of the purchase price. The entity has recourse only to the shares and the employees receive a right to settle the loan by tendering the shares bought, either directly or via a right to put the shares back to the entity. If the market price of the shares is less than the amount of the loan when the shares are to be tendered to the entity, then the entity receives the shares as settlement of the loan in full – i.e. the entity accepts the risk that its share price will decrease by greater than 30 percent. If the cash payment by the employee represents substantially all of the reasonably possible losses – based on the expected volatility of the shares – then in our view the fact that the loan has recourse only to the shares does not preclude accounting for the transaction as the issuance of shares and a financial asset. This is because, subsequent to the date of issuance, the employee is not only able to benefit from increases in the entity's share price, but is also at risk for substantially all of the reasonably possible decreases in the share price.

**Example 6.5.7 – Share purchase partially funded through loan**

Company P issues shares to its employees at the market price on the date of issue. P issues a loan to employees at an amount equal to 70% of the total market price of the shares issued; the employees are required to pay in cash the remaining 30% of the purchase price. The entity has recourse only to the shares and the employees receive a right to settle the loan by tendering the shares bought either directly or via a right to put the shares back to the entity. If the market price of the shares is less than the amount of the loan when the shares are to be tendered to the entity, then the entity receives the shares as settlement of the loan in full – i.e. the entity accepts the risk that its share price will decrease by greater than 30%.

If the cash payment by the employees represents substantially all of the reasonably possible loss based on the expected volatility of the shares – i.e. the expected volatility is less than 30% – then we believe that the fact that the loan is recourse only to the shares does not preclude accounting for the transaction as the issuance of shares and a financial asset.

**Accounting for interest and dividends in a grant of share options**

As a consequence of treating a share purchase funded through a limited recourse loan as an option, an issue arises about how to account for the share purchase, the loan issue, any interest on the loan and any dividends on the shares.

In our view, the share purchase, loan issue, interest and dividends should be accounted for in accordance with the substance of the arrangement. If the share purchase funded through a non-full recourse loan is in substance a share option, then we believe that neither the loan nor the shares should be recognised as outstanding and the repayment of the loan by the employee should be treated as the payment of the exercise price.

Consequently, we believe that interest is not accrued over the vesting period but should be recognised only as part of the exercise price when it is received. Interest therefore decreases the grant-date fair value of the option due to an increased exercise price. The right to receive dividends should also be taken into account in estimating the grant-date fair value of the option – i.e. any entitlement increases the grant-date fair value compared with an option without dividend entitlement.

However, we believe that forfeitable dividends declared but not paid out before exercise of the option should be recognised only when the loan amount, reduced for the dividends, becomes a recognised receivable on exercise. This is because the obligation to pay the dividends only reduces the unrecognised receivable due from the employee, rather than being a liability in its own right; this treatment is different from dividends declared on unvested shares (see 6.6.20). In our view, the entity should choose an accounting policy, to be applied consistently, to either recognise the dividends by netting the amount with the proceeds from the exercise price or recognise a separate distribution in equity.



**Example 6.5.8 – Share purchase funded through loan: Fixed interest, no dividends**

On 1 January Year 1, Company B grants one of its employees a right to buy a share, subject to a three-year service condition; the share purchase is funded through a loan to the employee. The loan amount equals the share price of 100 at grant date. The employee signs the loan note and takes legal ownership of the share but the share is not delivered to the employee; it is held under control of the entity (i.e. the employee cannot sell the share).

The loan bears a fixed interest rate of 5% per annum (not compounded), to be paid at the maturity date of the loan, which is the vesting date. The employee is not entitled to receive dividends declared during the vesting period. No dividends are expected to be paid, and none are actually paid during the vesting period.

At the end of the service period, the employee can choose:

- to repay the loan including interest, in which case the share will be delivered to the employee; or
- not to repay the loan, in which case the share is returned to the entity.

B applies an option pricing model and estimates the grant-date fair value of the option at 13.50. The exercise price assumed in the model is 115, being the loan amount of 100 plus three years' interest at 5 per annum. B expects the employee to provide the requisite service, which they do.

B accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Scenario A – Share price is 120 at end of Year 3 – employee repays loan (including interest)</b>		
<b>Year 1</b>		
Expenses	4.50	
Equity		4.50
<i>To recognise share-based payment expense for Year 1 of service period (13.50 x 1/3)</i>		
<b>Year 2</b>		
Expenses	4.50	
Equity		4.50
<i>To recognise share-based payment expense for Year 2 of service period (13.50 x 1/3)</i>		
<b>Year 3</b>		
Expenses	4.50	
Equity		4.50
<i>To recognise share-based payment expense for Year 3 of service period (13.50 x 1/3)</i>		

	<i>Debit</i>	<i>Credit</i>
Cash	115.00	
Equity		115.00
<i>To recognise receipt of 'exercise price' (100 + (100 × 0.05 × 3))</i>		
<b>Cumulative effects</b>		
Expenses	13.50	
Cash	115.00	
Equity		128.50
<b>Scenario B</b> – Share price is 110 at end of Year 3 – employee does not repay loan		
<b>Year 1 – Year 3 (cumulative)</b>		
Expenses	13.50	
Equity		13.50
<i>To recognise share-based payment expense – i.e. expense of 4.50 each year in Year 1, Year 2 and Year 3</i>		

Scenario B illustrates that the cumulative share-based payment expense previously recognised is not adjusted (see 6.2.10).



### Example 6.5.9 – Share purchase funded through loan: Fixed interest and dividends

Assume the same facts as in Example 6.5.8, except that the employee is entitled to dividends declared during the service period. If the employee leaves before vesting date or the option is not exercised by repaying the loan amount including interest, then the employee will lose the entitlement to those dividends.

Dividends are expected to be 5 each year from Year 1 to Year 3. Dividends declared are not paid to the employee, but used to repay part of the loan amount.

At the end of the service period, the employee can choose:

- to repay the loan (including interest) less any dividends declared during the service period, in which case the share will be delivered to the employee; or
- not to repay the loan (including interest) less any dividends declared during the service period, in which case the share is returned to the entity and the dividends declared will not be paid to the employee.

B applies an option pricing model and estimates the grant-date fair value of the option at 21. The value of the option has increased compared with the value in Example 6.5.8 from 13.50 to 21 because of the dividend entitlement. For a discussion of how dividend protection features are taken into account in option pricing models, see A2.50. B expects the employee to provide the requisite service, which they do.

The actual dividends declared are 4 in Year 1, 5 in Year 2 and 7 in Year 3, for a total amount of 16.

For simplicity, this example assumes that dividends declared do not reduce the loan amount for the purpose of calculating interest on the loan, and the dividends themselves are not interest-bearing for the employee.

B accounts for the transaction as follows.

	Debit	Credit
<b>Scenario A</b> – Share price is 120 at end of Year 3 – employee repays loan (including interest) less dividends declared		
<b>Approach 1 – Dividends as part of exercise price</b>		
<b>Year 1</b>		
Expenses	7	
Equity		7
<i>To recognise share-based payment expense for Year 1 of service period (21 x 1/3)</i>		
<b>Year 2</b>		
Expenses	7	
Equity		7
<i>To recognise share-based payment expense for Year 2 of service period (21 x 1/3)</i>		
<b>Year 3</b>		
Expenses	7	
Equity		7
<i>To recognise share-based payment expense for Year 3 of service period (21 x 1/3)</i>		
Cash	99	
Equity		99
<i>To recognise receipt of exercise price (100 + 15 - 16)</i>		
<b>Cumulative effects</b>		
Expenses	21	
Cash	99	
Equity		120
<b>Approach 2 – Dividends as separate distribution</b>		
<b>Year 1 – Year 3 (cumulative)</b>		
Expenses	21	
Equity		21
<i>To recognise share-based payment expense – i.e. expense of 7 each year in Year 1, Year 2 and Year 3</i>		
<b>Year 3</b>		
Cash	99	
Equity (distribution)	16	
Equity		115
<i>To recognise net payment of 99, comprising a gross payment from employee of 115 – i.e. the loan amount and the interest – and a payment of dividends of 16 to the employee, recognised as a distribution</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Cumulative effects</b>		
Expenses	21	
Cash	99	
Equity (distribution)	16	
Equity		136
<b>Scenario B – Share price is 90 at end of Year 3 – employee does not repay loan</b>		
<b>Year 1 – Year 3 (cumulative)</b>		
Expenses	21	
Equity		21
<i>To recognise share-based payment expense – i.e. expense of 7 each year in Year 1, Year 2 and Year 3</i>		

### 6.5.30

### Free shares

In some share-based payments, employees are entitled to shares for no cash consideration; however, the grant is conditional on the fulfilment of vesting conditions. If the holders of such shares have the same rights as holders of shares not subject to a vesting condition, then the value of the shares granted is equal to the value of vested shares. However, if the holders of such shares are not entitled to dividends during the vesting period, then the measurement of grant-date fair value reflects the fact that expected future dividends will not be received by employees.

The existence of market conditions and non-vesting conditions further reduces the grant-date fair value used for equity-settled share-based payments, regardless of whether they are shares or options. For more details on the measurement of equity instruments with market and non-vesting conditions, see 6.6.10 and A2.50.

## 6.6

## Measurement principles

### 6.6.10

### Determining fair value of equity instruments granted

*IFRS 2.11*

Share-based payment transactions with employees are measured with reference to the fair value of the equity instruments granted.

*IFRS 2.16–17*

The fair value of the equity instruments granted is determined as follows.

- If market prices are available for the actual equity instruments granted – i.e. shares or share options with the same terms and conditions – then the estimate of fair value is based on these market prices.
- If market prices are not available for the equity instruments granted, then the fair value of equity instruments granted is estimated using a *valuation technique*.

*IFRS 2.18, B2–B41*

IFRS 2 includes an appendix that provides guidance on measuring the fair value of shares and of share options. Because the methods of measuring these two types of share-based payments are different, it is important to determine the type of equity instrument granted (see Chapter 6.5). The key difference between measuring the fair value of a share granted and the fair value of a share option granted is that the option holder benefits only from that part of the share price at the exercise date that exceeds the exercise price. Another common difference is that option holders are often not entitled to any

dividends declared before the exercise of the option, whereas shareholders are usually entitled to them. This difference in dividend entitlement also affects the valuation. For detailed guidance on applying appropriate measurement methods, see [A2.20–30](#).

### No track record of market price

*IFRS 2.B4, B26–B30*

In many situations, a market price for equity instruments (e.g. share options) will not exist. This is because equity instruments issued to employees often have terms and conditions (e.g. vesting conditions) different from those instruments traded in the market and therefore a valuation technique is used. A valuation technique requires the estimation of a number of variables, including the expected future volatility of the entity. In our view, if no equity instruments of the entity are traded, then an implied volatility should be calculated – e.g. based on actual experience of similar entities that have traded equity instruments. We believe that an entity, even one without a historical track record (e.g. a newly listed entity), should not estimate its expected volatility at zero. In rare cases, an entity may be unable to estimate, at grant date, expected volatility and therefore the fair value of the equity instruments cannot be measured; in such rare cases use of the intrinsic value may be required (see [6.2.10](#)).

### Considering market and non-vesting conditions

*IFRS 2.19–21A*

In determining the grant-date fair value of the equity instruments granted, the impact of any market and non-vesting conditions is taken into account – i.e. they result in downward adjustments compared with the fair value without these conditions (see above).

Although incorporating the impact of market conditions into the fair value may not usually be too difficult, because a market condition is by definition linked to the share price, in our experience the more difficult area is the determination of the value adjustment for non-vesting conditions.

Non-vesting conditions can be based on non-controllable factors. Some of these can be quantified because there is market-based data on trend and volatility; for example, non-vesting conditions linked to a commodity price or an inflation factor (see [A2.50](#)).

Non-vesting conditions can also arise when the performance assessment period for a non-market based performance measure (e.g. EBITDA or EPS) exceeds the required service period. In these cases, the entity will need to determine an appropriate method for incorporating the condition when determining the fair value of the award.



#### Example 6.6.1 – EPS target treated as a non-vesting condition

Company C issues shares to employees, subject to a three-year service condition and the achievement of growth in EPS of 30% by the end of the service period. The share-based payment arrangement further contains a good leaver clause according to which any employees leaving the company because they are eligible for retirement before the end of the service condition are treated as if they had met the service condition. However, vesting is still subject to the achievement of the EPS target.

For those employees who will reach retirement age before the end of three years ('good leavers') the EPS target represents a non-vesting condition because the performance assessment period for the EPS target extends beyond the required service period (the period up to when the employee becomes eligible for retirement). Because the EPS target represents a non-vesting condition, it is taken into account when measuring the fair value of the award at grant date.

C's share price at grant date is 10 per share and no dividends are expected to be paid by the company before the end of the service period. Management has assessed that the probability of achieving the EPS target is 70%.

Company C incorporates the EPS target into the measurement of the grant-date fair value by choosing to adjust the share price on grant date by the probability of the EPS target not being achieved (30%). Therefore, the grant-date fair value of the award for the employees who are eligible for retirement is 7. This amount is recognised immediately for those who are eligible to retire at grant date, and over the employees' requisite service period for those who will become eligible to retire before the end of the three-year stated service period. For good leavers, there is no reversal of compensation cost if the EPS target is not achieved because the condition is a non-vesting condition.

Conversely, for the employees who will not become eligible to retire before the end of the explicit service period, the award is an equity-classified award that vests on the achievement of a performance condition. As such, for these employees the grant-date fair value of the award is 10 and compensation cost will be recognised if the performance target is probable of achievement; however, the recognised compensation cost would be reversed for these employees if the performance target fails to be achieved.

### Non-vesting conditions that employee can choose to meet

*IFRS 2.B3,  
IG15A.Ex9A,  
BC171B, IU 11-06*

Common examples of non-vesting conditions that the employee can choose to meet are non-compete agreements, transfer restrictions after vesting, savings conditions or a requirement to hold shares. Post-vesting restrictions are included in the grant-date measurement of fair value to the extent that the restrictions affect the price that a knowledgeable, willing market participant would pay for that share. The accounting standard's guidance on valuation notes that post-vesting transfer restrictions may have little, if any, effect on fair value when the shares are traded actively in a deep and liquid market.



#### Example 6.6.2 – Post-vesting transfer restriction

Company C has granted shares to employees subject to a one-year service condition. After the service period, employees are entitled unconditionally to the shares. However, under the arrangement they are not allowed to sell the shares for a further five-year period.

The five-year restriction on the sale of the shares is a post-vesting restriction, which is a non-vesting condition (see [Chapter 5.4](#)), and is taken into account by C in measuring the grant-date fair value.

For further guidance on how to incorporate the impact of post-vesting transfer restrictions into the grant-date fair value, see [A2.50](#).

*IFRS 2.B3, B10,  
BC168, IU 11-06*

The IFRS Interpretations Committee discussed the fair value measurement of post-vesting transfer restrictions and noted that it is not appropriate to determine the fair value of equity instruments issued only to employees and subject to post-vesting restrictions, based on an approach that looks solely or primarily to an actual or synthetic market consisting only of transactions between an entity and its employees and in which prices, for example, reflect an employee's personal borrowing rate. This is because the objective of IFRS 2 is to estimate the fair value of an equity instrument and not the value from the employee's perspective. The Committee also noted that factors that affect only the employee's specific perspective on the value of the equity instruments are not relevant to estimating the price that would be set by a knowledgeable, willing market participant. Therefore, hypothetical transactions with actual or potential market participants willing to invest in restricted shares should be considered.

The effect on the grant-date fair value of other non-vesting conditions that the employee can choose to meet – e.g. savings conditions or a requirement to hold shares – is difficult to estimate because it relies on the ability of the entity to forecast employee behaviour. Entities may not have gathered such information historically and, in any case, past practice may not be a reliable indication of future behaviour; therefore, judgement is required. For a discussion of non-vesting conditions, see [A2.50](#).

**Non-vesting conditions that entity can choose to meet***IFRS 2.IG24*

An example of a non-vesting condition that the entity can choose to meet is the continuation of the plan by the employer. Applying the general requirements for non-vesting conditions would require the entity to estimate the probability that it would not continue with the plan and adjust the grant-date fair value accordingly. As an exception to the general requirement to reflect the expected outcome of non-vesting conditions in the measurement of grant-date fair value, the entity is prohibited from considering the possibility of not continuing the plan in the estimate of the grant-date fair value.

**6.6.20 Dividends***IFRS 2.B31*

The treatment of expected dividends in measuring the fair value of the equity instruments depends on whether the employees are entitled to dividends.

*IFRS 2.B34*

If the employees are not entitled to dividends declared during the vesting period, then the grant-date fair value of these equity instruments is reduced by the present value of dividends expected to be paid during this period compared with the fair value of equity instruments that are entitled to dividends.

*IFRS 2.B32*

If the employees are entitled to dividends declared during the vesting period, then in our view the accounting treatment depends on whether the dividends are forfeitable – i.e. whether dividends have to be paid back if vesting conditions are not met.

**Cost measurement and recognition for forfeitable dividend rights**

We believe that forfeitable dividends should be treated as dividend entitlements during the vesting period. If the vesting conditions are not met, then any true-up of the share-based payment would recognise the profit or loss effect of the forfeiture of the dividend automatically because the dividend entitlements are reflected in the grant-date fair value of the award (for a discussion of when a true-up applies, see 6.2.10).

**Cost measurement and recognition for non-forfeitable dividend rights***IFRS 2.B31–B36*

In our view, an entity should choose an accounting policy, to be applied consistently, to account for non-forfeitable dividends using one of the following approaches.

One approach is to treat non-forfeitable dividends as a dividend entitlement during the vesting period when determining the grant-date fair value of the share-based payment. The value of the dividend right is reflected in the grant-date fair value of the share-based payment, and therefore increases the cost of the share-based payment. If the share-based payment does not vest, then in our view the total amount previously recognised as a share-based payment cost should be split into:

- the value for the non-forfeitable dividends; and
- the balance of the share-based payment.

We believe that only the balance of the share-based payment cost – i.e. the amount excluding the non-forfeitable dividends – would be subject to true-up for failure to satisfy vesting conditions to reflect the benefit retained by the employee.

The other approach is to view non-forfeitable dividends as a payment for services with vesting conditions different from the vesting conditions of the underlying share-based payment. Under this approach, the dividend rights would be considered to be a benefit – e.g. under IAS 19 if the services are employee services – rather than a share-based payment because dividend amounts are unlikely to be based on the price (or value) of the entity's equity instruments. Accordingly, the grant-date fair value of the share-based payment would be lower than under the approach above.

Generally, dividends are considered to be part of the measurement of the grant-date fair value, which supports the first approach discussed above – i.e. to treat dividend entitlements as part of the share-based payment. However, in some circumstances there may be evidence that the share component of the transaction is merely a mechanism to deliver the dividend payments (see 3.5.30). In fact patterns in which the dividend payment is the primary consideration, the second approach above, which accounts separately for dividends, might be more relevant.

### Dividend recognition

In our view, when the dividend rights are treated as dividend entitlements regardless of whether the dividends are forfeitable or non-forfeitable, dividends declared during the vesting period should be accounted for in accordance with the requirements of other IFRS Accounting Standards – i.e. as a distribution. Therefore, neither the declaration nor the payment of the dividends results in additional cost directly, because we believe that the recognition of cost for the grant of dividend rights should be considered separately, as discussed above (see 6.6.20). In particular under the first approach in 6.6.20, if the dividend amounts are retained even if the vesting conditions are not met, then we believe that no adjustment of the dividend accounting is necessary because the portion of the share-based payment cost related to the non-forfeitable dividend would not be trued up.

In relation to a grant of shares, in our view dividends that are declared during the vesting period but not paid until vesting should also be charged to equity and recognised as a liability when they are declared. For a discussion of the accounting for dividends declared in relation to a share purchase funded through a loan and accounted for as a grant of share options, see 6.5.20.

In our view, if the share-based payment, and therefore forfeitable dividends thereon, are forfeited because of failure to satisfy a vesting condition, then the return of dividends or reduction in dividend payable should be accounted for as a transaction with a shareholder – i.e. the return should be recognised directly in equity as an adjustment of previously recognised dividends.



#### Example 6.6.3 – Forfeitable dividends

On 1 January Year 1, Company F grants one share option to an employee, subject to a four-year service condition. F expects the employee to remain employed until vesting date.

During the vesting period, the employee is entitled to receive dividends equal to dividends declared on common shares. The employee is required to return the dividends received if the service condition is not met.

The employee leaves in April Year 2.

F estimates the fair value of a share option without dividend entitlement at 80 and the fair value of the dividend entitlement at 20.

The dividends declared and paid on a common share are as follows.

In Year 1	5
In Year 2	7 <sup>1</sup>
In Year 3	3
In Year 4	8

#### Note

1. Declared after the employee left in April Year 2.

The accounting is as follows.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	1	100	25 <sup>1</sup>	25
Year 2	-	-	-	(25)
Year 3	-	-	-	-
Year 4	-	-	-	-

**Note**

1. 100 x 1/4.

F accounts for the transaction as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses	25	
Equity		25
<i>To recognise share-based payment expense</i>		
Equity (distribution)	5	
Cash		5
<i>To recognise dividend declared and paid</i>		
<b>Year 2</b>		
Equity	25	
Expenses		25
<i>To recognise true-up of share-based payment expense</i>		
Cash	5	
Equity (distribution)		5
<i>To recognise return of dividend paid in Year 1</i>		
<b>Cumulative effects</b>		
Expenses	-	
Equity		-
Cash		-

## 6.7 Variable number of equity instruments or variable exercise price

### 6.7.10 Shares ‘to the value of’

If a variable number of equity instruments to the value of a fixed amount is granted, commonly known as ‘shares to the value of’, then we believe that such an arrangement is an equity-settled share-based payment (see [Chapter 4.3](#)).

A question arises about the measurement of such a grant if the date of delivery of the shares is in the future because there is a service requirement. In our view, there are two acceptable approaches in respect of measurement:

- as a fixed amount of cash that will be received in the future based on its discounted amount, similar to the net present value of a financial liability (Approach 1); or
- as a grant of free shares that are subject only to a service requirement – i.e. referenced to the share price, without discounting – because in contrast to a financial liability there is no outflow of resources (Approach 2).



#### Example 6.7.1 – Measurement of a grant of a variable number of equity instruments to the value of a fixed amount

Company C, which is listed on a stock exchange, grants shares to its CEO with a value equal to a fixed cash amount of 1,000, subject to a two-year service condition. The number of shares to be delivered depends on the share price on vesting date. C determines that the appropriate discount rate is 2%.

If C elects to apply Approach 1 to measure the grant, then the grant-date fair value to recognise over the service period is 961 ( $1,000 / 1.02^2$ ) – i.e. a discounted amount. The difference between 961 and 1,000 is not subsequently recognised.

Conversely, if C elects to apply Approach 2 to measure the grant, then the grant-date fair value to recognise over the service period is the total 1,000 – i.e. the undiscounted amount.

Although IFRS 2 is silent on discounting in this fact pattern, other IFRS Accounting Standards require discounting to reflect the time value of money. Therefore, measurement on a discounted basis is generally more appropriate if the payment is due to be settled more than 12 months after the reporting date.

### 6.7.20 Non-market performance condition and variable number of equity instruments

If there is a performance condition attached to a share-based payment arrangement, then often such conditions determine whether the employee receives the share-based payment in an ‘all-or-nothing’ manner (see [Examples 6.2.2 and 3](#)).

However, sometimes performance conditions are not designed as all-or-nothing conditions, but they determine the number of equity instruments to be received or the exercise price to be paid.

*IFRS 2.IG12.Ex3*

If the number of equity instruments granted varies with the level of achievement of a non-market performance target, then the entity trues up the number of equity instruments to be equal to the actual number of instruments that vest.



**Example 6.7.2 – Non-market performance condition with variable number of equity instruments**

On 1 January Year 1, Company B grants share options to an employee, subject to a three-year service condition. The grant-date fair value of a share option is 10.

The grant is further subject to a cumulative profit target.

- Level 1: If profits of 10 million are achieved, then the employee receives 1,000 share options.
- Level 2: If profits of more than 15 million are achieved, then the employee receives 2,000 share options.

B expects the employee to satisfy the service requirement. At grant date and throughout Year 1, B expects the Level 1 profit target to be met. In Year 2, B revises its estimate and expects that the Level 2 profit target will be met. Although the employee is still employed at the end of Year 3, neither profit target is met.

End of	Instruments for which it is expected that service and NMP <sup>1</sup> condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	1,000	10,000 <sup>2</sup>	3,333 <sup>5</sup>	3,333
Year 2	2,000	20,000 <sup>3</sup>	13,333 <sup>6</sup>	10,000
Year 3	-	- <sup>4</sup>	-	(13,333)

**Notes**

1. Non-market performance.
2. 1,000 x 10.
3. 2,000 x 10.
4. 0 x 10.
5. 10,000 x 1/3.
6. 20,000 x 2/3.

**6.7.30**

IFRS 2.IG12.Ex4

**Non-market performance condition and variable exercise price**

If the exercise price of share options granted varies with the level of achievement of a non-market performance target, then the entity uses the grant-date fair value that applies to the most likely outcome of the non-market performance target when it trues up the actual cost to be recognised.



**Example 6.7.3 – Non-market performance condition with variable exercise price**

On 1 January Year 1, Company C grants 100 share options to an employee, subject to a two-year service condition.

The grant is also subject to a cumulative profits target.

- Level 1: If profits of 10 million are achieved, then the exercise price is 100. The grant-date fair value in this case is estimated to be 20.
- Level 2: If profits of more than 15 million are achieved, then the exercise price is reduced to 80. The grant-date fair value in this case is estimated to be 28.

B expects the employee to satisfy the service requirement. At grant date and throughout Year 1, B expects the Level 1 profit target to be met. At the end of Year 2, the employee is still employed and the Level 2 profit target is achieved.

End of	Instruments for which it is expected that service and NMP <sup>1</sup> condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	100	2,000 <sup>2</sup>	1,000 <sup>4</sup>	1,000
Year 2	100	2,800 <sup>3</sup>	2,800 <sup>5</sup>	1,800

**Notes**

1. Non-market performance.
2. 100 x 20.
3. 100 x 28.
4. 2,000 x 1/2.
5. 2,800 x 2/2.

**Example 6.7.3** illustrates that sometimes it is necessary to determine two or more different grant-date fair values of the equity instruments granted, none of which is remeasured subsequently, in the absence of a modification. The concept of switching from one grant-date fair value to another is not addressed in IFRS 2, but is illustrated in the accounting standard's implementation guidance. In our experience, this concept is key to applying the accounting standard to share-based payments with multiple vesting conditions (see [Chapter 6.8](#)).

## 6.7.40

### Market condition and variable number of equity instruments

Typically, an employee is granted a share-based payment to receive a fixed number of equity instruments subject to vesting conditions. In such situations, the entity values the individual equity instruments granted to determine the grant-date fair value of the share-based payment.

Sometimes a share-based payment is granted in which the number of equity instruments that the employee receives varies based on the achievement of a market condition. In these situations, the employee has been granted a right to receive a variable number of equity instruments, and the value of this right depends on the outcome of the market condition.

If a share-based payment includes a market condition, then the grant-date fair value reflects the probability of satisfying the market condition. In the case just described, the market condition creates variability in the number of equity instruments that will be received. Therefore, the entity determines the grant-date fair value of the right to receive a variable number of equity instruments reflecting the probability of different outcomes.

In our view, the grant-date fair value of the share-based payment for each right should be valued by applying a valuation technique that considers the different possible outcomes, such as binomial or Monte Carlo (see [A2.100](#)). We believe that the value of the share-based payment per right should not be adjusted for changes in the share price or related to the market condition, because it is a share-based payment with a market condition. Changes resulting from failure to meet a service condition are trued up as required.

**Example 6.7.4 – Market condition with variable number of equity instruments: Grant to one employee**

On 1 January Year 1, Company D grants a right to share options to an employee, subject to a three-year service condition.

The grant is also subject to a share price target.

- Level 1: If a share price of at least 100 is achieved, then the employee receives 1,000 share options.
- Level 2: If a share price of more than 120 is achieved, then the employee receives 2,000 share options.
- If the share price does not reach 100, then no options are received.

D expects the employee to satisfy the service condition. D estimates the grant-date fair value of the right to receive the variable number of equity instruments by applying an appropriate valuation technique to be 13,545.

At the end of Year 3, the employee is still employed and the Level 2 share price target is met. The actual achievement of the share price target does not affect the accounting. Because the probability of meeting a share price target to obtain the extra 1,000 share options was already factored into the grant-date fair value of 13,545, the share-based payment is not remeasured.

End of	Service condition expected to be met?	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	Yes	13,545	4,515 <sup>1</sup>	4,515
Year 2	Yes	13,545	9,030 <sup>2</sup>	4,515
Year 3	Yes	13,545	13,545 <sup>3</sup>	4,515

**Notes**

1. 13,545 x 1/3.
2. 13,545 x 2/3.
3. 13,545 x 3/3.

**Example 6.7.5 – Market condition with variable number of equity instruments: Grant to more than one employee**

Assume the same facts as in [Example 6.7.4](#), except that the grant was made to more than one employee. In this case, the same grant-date fair value of the share-based payment applies to the rights given to each employee and the grant is trued up as required if the service condition is not met. For example, if the same grant is made to 10 employees and eight are expected to meet the service requirement, then the total share-based payment expense would be 108,360 (13,545 x 8). If only seven employees ultimately meet the service requirement, then the share-based payment expense is trued up to 94,815 (13,545 x 7).

## 6.8 Multiple vesting conditions

### 6.8.10 Introduction

IFRS 2 provides examples in which share-based payments are subject to a single performance condition – i.e. a service requirement and one performance target (see [Examples 6.2.1, 2 and 3](#)). Examples in which the share-based payment is subject to two performance conditions are not included in the accounting standard. In our experience, it is not unusual for a share-based payment to contain two performance conditions – e.g. one market condition and one non-market performance condition. In some cases, both conditions need to be satisfied ('and' conditions); in other cases, only one condition needs to be satisfied ('or' conditions).

In our experience, good leaver clauses are also commonly found in share-based payment arrangements under which, for example, an employee eligible for retirement may have a shorter service requirement (see [6.8.30](#)). Another example of multiple vesting conditions is when vesting is accelerated if the employee leaves under specified circumstances, usually contingent on future events such as termination following actions by the employer (see [6.9.20](#)).

### 6.8.20 Multiple cumulative performance conditions ('and' conditions)

Vesting conditions may require two performance conditions to be satisfied – e.g. one market condition and one non-market performance condition.

In our view, in a share-based payment subject to both market and non-market performance conditions, the grant-date fair value used to measure the share-based payment should reflect the probability of not achieving the market condition.

In our view, if the non-market performance condition is not satisfied, then the entity should true up the cumulative share-based payment cost.



#### Example 6.8.1 – Equity-settled share-based payment transaction with 'and' conditions

On 1 January Year 1, Company B grants 100 share options, subject to the following conditions:

- the employee remains in service with B until 31 December Year 3;
- a total shareholder return (TSR) of 15% is achieved; and
- the cumulative profits are at least 10 million.

Under these conditions, the employee can exercise the vested options on any date in Year 4; B delivers one share per option exercised.

At grant date, the fair value of a share option without considering any condition is 7 and the fair value considering the market condition is 5.50, resulting in a total share-based payment expense of 550 if all of the conditions are met.

Assuming that the service condition is expected to be met and ultimately is, the four possible outcomes and the total share-based payment expense that we believe should be recognised are set out in the table below.

Outcome	Total share-based payment expense
The entity achieves both the market (TSR) and the non-market (cumulative profits) performance conditions – the award vests	550
The entity achieves the market condition but does not achieve the non-market performance condition – the award does not vest	-
The entity does not achieve the market condition but achieves the non-market performance condition – the award does not vest	550
The entity achieves neither the market nor the non-market performance condition – the award does not vest	-

### 6.8.30 Multiple alternative performance conditions ('or' conditions)

Some share-based payment transactions may require the satisfaction of both a service condition and at least one of two alternative performance conditions – e.g. one market condition or one non-market performance condition – for the share-based payment to vest. Such arrangements with multiple alternative vesting conditions are sometimes referred to as containing 'multiple interactive vesting conditions'. Share-based payments containing multiple interactive vesting conditions raise complicated accounting issues, because there is limited guidance in relation to grants of share-based payments that combine market and non-market performance conditions.

*IFRS 2.IG12.Ex4*

The implementation guidance to IFRS 2 contains an example of a share-based payment for which the exercise price varies with a non-market performance condition. This example illustrates that a 'switching' approach is taken when there are multiple mutually exclusive outcomes in a share-based payment (see 6.730).

*IFRS 2.15, 21, IG12.Ex4*

In our view, this switching approach should be followed by analogy for a grant with multiple interactive vesting conditions. At grant date, the entity should estimate the fair value of the equity instruments for each possible outcome and account for the share-based payment based on the most likely outcome at the reporting date. The following table sets out all of the possible outcomes.

Possible outcomes	Market condition	Non-market performance condition
<b>Scenario 1</b>	Met	Not met
<b>Scenario 2</b>	Not met	Met
<b>Scenario 3</b>	Not met	Not met
<b>Scenario 4</b>	Met	Met

In estimating the fair value for each possible outcome, one fair value ignoring the probability of not achieving the market condition is calculated at grant date for the award, assuming that all of the vesting conditions are met. In the discussion below, this is referred to as the 'non-adjusted fair value'. That fair value is used, with an adjustment to reflect the probability of not achieving the market condition, to measure the fair value of the award with the market condition; this is referred to below as the 'adjusted fair value'.

The non-adjusted fair value of the award is used to measure the fair value of the award with the non-market performance condition; with regard to the non-market performance condition, the estimate of the number of awards expected to vest is trued up to the actual number of instruments that vest because of the satisfaction of the non-market performance condition.

In our view, the entity should recognise the share-based payment cost based on the fair value of the equity instrument for the most likely outcome over the expected period of the most likely condition, with true-up if the required service condition is not met. Assuming that the service requirement is met in all cases, the application of this guidance to the four possible outcomes is discussed below.

Effectively this means the following.

- If vesting is achieved through the market condition only (Scenario 1), then the total cost recognised will be based on the fair value that reflects the grant-date estimate of the probability of achieving (or not achieving) the market condition – i.e. the adjusted fair value.
- If vesting is achieved through the non-market performance condition only (Scenario 2), then the total cost recognised will be based on the fair value related to the non-market performance condition – i.e. the non-adjusted fair value.
- If neither the market nor the non-market performance condition is achieved (Scenario 3), then we believe that the entity should recognise the share-based payment cost based on the adjusted fair value – i.e. the fair value that was adjusted to reflect the probability of achieving the market condition. This is because there is no true-up for differences between estimated and actual vesting due to market conditions.
- If both conditions are met (Scenario 4), then we believe that the share-based payment cost should reflect the grant-date fair value *without* adjustment, to reflect the probability of achieving the market condition. This is because we believe that, when both conditions are met, the share-based payment cost should not ignore the non-market fair value increment.

Most likely outcome during the vesting period	Market condition	Non-market performance condition	Expenses based on
<b>Scenario 1</b>	Probable	Not probable	Adjusted fair value
<b>Scenario 2</b>	Not probable	Probable	Non-adjusted fair value
<b>Scenario 3</b>	Not probable	Not probable	Adjusted fair value
<b>Scenario 4</b>	Probable	Probable	Non-adjusted fair value

The amount to be recognised depends on whether the non-market performance condition is met, regardless of whether the market condition is met. We believe that if the non-market performance condition is met (Scenarios 2 and 4), then the non-adjusted fair value should be recognised as if no market condition existed. If the non-market performance condition is not met (Scenarios 1 and 3), then the adjusted fair value should be recognised.

At grant date, the entity estimates which of the four possible outcomes is most likely and begins recognising costs based on the relevant fair value – i.e. either the adjusted fair value for Scenarios 1 and 3, or the non-adjusted fair value for Scenarios 2 and 4. At each reporting date, the entity should reassess the most likely outcome and change the fair value from one to the other as necessary.

If, for example, the entity assesses at grant date that it is most likely that it will achieve only the market condition (Scenario 1), then the adjusted fair value should be recognised over the vesting period. If during the vesting period achievement of the non-market performance condition also becomes probable, then the non-adjusted fair value should be recognised over the remaining service period, with a ‘catch-up’ recognised in profit or loss for services already provided.

If, in contrast, the entity assesses at grant date that it is most likely that it will achieve only the non-market performance condition (Scenario 2), then the non-adjusted fair value should be recognised over the vesting period. In the case of a later switch when it is no longer most likely that the non-market performance condition will be met, the cost per period decreases, because recognition should then be based on the adjusted grant-date fair value. This results in a negative catch-up recognised in profit or loss for services already provided.



**Example 6.8.2 – Equity-settled share-based payment transaction with ‘or’ conditions**

On 1 January Year 1, Company C grants 100 share options to an employee, subject to the following conditions:

- the employee remains in service with C until 31 December Year 3; and
- either:
  - a TSR of 15% is achieved; or
  - the cumulative profits are at least 10 million.

Under these conditions, the employee can exercise the options on any date in Year 4 and C has to deliver one share per option exercised.

At grant date, the fair value of a share option without considering any condition is 7 and the fair value considering the market condition is 5.50.

Assuming that the service condition is expected to be met and actually is, the four possible outcomes and the total share-based payment expenses that we believe should be recognised are as follows.

Outcome	Total share-based payment expense
The entity achieves the market condition (TSR) but does not achieve the non-market performance condition (cumulative profits) – the award vests (Scenario 1)	550
The entity does not achieve the market condition but achieves the non-market performance condition – the award vests (Scenario 2)	700
The entity achieves neither the market nor the non-market performance condition – the award does not vest (Scenario 3)	550
The entity achieves both the market and the non-market performance condition – the award vests (Scenario 4)	700

C estimates at grant date that it is probable that only the non-market performance condition will be met (Scenario 2). In Year 2, C revises this estimate in favour of the market condition being probable and the non-market performance condition no longer being probable (Scenario 1). Eventually, neither of the performance conditions is met (Scenario 3).

C accounts for the transaction as follows.

End of	Non-market performance condition expected to be met	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	Yes	700 <sup>1</sup>	233 <sup>3</sup>	233
Year 2	No	550 <sup>2</sup>	367 <sup>4</sup>	134
Year 3	No	550 <sup>2</sup>	550 <sup>5</sup>	183
Total				550

**Notes**

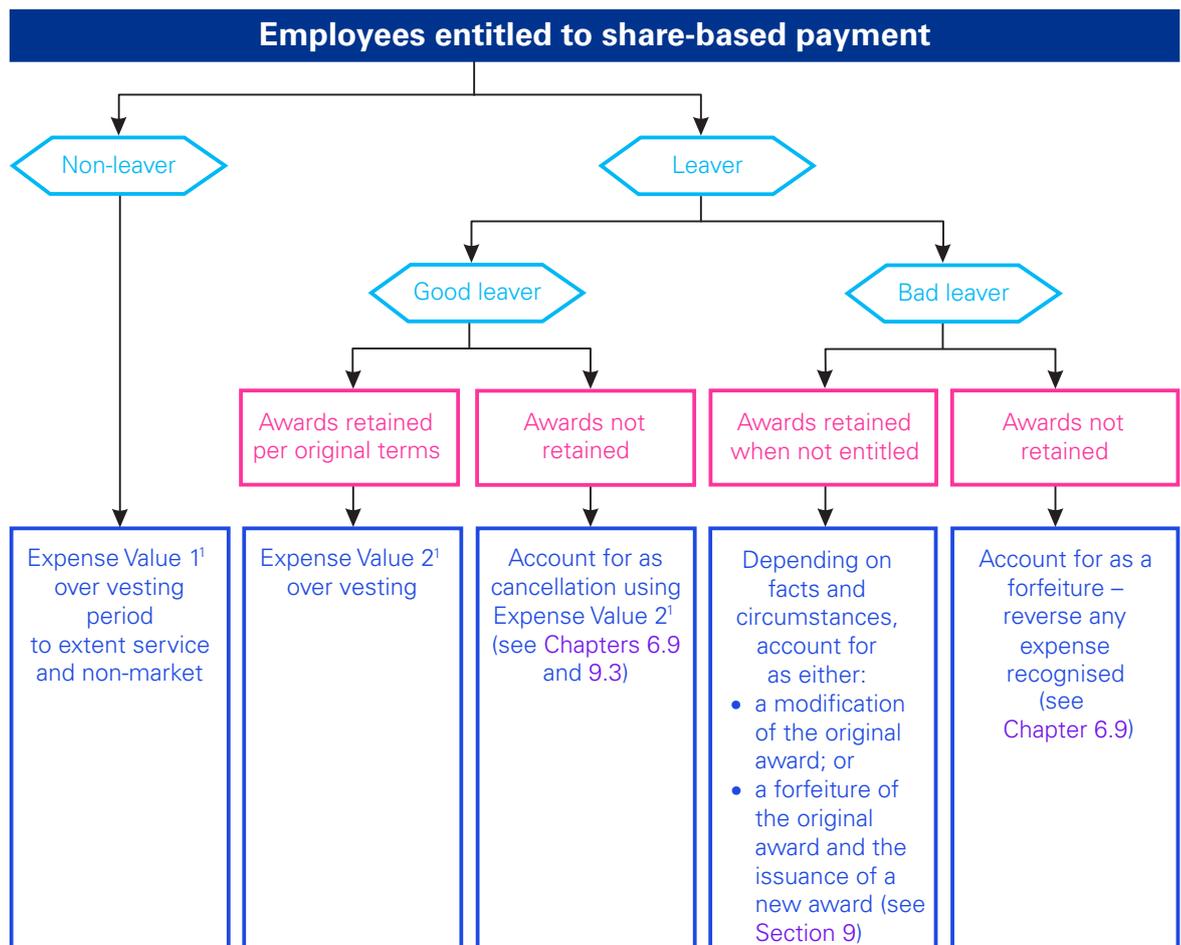
1. 100 x 7.
2. 100 x 5.5.
3. 700 x 1/3.
4. 550 x 2/3.
5. 550 x 3/3.

## Good leaver clauses

Share-based payment arrangements may contain 'good leaver' clauses. For an introduction to leaver clauses and their effect on classification, see 5.5.10.

If a good leaver clause specifies that the share-based payment vests if an employee is eligible for retirement (retiree) before the end of the service period, then questions arise about how to recognise and measure the share-based payment. Usually, the service requirement for retirees differs from other employees because they only have to provide services until the earlier of the date on which they retire and the end of the service period. The grant-date fair value of an equity instrument granted to a retiree may also be different from the fair value of an identical equity instrument granted to other employees. This is because the fair value of an option depends partially on its expected exercise date, which in turn may be influenced by vesting date and vesting date is earlier for the retirees. The terms of the share-based payment may also vary for the retirees and will need to be taken into account as usual – e.g. a shorter exercise period, pro rata vesting or adjustments to performance targets.

The following flowchart sets out the possible outcomes for a share-based payment arrangement that contains a good leaver clause under which employees who are good leavers retain their award, subject to the future outcomes of the original non-market performance condition(s).



### Note

- The entity calculates two grant-date fair values for the arrangement (see 6.8.30).
  - Value 1: Grant-date fair value based on stated terms for a non-leaver.
  - Value 2: Grant-date fair value based on good leaver terms.

**Example 6.8.3 – Good leaver clause for retirees**

On 1 January Year 1, Company B grants one share option each to 100 employees, subject to a five-year service condition. The share options can be exercised at any date from vesting to the end of Year 7.

The arrangement contains a good leaver clause under which employees leaving before 31 December Year 5 may keep the entitlement if their leaving is due to retirement. A retiree can exercise the option at any date from leaving B to the end of Year 7.

On grant date, B estimates that:

- 80 employees will remain employed until 31 December Year 5 (non-leavers);
- three employees will leave before 31 December Year 5 as good leavers due to retirement before vesting date; and
- 17 employees will leave before 31 December Year 5 for other reasons.

The grant-date fair value of an equity instrument granted is 10. The grant-date fair value of equity instruments granted to the three expected retirees is lower because of expected early exercise behaviour (see A2.40).

The grant-date fair values of the share options granted to retirees are as follows.

Employee	Retirement date	Grant-date fair value
1	31 December Year 4	9
2	31 December Year 3	8
3	23 July Year 3	7

Ultimately, the three expected good leavers retire as scheduled, 19 employees leave as bad leavers and 78 stay in service until vesting date.

B accounts for the expected and actual non-leavers as usual – i.e. recognising the grant-date fair value of 780 (78 x 10) over the vesting period of five years.

B accounts for the three expected and actual retirees as usual – i.e. recognising the grant-date fair value of 9, 8 and 7 for each of the three retirees over the respective service period from grant date to retirement date.

**Example 6.8.4 – Good leaver clause and a non-vesting condition**

On 1 January Year 1, Company X grants 500 performance shares each to 100 employees, subject to a three-year service condition and non-market performance condition that depends on growth in EPS for the same three years.

The arrangement also contains a good leaver clause, under which employees leaving before 31 December Year 3 may keep the entitlement if their leaving is due to retirement or redundancy. A good leaver will receive the performance shares at the end of Year 3 if the growth in EPS target is met at the end of three years. The EPS target is a non-vesting condition for good leavers because the performance period extends beyond the service period. All bad leavers will forfeit their awards.

On grant date, X initially estimates that:

- 85 employees will remain employed until 31 December Year 3 (non-leavers);
- five employees will leave as retirees (good leavers) at the end of Year 2;
- 10 employees will leave before 31 December Year 3 for other reasons; and
- no employees will be made redundant before 31 December Year 3.

The grant-date fair value of the awards to the non-retiring employees (non-leavers) is 6 per share. The grant-date fair value of awards to the good leavers is 4.50 per share, after taking into account the effect of the non-vesting condition. At the end of Year 1, the share-based payment expense is estimated as follows (no changes to the initial estimates have been made).

	Year 1
Non-leaver	85,000 <sup>1</sup>
Retirees	5,625 <sup>2</sup>
<b>Year 1 expense</b>	<b>90,625</b>

#### Notes

1.  $(500 \text{ shares} \times 85 \text{ non-leavers} \times 6 \text{ a share}) / 3$ .
2.  $(500 \text{ shares} \times 5 \text{ retirees} \times 4.50 \text{ a share}) / 2$ .

At the end of Year 2, X makes two employees redundant (previously expected to be non-leavers) and allows them to retain their awards in accordance with the good leaver terms.

The actual awards that vest at the end of Year 3 are the same as the entity's estimates of awards that are expected to vest except for the two employees who were made redundant at the end of Year 2.

X continues to account for the actual 83 non-leavers as usual – i.e. recognising the grant-date fair value over the three-year service period.

X accounts for the five retirees as usual – i.e. recognising the grant-date fair value of 11,250 over the two-year service period from grant date to retirement date.

X accounts for the two employees made redundant by recognising an expense of 2,500 in Year 2. This represents a cumulative catch-up for the change in the status of the employees from non-leaver to good leaver. In Year 1, an expense of 2,000  $(500 \times 2 \times 6 / 3)$  was included in the 85,000 non-leaver expense based on the non-leaver grant-date fair value. In Year 2, with the switch to good leaver, a total expense of 4,500  $(500 \times 2 \times 4.5)$  needs to be recognised based on the good leaver grant-date fair value. Because 2,000 was recognised in Year 1, 2,500 is recognised in Year 2.

The table below summarises the expense recognised in Years 2 and 3, continuing on from Year 1.

	Year 1	Year 2	Year 3	Total
Non-leaver	85,000	83,000 <sup>1</sup>	83,000 <sup>1</sup>	251,000
Retirees	5,625	5,625 <sup>2</sup>	-	11,250
Redundancies	-	2,500 <sup>3</sup>	-	2,500
	<b>90,625</b>	<b>91,125</b>	<b>83,000</b>	<b>264,750</b>

#### Notes

1.  $(500 \text{ shares} \times 83 \text{ non-leavers} \times 6 \text{ a share}) / 3$ .
2.  $(500 \text{ shares} \times 5 \text{ retirees} \times 4.50 \text{ a share}) / 2$ .
3.  $(500 \text{ shares} \times 2 \text{ redundancies} \times 4.50 \text{ a share}) - 2,000$  recognised in Year 1 on the basis they were non-leavers.



### Example 6.8.5 – Good leaver: Cancellation of award for leaver who qualifies as a good leaver

Assume the same facts as in [Example 6.8.4](#), except that during Year 1 one person retires but the Company decides to cancel their award, despite the person qualifying as a good leaver.

Company X accounts for the awards cancelled in accordance with the cancellation guidance and therefore recognises the grant-date fair value of the awards of 2,250 (500 x 4.50) immediately as an expense in profit or loss.



### Example 6.8.6 – Bad leaver allowed to keep their award

Assume the same facts as [Example 6.8.4](#), except that during Year 1 one person holding 500 awards leaves but is allowed to keep their award, subject to the non-market condition being met at the end of Year 3, despite being a bad leaver. Therefore, after modification the award has no service period but the condition that was previously a non-market vesting condition now represents a non-vesting condition because the performance assessment period extends beyond the service period.

X either modifies the terms of the original award or grants a new award to the bad leaver and identifies this award as a replacement of the original award.

In these circumstances, X accounts for the 500 awards as a modification of the original award granted.

X determines that the fair value of the bad leaver's award based on the original terms of the award at the modification date is 4.00 per share, and the fair value of the modified award is 3.50.

Because the modification does not increase the fair value of the equity instruments granted (i.e. it is not beneficial), X recognises all of the original grant-date fair value of the award of 3,000 (500 x 6) in Year 1 as an expense because the modified vesting period is complete on the date the person leaves.

## Separate grants

IFRS 2.IG11

In contrast to [Examples 6.7.2–3](#), a share-based payment arrangement may include several awards. For example, a grant may contain one award that grants shares that vest subject to a one-year service condition and a market condition, and another award that grants shares that vest subject to a one-year service condition and a non-market performance condition. In our view, these two awards should be accounted for as separate share-based payments because their vesting is not interdependent.

For more discussion on the treatment of dividends when their vesting terms differ from the terms of the related share-based payment, see also [6.6.20](#).

## 6.9 Forfeiture or cancellation

### 6.9.10 Introduction

*IFRS 2.19, IG24*

Under the modified grant-date method, the estimated share-based payment cost is trued up for forfeitures that result from an employee failing to meet the service condition.

*IFRS 2.19, IG24*

If an employee resigns before the end of the vesting period, then it is clear that the requested services have not been rendered and the termination is treated as a forfeiture.

Before the amendments introduced to IFRS 2 by the *Annual Improvements to IFRSs 2010–2012 Cycle*, it was not clear whether an award should be viewed as *forfeited* if an employer terminates the services of an employee and therefore prevents the required service from being provided. The amendments clarified that failure to complete the service period, regardless of the reason – i.e. whether an employee resigns voluntarily or is dismissed by the employer – results in the service condition not being met. Consequently, a failure to complete a service period is treated as a forfeiture. As noted in [5.3.10](#), the amendments are applied prospectively to share-based payment transactions for which grant date is on or after 1 July 2014, with earlier application permitted.

However, because IFRS 2 was not previously clear about this treatment, in our view an entity should choose an accounting policy, to be applied consistently, to account for the termination of service by the employer in share-based payment transactions for which the grant date is before 1 July 2014, provided that the entity does not elect to adopt the amendments early, based on one of the following approaches:

- treat it as a forfeiture because the employer has not received the agreed services; or
- treat it as a cancellation because it is the employer who is precluding the service from being provided; for a discussion of the accounting consequences of cancellations, see [Chapter 9.3](#).

Similarly, an employee may be precluded from providing services due to a sale of an operation that results in termination of employment. In our view, for share-based payment transactions for which grant date is before 1 July 2014, provided that an entity does not elect to adopt the amendments early, the approaches discussed above are available in such circumstances – i.e. we believe that treatment as a forfeiture or as a cancellation is acceptable.



#### Example 6.9.1 – Termination of employment due to sale of division

On 1 January 2016, Company P grants share-based payments settled in its own equity instruments to employees of P's Division D, subject to a three-year service condition. P sells D to a third party before the vesting date of the share-based payment. The terms of the share-based payment arrangement do not contain any clause regarding a sale of a division.

Because the employees have not provided the agreed services, P treats the failure to provide the required services as a forfeiture.

### 6.9.20 Clauses setting out entitlement in case of failure to meet service condition because of action by employer

*IFRS 2.15, 21*

In contrast to the situations addressed in [6.9.10](#), share-based payment arrangements may contain clauses setting out the employee's entitlement (e.g. acceleration of vesting) in the specific event of termination by the employer on the sale of an operation. The accounting should reflect the terms of the arrangement in these cases.

**Example 6.9.2 – Pro rata accelerated vesting in case of termination by employer**

On 1 January Year 1, Company P grants 100 share options each to its 200 employees, subject to a four-year service condition. The arrangement contains a clause that entitles the employee to a pro rata share in the case of a termination of employment by the employer. The grant-date fair value of an option granted is 10.

Initially, P accounts for the share-based payment by recognising the instruments expected to vest at their grant-date fair value – i.e. without considering the alternative pro rata vesting in the event of termination of employment. This is because P does not initially expect to terminate any employees. On 1 January Year 1, P expects 180 employees to stay in service – i.e. P expects 20 employees to leave before the vesting date.

At the end of Year 2, P terminates the employment of 30 employees, who are entitled to half of the options granted to them. P still expects 20 more employees to elect to leave before the vesting date and accordingly adjusts its estimate for the employees for which the four-year service condition is expected to be met to 150. Twenty employees leave during Year 4 and 150 employees provide the four years of service.

P calculates the share-based payment expenses as follows.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	18,000 <sup>1</sup>	180,000 <sup>3</sup>	45,000 <sup>5</sup>	45,000
Year 2	16,500 <sup>2</sup>	165,000 <sup>4</sup>	90,000 <sup>6</sup>	45,000
Year 3	16,500 <sup>2</sup>	165,000 <sup>4</sup>	127,500 <sup>7</sup>	37,500
Year 4	16,500 <sup>2</sup>	165,000 <sup>4</sup>	165,000 <sup>8</sup>	37,500

**Notes**

- 180 x 100.
- (150 x 100) + (30 x 50).
- 18,000 x 10.
- 16,500 x 10.
- 180,000 x 1/4.
- (150,000 x 2/4) + 15,000.
- (150,000 x 3/4) + 15,000.
- (150,000 x 4/4) + 15,000.

The example illustrates that the total amount recognised as share-based payment expense of 165,000 is the sum of the pro rata vested amount for 30 employees of 15,000 (30 x 50 x 10) and the fully vested amount of 150,000 (150 x 100 x 10) for the remaining 150 employees who completed the four-year service requirement.

The accounting treatment of the options of the employees whose employment was terminated follows the terms and conditions of the arrangement, rather than being accounted for either as a forfeiture or as a cancellation.

**Example 6.9.3 – Full accelerated vesting in case of sale of division**

On 1 January Year 1, Company P grants 100 share options to 200 employees of Division D, subject to a four-year service condition. The arrangement contains a clause that entitles the employees to the full grant in the case of a sale of the division. The grant-date fair value of an option granted is 10.

P expects 180 employees to stay in service until vesting date.

On 31 May Year 2, when 190 employees are still employed, D is sold.

P calculates the share-based payment expenses as follows.

End of	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	18,000 <sup>1</sup>	180,000 <sup>3</sup>	45,000 <sup>5</sup>	45,000
Year 2	19,000 <sup>2</sup>	190,000 <sup>4</sup>	190,000 <sup>6</sup>	145,000
Year 3	-	-	-	-
Year 4	-	-	-	-

**Notes**

- 180 x 100.
- 190 x 100.
- 18,000 x 10.
- 19,000 x 10.
- 180,000 x 1/4.
- 190,000 x 4/4.

The accounting treatment of the options of the employees of the subsequently sold division follows the terms and conditions of the arrangement, rather than being accounted for either as a forfeiture or as a cancellation.

## 6.10 Presentation in financial statements

### 6.10.10 Presentation of share-based payment cost in profit or loss

IAS 1.102

IAS 1 *Presentation of Financial Statements* does not contain specific guidance on the presentation of the share-based payment cost in profit or loss. In our view, share-based payments received in the capacity as an employee should be included in employee benefits. For a discussion on reporting share-based payment cost as an expense or as part of the cost of an asset, see [6.2.10](#).

### 6.10.20 Presentation of credit entry in equity

IFRS 2 does not specifically address the presentation of the credit entry within equity. In our view, an entity should choose an accounting policy, to be applied consistently, to present the credit entry in equity using one of the following approaches.

- *Approach 1:* Accrete the credit to equity as the employee cost is recognised. In our experience, this approach is the predominant practice.
- *Approach 2:* At inception of the grant, present the effect of an equity-settled share-based payment gross. In this case, the total expected cost is recognised within equity (e.g. share options outstanding) with a corresponding and offsetting debit also recognised in equity for services to be received. As services are rendered and the related costs recognised, the offsetting debit for deferred cost is reduced.

IAS 1.78(e), 79(b), 108

Except for those share-based payment transactions in which equity instruments of a subsidiary have been granted (see below), the IFRS Accounting Standards do not address whether an increase in equity recognised in connection with a share-based payment transaction should be presented in a separate component within equity or within retained earnings. In our view, either approach is allowed under IFRS Accounting Standards. If a separate component is presented, then the nature of the reserve should be disclosed.

IFRS 10.A

When equity instruments of a subsidiary have been granted to a counterparty – who is not part of the consolidated reporting entity – in a share-based payment transaction, the credit entry in equity in the consolidated financial statements of the parent is to non-controlling interests. This is because the definition of non-controlling interests refers to the equity in a subsidiary not attributable, directly or indirectly, to a parent (see also [10.2.10](#) and [Chapter 10.7](#)).

# 7 Cash-settled share-based payment transactions with employees

## Overview

- Employee services received in a cash-settled share-based payment are measured indirectly at the fair value of the liability at grant date.
- Market and non-vesting conditions are taken into account in determining the fair value of the liability.
- Service and non-market performance conditions are taken into account in estimating the number of awards that are expected to vest, with a true-up to the number ultimately satisfied.
- The grant-date fair value of the liability is recognised over the vesting period.
- The grant-date fair value of the liability is capitalised if the services received qualify for asset recognition.
- The liability is remeasured at each reporting date and at settlement date so that the ultimate liability equals the cash payment on settlement date.
- Remeasurements during the vesting period are recognised immediately to the extent that they relate to past services, and recognised over the remaining vesting period to the extent that they relate to future services. Remeasurements after the vesting period are recognised immediately.
- Remeasurements of the liability are recognised in profit or loss.

## 7.1 Scope of this section

This section addresses recognition and measurement requirements for cash-settled share-based payment transactions with employees.

For a discussion of when a payment is considered to be based on the price (or value) of an equity instrument, see [3.5.20–60](#).

For further considerations in respect of the assessment of whether the counterparty is an employee, see [Chapter 6.1](#). Cash-settled share-based payment transactions with non-employees are addressed in [Section 11](#).

For a discussion of additional aspects of cash-settled share-based payments in the context of group share-based payments, see [Section 10](#).

## 7.2 Basic principles of accounting for cash-settled share-based payment transactions with employees

### 7.2.10 Initial measurement

IFRS 2.30

Cash-settled share-based payments result in the recognition of a liability, which is an obligation to make a payment in cash or other assets, based on the price of the underlying equity instrument (e.g. share price).

IFRS 2.32–33

Employee services received in a cash-settled share-based payment are measured indirectly at the fair value of the liability at grant date. The initial measurement of the liability is based on the fair value of the underlying instruments. Measurement of the liability takes into account the extent to which services have been rendered to date.

IFRS 2.33A–33D,  
IG19.Ex12,  
BC371–BC382

An entity measures the fair value of a cash-settled liability taking into account only market and non-vesting conditions, meaning that service and non-market performance conditions affect the measurement of the liability by adjusting the number of rights to receive cash based on the best estimate of the service and non-market performance conditions that are expected to be satisfied – i.e. the accounting for the effects of vesting conditions on cash-settled share-based payment transactions follows the approach used for equity-settled share-based payments; see 6.2.10.

IFRS 2.32,  
BC243–BC245

The grant-date fair value of the liability is recognised over the vesting period. If no services are required, then the amount is recognised immediately.

IFRS 2.8

The grant-date fair value of the liability is capitalised if the services received qualify for asset recognition. For a more detailed discussion, see 7.2.20.

### 7.2.20 Remeasurements

IFRS 2.30

At each reporting date, and ultimately at the settlement date, the fair value of the recognised liability is remeasured. Remeasurement applies to the recognised portion of the liability through to vesting date. The full amount is remeasured from vesting date to settlement date. The cumulative net cost (asset recognition (see below) and amounts recognised in profit or loss) that will ultimately be recognised in respect of the transaction will be equal to the amount paid to settle the liability. This is different from equity-settled transactions for which there is no true-up of the share-based payment cost for failure to satisfy a market or non-vesting condition (see 6.2.10).

IFRS 2.IG19.Ex12

Remeasurements during the vesting period are recognised immediately to the extent that they relate to past services and recognition is spread over the remaining vesting period to the extent that they relate to future services. That is, in the period of the remeasurement there is a catch-up adjustment for prior periods in order for the *recognised* liability at each reporting date to equal a defined proportion of the *total* fair value of the liability. The recognised proportion is generally calculated by dividing the period for which services have been provided as at the reporting date by the total vesting period. Remeasurements are recognised in profit or loss.

IFRS 2.32

Remeasurements after the vesting period are recognised immediately in profit or loss.

**Example 7.2.1 – Cash-settled share-based payment transaction with change in value of equity instrument**

On 1 January Year 1, Company B grants one SAR to each of its 100 employees, subject to a three-year service condition. If the service condition is met, then the SAR will be settled in cash on 29 January Year 4. The employees will receive the intrinsic value of the SAR at settlement date – i.e. any increase in the share price between grant date and 29 January Year 4.

At grant date and throughout the vesting period, B expects all employees to remain in service with B and they eventually do.

The fair value of the SARs develops as follows.

	Fair value
1 January Year 1 (grant date)	9.00
31 December Year 1	12.00
31 December Year 2	13.50
31 December Year 3 (vesting date)	15.00
29 January Year 4 (settlement date)	14.00 <sup>1</sup>

**Note**

1. Intrinsic value.

Assuming that the services received do not qualify for asset recognition (for an illustration in which they do, see [Example 7.2.2](#)), the accounting for the share-based payment is as follows.

The grant-date fair value of 900 (100 SARs for which the service condition is expected to be satisfied multiplied by the fair value of 9) is recognised over the vesting period – i.e. 300 per annum. Additionally, the pro rata share of the remeasurement is recognised in each period.

	Instruments for which it is expected that the service condition will be satisfied	Current fair value at end of period	Expected total net expense	Recognised proportion of the liability	Net expenses in current period	Analysis of expenses	
						Recognition of initial liability (1/3 per annum)	Remeasurement of recognised liability
31 December Year 1	100	12.00	1,200	400 <sup>1</sup>	<b>400</b>	300	100
31 December Year 2	100	13.50	1,350	900 <sup>2</sup>	<b>500</b>	300	200
31 December Year 3	100	15.00	1,500	1,500 <sup>3</sup>	<b>600</b>	300	300
Settlement date (Year 4)	100	14.00	1,400	1,400	<b>(100)</b>	-	(100)
Totals					<b>1,400</b>	900	500

**Notes**

- 1,200 × 1/3.
- 1,350 × 2/3.
- 1,500 × 3/3.

B accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	300	
Liability		300
<i>To recognise services received in Year 1 (1/3 x 900)</i>		
Expenses	100	
Liability		100
<i>To recognise 1/3 of remeasurement of 300 (100 x (12 - 9))</i>		
<b>Year 2</b>		
Expenses	300	
Liability		300
<i>To recognise services received in Year 2 (1/3 x 900)</i>		
Expenses	200	
Liability		200
<i>To recognise 2/3 of remeasurement of 450 (100 x (13.5 - 9)), less previously recognised remeasurement of 100</i>		
<b>Year 3</b>		
Expenses	300	
Liability		300
<i>To recognise services received in Year 3 (1/3 x 900)</i>		
Expenses	300	
Liability		300
<i>To recognise 3/3 of remeasurement of 600 (100 x 15 - 9), less previously recognised remeasurement of 300</i>		
<b>Year 4</b>		
Liability	100	
Expenses		100
<i>To recognise entire remeasurement of liability of (100) on settlement date because it occurs after end of vesting period</i>		
Liability	1,400	
Cash		1,400
<i>To recognise settlement of liability</i>		
<b>Cumulative effects</b>		
Expenses	1,400	
Cash		1,400

## Capitalisation of the services received

IFRS 2.IG19

Only the grant-date fair value of the arrangement may qualify for capitalisation under other IFRS Accounting Standards. Accordingly, the remeasurement of the liability is recognised in profit or loss even if the related share-based payment cost has been capitalised (see [Example 7.2.2](#)). Failure to satisfy a market or non-vesting condition will trigger a remeasurement of the liability to zero through profit or loss and will not impact any amounts capitalised for services received (see [Example 7.2.3](#)).

IFRS 2.9

Common examples in which services received qualify for capitalisation include:

- employees working on a development project that qualifies for recognition as an intangible asset under IAS 38 *Intangible Assets*; and
- employee services forming part of the cost of inventory under IAS 2 *Inventories*.



### Example 7.2.2 – Cash-settled share-based payment with capitalisation

The facts and circumstances are the same as in [Example 7.2.1](#). However, Company B is a boat manufacturer and the costs of the employee services relate directly to the manufacturing of boats held as inventory. Therefore, the services received qualify for capitalisation as part of the cost of the boats.

As a result of capitalising the grant-date fair value of the liability as part of inventory, the cumulative effect of the entries recognised by B is as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Cumulative effects</b>		
Inventory	900	
Expenses	500	
Cash		1,400

This example illustrates that if the services received qualify for asset recognition, then only the initial measurement of the liability – i.e. the grant-date fair value – can be capitalised. Remeasurements are recognised in profit or loss.



### Example 7.2.3 – Cash-settled share-based payment with service and market conditions

On 1 January Year 1, Company C grants one SAR to each of its 100 employees, subject to a three-year service condition and the share price achieving a target price of at least 120 at the end of the vesting period (market condition). If the service and market conditions are met, then the SARs will be settled in cash on 29 January Year 4 at the intrinsic value of the SARs at that date.

C is a boat manufacturer and the costs of the employee services relate directly to the manufacturing of boats held as inventory. Therefore, the services received qualify for capitalisation as part of the cost of the boats.

C's expectation about the number of employees that will satisfy the service condition develops as follows.

1 January Year 1	90
31 December Year 1	80
31 December Year 2	75
31 December Year 3	70

At the end of the vesting period, the share price target is not met.

The values of the SARs develop as follows.

	Fair value without market condition	Fair value considering market condition
1 January Year 1 (grant date)	9.50	7.00
31 December Year 1	12.00	9.00
31 December Year 2	13.50	10.00
31 December Year 3 (vesting date)	15.00	-
29 January Year 4 (settlement date)	14.00	-

The cost can be analysed as follows.

	Instruments for which it is expected that the service condition will be satisfied	Current fair value at end of period considering the market condition	Expected total cost	Recognised proportion of the liability	Net cost in current period	Analysis of expenses	
						Recognition of initial liability, capitalised as part of the cost of an asset	Remeasurement, recognised in profit or loss
31 December Year 1	80	9	720 <sup>1</sup>	240 <sup>4</sup>	240	187 <sup>6</sup>	53 <sup>9</sup>
31 December Year 2	75	10	750 <sup>2</sup>	500 <sup>5</sup>	260	163 <sup>7</sup>	97 <sup>10</sup>
31 December Year 3	70	-	- <sup>3</sup>	-	(500)	140 <sup>8</sup>	(640) <sup>11</sup>
Settlement date	70	-	-	-	-	-	-
Totals						490	(490)

**Notes**

1. 80 x 9.
2. 75 x 10.
3. 70 x 0.
4. 720 x 1/3.
5. 750 x 2/3.
6. 80 x 7 x 1/3.
7. 75 x 7 x 2/3 - 187.
8. 70 x 7 - 187 - 163.
9. 80 x (9 - 7) x 1/3.
10. 75 x (10 - 7) x 2/3 - 53.
11. 70 x (0 - 7) - 53 - 97.

The accounting for the share-based payment is as follows.

	Debit	Credit
<b>Year 1</b>		
Inventory	187	
Liability		187
<i>To recognise services received for 80 employees for one year measured at grant-date fair value of SARs</i>		
Expenses	53	
Liability		53
<i>To recognise 1/3 of remeasurement of 160 (80 x (9 - 7))</i>		
<b>Year 2</b>		
Inventory	163	
Liability		163
<i>To recognise services received for 75 employees for two years measured at grant-date fair value of SARs of 350 less previously capitalised amounts of 187</i>		
Expenses	97	
Liability		97
<i>To recognise 2/3 of remeasurement of 225 (75 x (10 - 7)) less previously recognised remeasurement of 53</i>		
<b>Year 3</b>		
Inventory	140	
Liability		140
<i>To recognise services received for 70 employees measured at grant-date fair value of SARs of 490 less previously capitalised amounts of 350</i>		
Liability	640	
Expenses		640
<i>To recognise 3/3 of remeasurement of (490) (70 x (0 - 7)), less previously recognised remeasurement of 150</i>		
<b>Cumulative effects</b>		
Inventory	490	
Expenses		490

The example illustrates that the amount capitalised (490) is the grant-date fair value (7) multiplied by the number of employees that have satisfied the service condition (70). The failure to meet the market condition is reflected in the remeasurement of the liability, which is recognised as a credit in profit or loss (see above).

### No service period required

#### IFRS 2.32

If there is no service period required, then the grant-date fair value is recognised immediately. Nevertheless, remeasurement is required until settlement date and remeasurements are recognised in full in profit or loss because there is no vesting period.

### Fair value vs intrinsic value

IFRS 2.33,  
 BC246–BC250

Remeasurement of the liability until settlement is based on the fair value of the underlying instruments, even though the cash payment may be based on an intrinsic value, because the fair value represents the present value of the expected intrinsic value at settlement date.

A payment under a SAR is equal to the increase in value of a share between two dates (the employee does not suffer loss if the share price declines). Consequently, a SAR is equivalent to an option to buy a share with an exercise price equal to the reference price – i.e. grant-date share price. The fair value of the liability for the SAR will be equal to the fair value of the equivalent share option because the fair value of a SAR that settles on a future date is the intrinsic value plus a premium (time value) for the possibility of future increases in the intrinsic value.

IFRS 2.BC249

The final remeasurement of the liability is made on settlement date to equal the ultimate cash payment. That is, the measurement switches from a fair value-based measurement to an intrinsic value-based measurement.

If the settlement of a SAR is at a fixed date, then the fair value of the liability on that date will equal the intrinsic value of the SAR.

However, if the settlement is not at a fixed date but instead the SAR can be settled on any date in a period, then the fair value and the intrinsic value of the SAR will be equal only on the last day of that period. Between vesting date and the end of the settlement period of the SAR, the intrinsic value and the fair value will differ, because by exercising their settlement right before the end of the period the employee gives up the time value of the option. That means that an adjustment is required from fair value measurement to intrinsic value measurement for those SARs that are settled before the end of the settlement period.



#### Example 7.2.4 – Cash-settled share-based payment: Early settlement of SARs with variable settlement period

On 1 January Year 1, Company C grants 100 SARs to five members of the board, subject to a three-year service condition. If the service condition is met, then, at any date in Year 4 or Year 5, they can exercise their right to be paid for the appreciation in value of C’s shares. Therefore, C has to pay a cash amount equal to the intrinsic value of the SARs at the date of exercise.

At grant date and throughout the vesting period, C expects all five board members to remain in service and eventually they do. Three board members exercise their SARs on 31 May Year 4 and two on 31 December Year 5.

The value of the SARs is as follows.

	Fair value	Intrinsic value
1 January Year 1 (grant date)	20	N/A
31 December Year 3 (vesting date)	18	N/A
31 May Year 4 (settlement date 1)	17	11
31 December Year 4	16	13
31 December Year 5 (settlement date 2)	15	15

Assuming that the services received do not qualify for capitalisation as part of the cost of an asset, the accounting for the share-based payment transaction is as follows.

	Expense in current period	Intrinsic value at settlement (cash payment)
Year 1 – Year 3 (cumulative)	9,000 <sup>1</sup>	-
Settlement date 1	(2,100) <sup>2</sup>	3,300 <sup>5</sup>
31 December Year 4	(400) <sup>3</sup>	-
Settlement date 2	(200) <sup>4</sup>	3,000 <sup>6</sup>
Totals	6,300	6,300

**Notes**

- (500 x 20) - (500 x 2). Grant-date fair value adjusted for remeasurement.
- 300 x (11 - 18). In theory, this step comprises: (a) a remeasurement from the fair value at the last measurement date of 18 to the fair value at settlement date of 17; and (b) a further remeasurement from that measure of 17 to the intrinsic value at settlement date of 11. Effectively, the net effect of (7) (remeasurement from 18 to 11) is recognised in profit or loss. No remeasurement of the outstanding SARs or options is included in this amount.
- 200 x (16 - 18).
- 200 x (15 - 16).
- 300 x 11.
- 200 x 15.

B accounts for the transaction as follows.

	Debit	Credit
<b>Year 1 – Year 3 (cumulative)</b>		
Expenses	10,000	
Liability		10,000
<i>To recognise services received at their grant-date fair value (100 x 5 x 20)</i>		
Liability	1,000	
Expenses		1,000
<i>To recognise remeasurement (100 x 5 x (20 - 18))</i>		
<b>31 May Year 4 (settlement date 1)</b>		
Liability	2,100	
Expenses		2,100
<i>To recognise remeasurement of liability on settlement date for 300 SARs from fair value on last measurement date to intrinsic value on settlement date (100 x 3 x (18 - 11))</i>		
Liability	3,300	
Cash		3,300
<i>To recognise settlement of liability for 300 SARs (100 x 3 x 11)</i>		
<b>31 December Year 4</b>		
Liability	400	
Expenses		400
<i>To recognise remeasurement of liability for remaining 200 SARs from last measurement date to this measurement date (100 x 2 x (18 - 16))</i>		

	<i>Debit</i>	<i>Credit</i>
<b>31 December Year 5 (settlement date 2)</b>		
Liability	200	
Expenses		200
<i>To recognise remeasurement of liability on settlement date for 200 SARs from fair value on last measurement date to intrinsic value on settlement date (100 x 2 x (16 - 15))</i>		
Liability	3,000	
Cash		3,000
<i>To recognise settlement of liability for 200 SARs (100 x 2 x 15)</i>		
<b>Cumulative effects</b>		
Expenses	6,300	
Cash		6,300

For a discussion of how to value a payment that is based on a share rather than a share option (as illustrated in [Example 7.2.4](#)), see [A2.20](#).

## 7.3 Presentation in profit or loss

The expense reflecting the recognition of the grant-date fair value of a cash-settled share-based payment to employees is presented as an employee benefit expense, similar to expenses under equity-settled share-based payments (see [Chapter 6.10](#)).

*IFRS 2.BC252–BC255*

There is no guidance on whether the remeasurement should be presented as an employee cost or as finance income or finance costs. In our view, an entity should choose an accounting policy, to be applied consistently, between these presentations.

*IAS 1.32–35*

If the remeasurement results in a credit to profit or loss in a period or cumulatively at the end of a period, then in determining how to present the credit in profit or loss the entity considers the general requirements for offsetting income and expenses.

## 7.4 Comparison with accounting for equity-settled share-based payment transactions with employees

### Similarities to accounting for equity-settled share-based payments with employees

The cost is recognised immediately if there is no service condition and it is recognised over the vesting period, if there is one.

The cost is recognised as an expense, unless the goods or services received qualify for asset recognition.

The grant-date fair value is (at least) based on the fair value of the (underlying) equity instruments, taking into account market and non-vesting conditions.

An estimate is made of the number of awards for which service and non-market performance conditions are expected to be satisfied, with a true-up to the number ultimately satisfied.

### Key differences in the accounting for equity-settled and cash-settled share-based payments

Equity-settled	Cash-settled
The credit entry is in equity.	The credit entry is a liability.
No remeasurement of the grant-date fair value.	Remeasurement of the liability at each reporting date and on settlement date.
The cumulative cost is trueed up only for changes in estimates about service and non-market performance conditions; no subsequent true-up if market and non-vesting conditions are not satisfied.	The cumulative net cost is ultimately equal to the settlement amount.
Equity-settled expense is recognised over the vesting period.	Cash-settled expense is recognised until settlement.

## 7.5 Redeemable shares

### IFRS 2.31

Grants of equity instruments that are redeemable are classified as cash-settled share-based payments under certain conditions depending on which party has the option to redeem (see [Chapter 4.5](#)). The accounting for such a transaction is not always straightforward, as explained below.

### IFRS 2.31

In our view, for a grant of options to acquire redeemable shares, the settlement of the share-based payment occurs only on redemption of the shares and not on exercise of the options. Therefore, we believe that an entity should recognise compensation cost and a corresponding cash-settled liability equal to the grant-date fair value of the options; this liability should be remeasured at each reporting date and ultimately at settlement date.

### IFRS 2.30

At the date on which the option is exercised, the redemption value of the share, and therefore of the liability recognised for the redeemable shares, will be equal to the sum of the exercise price and the intrinsic value of the option. Once the option is exercised, we believe that the entity should remeasure this cash-settled liability through profit or loss until the shares are redeemed.



### Example 7.5.1 – Accounting for options to acquire redeemable shares

On 1 January Year 1, Company B grants 1,000 share options to an employee, subject to a three-year service condition. The share options can be exercised only on 31 December Year 3. The shares to be delivered on exercise of the option are mandatorily redeemable if and when the employee leaves B. The redemption amount per share equals the then-current fair value.

The employee stays in service until 31 December Year 3, exercises all options and pays the exercise price of 40 per share for a total of 40,000. On 26 July Year 6, the employee leaves B and redeems the shares for 48 each for a total of 48,000.

The share price and the values of the option develop as follows.

	Share price	Exercise price	Intrinsic value	Time value	Fair value
1 January Year 1	40	40	-	10	10
31 December Year 1	42	40	2	7	9
31 December Year 2	44	40	4	2	6
31 December Year 3	46	40	6	-	6
31 December Year 4	45				
31 December Year 5	47				
26 July Year 6	48				

B accounts for the transaction as follows.

	Debit	Credit
<b>Year 1 – Year 3 (cumulative for the share-based payment)</b>		
Expenses	10,000	
Liability		10,000
<i>To recognise services received at their grant-date fair value (1,000 x 10)</i>		
Liability	4,000	
Expenses		4,000
<i>To recognise remeasurement (1,000 x (10 - 6))</i>		
<b>Year 3 (received for the exercise)</b>		
Cash	40,000	
Liability		40,000
<i>To remeasure liability to equal fair value of 46,000 of cash-settled liability to redeem shares, which is equal to intrinsic value of option of 6 plus exercise price of 40 per option</i>		
<b>Year 4</b>		
Liability	1,000	
Expenses		1,000
<i>To recognise remeasurement (1,000 x (45 - 46))</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Year 5</b>		
Expenses	2,000	
Liability		2,000
<i>To recognise remeasurement (1,000 x (47 - 45))</i>		
<b>Year 6</b>		
Expenses	1,000	
Liability		1,000
<i>To recognise remeasurement on settlement date (1,000 x (48 - 47))</i>		
Liability	48,000	
Cash		48,000
<i>To recognise cash settlement</i>		
<b>Cumulative effects</b>		
Expenses	8,000	
Cash		8,000
Equity		-
Liability		-

The expenses equal the difference between the cash outflow on redemption of 48,000 and the cash inflow on exercise of the options of 40,000.

In [Example 7.5.1](#), when the redeemable shares are issued to the employees in Year 3, entries may be required by local legislation. For example, an entry to credit share capital with the exercise price of 40,000 may be required. If a credit to share capital is required, then the shares would be treasury shares because they have not been issued unconditionally to the employee because of the obligation to redeem them that is recognised as a share-based payment liability. Accordingly, the net effect on equity would be zero because the shares issued on vesting date were issued conditionally and an equal and opposite debit to treasury shares of 40,000 was also made in equity. When the employee left, the shares were reacquired legally to reverse the transaction because the share-based payment did not vest, but no entries are required in equity because no issue of shares outside the entity has been recognised when the shares were issued.

## 7.6

## Disclosures

### 7.6.10

### Disclosures on measurement of fair value for cash-settled share-based payments

*IFRS 2.44, 47(a), 50*

There are specific disclosure requirements regarding the measurement of the fair value for share options. In our view, these disclosures should also be provided for cash-settled share-based payments – e.g. SARs. We believe that for cash-settled share-based payments, the following disclosures on measurement of fair value should be provided.

- Awards granted during the period: disclosures on measurement of fair value at grant date and at the reporting date.
- Awards granted in previous periods but unexercised at the reporting date: disclosures on measurement of fair value at the reporting date.

# 8 Employee transactions – Choice of settlement

## Overview

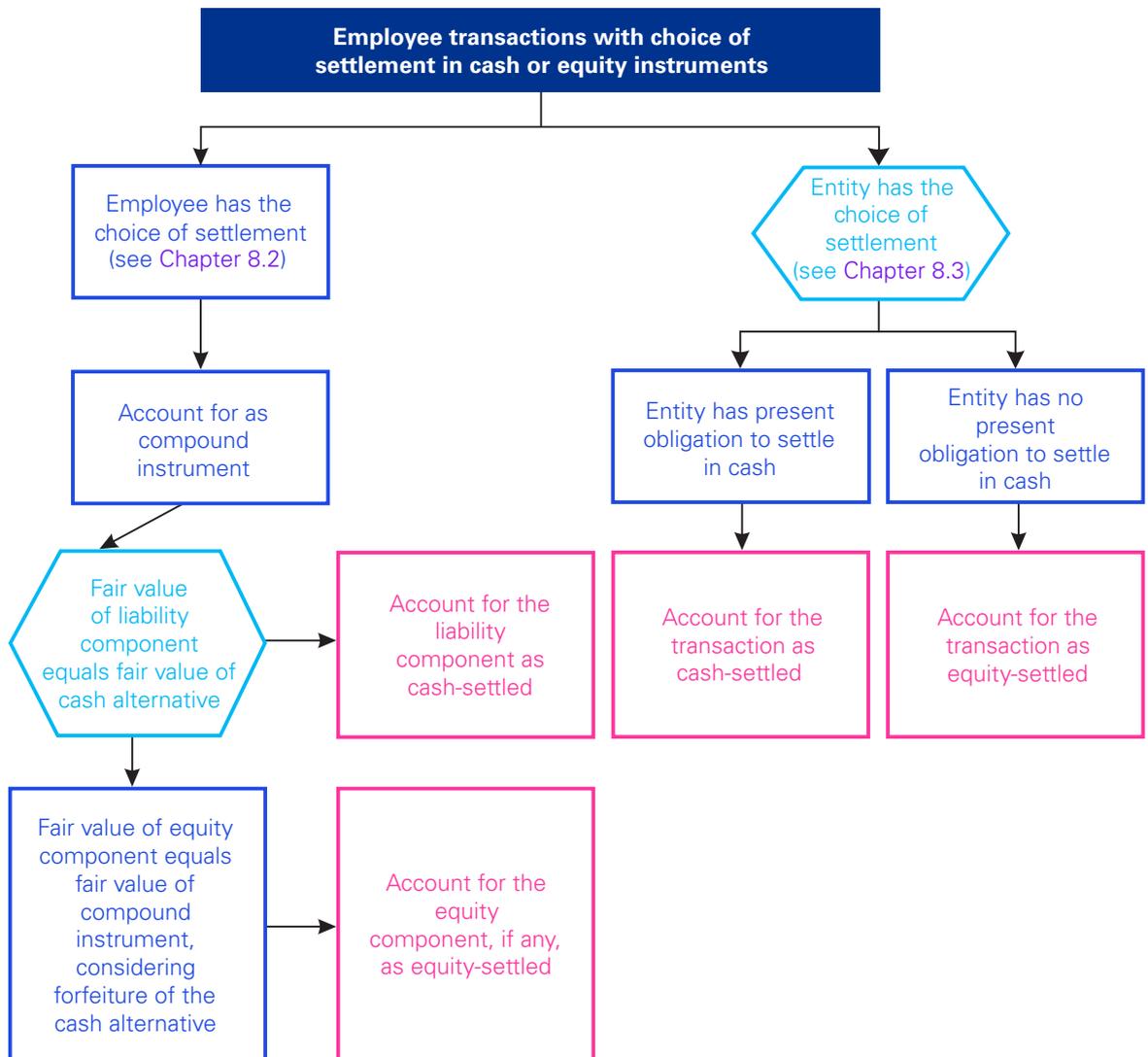
- A share-based payment transaction in which the *counterparty* (e.g. an employee) has a choice of settlement is a compound financial instrument that includes a liability component and an equity component.
- The entity measures the fair value of the liability component first, which equals the fair value of the cash alternative. The entity accounts for that component by applying the requirements for cash-settled share-based payments – i.e. the liability component is remeasured until settlement date.
- The value of the equity component takes into account that the counterparty forfeits the cash alternative. The entity accounts for the equity component, if there is any, by applying the requirements for equity-settled share-based payments – i.e. the equity component is not remeasured after the grant date.
- If the counterparty chooses equity settlement, then the liability is reclassified to equity. If the counterparty chooses cash settlement, then the equity component remains in equity.
- A share-based payment transaction in which the entity has the choice of settlement is accounted for either as an equity-settled share-based payment or as a cash-settled share-based payment, depending on whether the entity has a present obligation to settle in cash.
- In determining whether the entity has a present obligation to settle in cash, consideration is given to the entity's past practice, intent and ability to settle in equity.
- The assessment of whether the entity has a present obligation may need to be revised subsequently.
- If the entity chooses the settlement alternative with the higher fair value at the date of settlement, then recognition of additional expenses may be required.

## 8.1 Basic principles of accounting for employee transactions with choice of settlement

IFRS 2.34

If either the entity or the employee has a choice of settlement, then the transaction is accounted for at least in part as cash-settled if the entity will or can be required to settle in cash or other assets.

The following flowchart illustrates the effect on the accounting of the choice of settlement.



If the manner of settlement is not a choice within the control of the entity or the employee, but depends on an event outside both parties' control (i.e. an IPO or a change in control of the entity), then we believe that instead an entity should determine whether to classify the share-based payment as equity-settled or cash-settled using an approach that is based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (see Chapter 4.6).

## 8.2 Share-based payment transactions in which employee has choice of settlement

### 8.2.10 Introduction

*IFRS 2.35–36, IG22.Ex13*

If the employee has the choice of settlement, then the entity has granted a compound financial instrument that includes both a liability component and an equity component.

*IFRS 2.37*

At the measurement date, the fair value of the compound instrument (the value of services to be received) is the sum of the values of the liability component and the equity component.

*IFRS 2.37*

The liability component is measured first. It equals the fair value of the liability under the cash alternative.

*IFRS 2.37*

Next, the fair value of the equity component is measured. It takes into account that the employee forfeits their right to the cash alternative in order to receive the equity instruments.

### 8.2.20 Measuring the fair value of the equity component

*IFRS 2.IG22.Ex13*

Generally, to determine the fair value of the equity component, the grant-date fair value of the cash alternative that would have to be forfeited is subtracted from the fair value of the equity alternative. Any positive difference equals the fair value of the equity component.

*IFRS 2.37, BC259–BC261*

Share-based payment transactions in which the employee has a choice of settlement may be structured in such a way that the fair value of the cash alternative is the same as the fair value of the equity alternative. This will result in a grant-date fair value of the equity component of zero.



#### Example 8.2.1 – Choice between share options and SARs

Company B grants 1,000 SARs to an employee, subject to a two-year service condition. On vesting, the employee can choose a cash payment equal to the increase in share price between grant date and vesting date for 1,000 shares (i.e. the intrinsic value of the SARs). Alternatively, they can choose to exercise 1,000 share options at an exercise price that equals the share price at grant date. The fair value of a SAR and of a share option are identical – i.e. 5 at grant date.

In this case, assuming that the options can only be exercised at vesting date, the values of the SARs and of the share options are always the same. The fair value of the equity component is determined by subtracting the fair value of the cash alternative from the fair value of the equity alternative.

Fair value of the equity alternative	5,000 <sup>1</sup>
Fair value of the cash alternative	5,000 <sup>1</sup>
Fair value of the equity component	-

**Note**

1. 1,000 × 5.

**Example 8.2.2 – Shares redeemable at employee’s option**

Company C, a non-listed entity, grants shares for no consideration to its employees, subject to a two-year service condition. The shares are redeemable within one year after vesting at the employee’s option at the then-current fair value.

Because the value of the potential cash payment is always the same as the value of the shares, the value of the equity alternative is equal to the value of the liability component. Therefore, C accounts for the liability component only and there is no incremental equity component.

*IFRS 2.BC259*

Sometimes the entity grants extra value for choosing the equity alternative – i.e. the fair value of the equity alternative is higher than the fair value of the cash alternative. In this case, there is a residual amount attributable to the equity component.

**Example 8.2.3 – Choice between share options and SARs, additional share options**

The fact pattern is the same as in [Example 8.2.1](#), but employees are offered a choice between buying 1,200 shares and SARs for 1,000 shares.

In this case, the arrangement can be seen as comprising two components with different values: (1) a cash payment in which the total value is always the same as the total value of 1,000 options; and (2) an incremental equity component of 200 share options. Accordingly, the grant-date fair value of the equity component is determined by subtracting the fair value of the cash alternative from the fair value of the equity alternative.

Fair value of the equity alternative	6,000 <sup>1</sup>
Fair value of the cash alternative	5,000 <sup>2</sup>
Fair value of the equity component	1,000

**Notes**

- 1,200 × 5.
- 1,000 × 5.

*IFRS 2.BC259–BC261*

Measuring the fair value of a compound financial instrument is more complex if the fair value of the cash alternative is not always the same as the fair value of the equity alternative. In that case, the fair value of the compound financial instrument will usually exceed both the individual fair value of the cash alternative (because of the possibility that the shares or share options may become more valuable than the cash alternative) and that of the equity alternative (because of the possibility that the cash alternative may become more valuable than the shares or options). In this case, the determination of the equity component still follows the same approach. First, the fair value of the cash alternative is determined for the liability component. Second, the grant-date fair value of the equity component is valued by taking into account the fact that the cash alternative is given up to obtain the equity alternative.

## 8.2.30 Subsequent accounting for components until settlement

IFRS 2.38

The entity accounts for the two components separately – i.e. applying the requirements for cash-settled share-based payments to the liability component, and applying the requirements for equity-settled share-based payments to the equity component, if that component has a recognised value.

IFRS 2.IG22.Ex13

Applying the requirements for equity-settled share-based payments, the value of the equity component is not remeasured subsequently (see 6.2.10).

IFRS 2.39–40

Applying the requirements for cash-settled share-based payments, the liability is remeasured at each reporting date and on settlement date to its fair value (see 7.2.20).

IFRS 2.40

If the employee chooses cash settlement, then the cash payment settles the liability. Any equity component previously recognised in equity remains in equity.

IFRS 2.39

If the employee chooses settlement in equity instruments, then the liability is transferred to equity as consideration for issuing the equity instruments.



### Example 8.2.4 – Subsequent accounting until settlement at employee's choice

On 1 January Year 1, Company E grants a share-based payment to its CEO, subject to a two-year service condition. After the service period, the CEO is entitled to either:

- 1,000 SARs settled in cash at their intrinsic value at settlement date; or
- 1,200 share options, to be exercised at an exercise price that equals the share price at grant date – i.e. 10.

The rights can be exercised only on 29 January Year 3. The CEO is expected to fulfil the service condition, and ultimately does.

The values of the individual SARs and the individual share options are always the same and develop as follows.

1 January Year 1	1.00	Fair value
31 December Year 1	1.30	Fair value
31 December Year 2	1.40	Fair value
29 January Year 3	1.35	Fair value = intrinsic value

The fair value of the liability component at grant date is 1,000 (1,000 × 1). The fair value of the equity alternative is 1,200 (1,200 × 1). Therefore, the grant-date fair value of the equity component is 200 (1,200 - 1,000).

E accounts for the transaction as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses	100	
Equity		100
<i>To recognise expense related to equity component (200 × 1/2)</i>		

	Debit	Credit
Expenses	650	
Liability		650
<i>To recognise expense related to liability component (1,000 x 1.30 x 1/2). This entry combines initial recognition of obligation with remeasurement of recognised portion</i>		
<b>Year 2</b>		
Expenses	100	
Equity		100
<i>To recognise expenses related to equity component (200 - 100)</i>		
Expenses	750	
Liability		750
<i>To recognise expenses related to liability component (1,000 x 1.40 - 650). This entry combines initial recognition of obligation with remeasurement of recognised portion</i>		
<b>Year 3</b>		
Liability	50	
Expenses		50
<i>To remeasure liability component to its fair value at settlement date (1,350 - 1,400)</i>		
<b>Cumulative effect before settlement</b>		
Expenses	1,550	
Equity		200
Liability		1,350

Settlement of the share-based payment is recognised as follows under the two possible settlement scenarios.

	Debit	Credit
<b>Scenario A – Employee chooses cash settlement</b>		
Liability	1,350	
Cash		1,350
<i>To recognise settlement of liability</i>		
<b>Cumulative effect after cash settlement</b>		
Expenses	1,550	
Equity		200
Cash		1,350
<b>Scenario B – Employee chooses equity settlement</b>		
Liability	1,350	
Equity		1,350
<i>To recognise reclassification of liability to equity</i>		
<b>Cumulative effect after equity settlement</b>		
Expenses	1,550	
Equity		1,550

## 8.2.40 Different settlement dates

IU 05-06

Determination of grant date and vesting period in respect of share-based payment transactions that provide employees with a subsequent choice of cash settlement at one date or shares at a later date can be challenging, because it may not be clear whether the date of cash settlement or the date of issuance of the shares should prevail.

IFRS 2.38, IU 05-06

The IFRS Interpretations Committee discussed share-based payment transactions in which an employee has a choice of settlement and noted that as a consequence of the requirement to account for the cash settlement component and the share component separately, the vesting periods of the two components should be determined separately.

IFRS 2.28, 40

In our view, choosing one alternative (i.e. cash settlement or shares) before the end of the vesting period of the other alternative should be treated as a cancellation of the second alternative by one of the parties. We believe that the term ‘forfeited’ used in paragraph 40 of IFRS 2 *Share-based Payment* should not be understood as forfeiture as used in applying the modified grant-date method. In the context of that method, forfeiture results in a reversal of previously recognised share-based payment cost. Reversal of the equity component when the cash alternative is selected is not appropriate because services have been provided. Therefore, we believe that the equity component should be recognised as long as the required services have been provided to be eligible for cash settlement, notwithstanding the fact that the equity alternative is surrendered when cash settlement is chosen. For a discussion of cancellation accounting, see [Chapter 9.3](#).

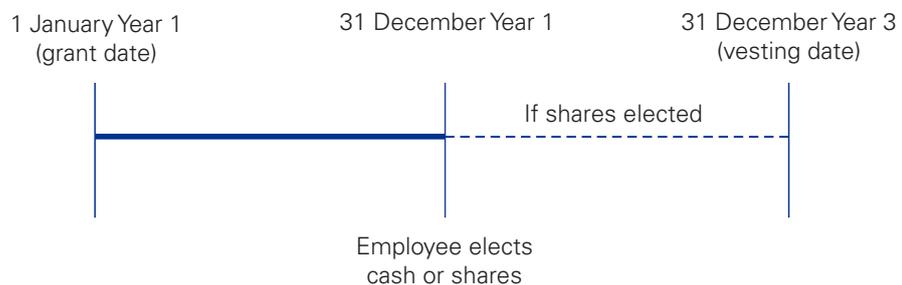


### Example 8.2.5 – Compound financial instrument with different settlement dates

On 1 January Year 1, Company R enters into a bonus arrangement with its employees. The terms of the arrangement allow the employees to choose on 31 December Year 1 to receive either:

- a cash payment equivalent to the increase in share price between 1 January and 31 December Year 1 for 100 shares; or
- shares with a value equivalent to 110% of the cash payment.

If an employee chooses to receive shares instead of a cash payment, then they are required to work for R until the end of Year 3 for the award to vest.



At the date on which the transaction was entered into, both the employer and the employees understood the terms and conditions of the plan, including the formula that would be used to determine the amount of cash to be paid or the number of shares to be delivered to each employee; however, the exact amount of cash or number of shares would be known only at a future point in time. Nonetheless, if the outcome is based on objective factors and different knowledgeable parties, independently of each other, would be able to make consistent calculations, then we believe that there is a shared understanding without having specified the actual grant term.

In this example, we believe that grant date is 1 January Year 1, even though the exact amount of cash or number of shares would only be known at a future point in time. For more details on how to determine grant date when the outcome is based on objective factors, see [Chapter 6.3](#).

The share-based payment transaction with cash alternatives at the choice of the employee is treated as a compound financial instrument, with the liability and equity components of the compound financial instrument accounted for separately. Therefore, we believe that in this example the vesting periods for the liability and equity components will be different: one year for the liability component and three years for the equity component.

If the grant-date fair value of the liability component is 500 and the incremental grant-date fair value of the equity component is 300, then at the end of Year 1 R will have recognised the entire fair value of the cash component of 500 and 100 ( $300 \times 1/3$ ) for the equity component. If, at the end of Year 1, the employee elects to receive the cash payment, then we believe that this should be treated as a cancellation of the equity component by that employee.

For a more detailed illustration of treating the choice of one alternative as a cancellation of the other alternative, see [Example 8.2.6](#).

## 8.2.50

*IFRS 2.35, IU 05-06*

### Non-share-based cash alternative

As explained in [3.5.20](#), we believe that an arrangement that provides the employee with a choice of two settlement alternatives that are mutually exclusive, and in which only one of the alternatives would be accounted for under IFRS 2, should be accounted for as a share-based payment by applying the requirements in IFRS 2 for compound instruments by analogy.

Therefore, for an arrangement that includes a cash- or equity-settled share-based payment and a cash alternative that is not a share-based payment, we believe that the compound approach in IFRS 2 should be applied. In our view, the liability for the cash alternative that is not share-based embodies the liability component of a compound instrument under IFRS 2, which should be measured and remeasured in accordance with the appropriate accounting standard – e.g. IAS 19 *Employee Benefits* – for such arrangements with employees. Any incremental fair value of the equity-settled share-based payment over the initial value of the liability component is accounted for as an equity component (see [8.2.20](#)).

Even if there is no recognised value for the equity component to account for, we believe that the disclosure requirements of IFRS 2 should be applied to both elements.

*IFRS 2.39–40*

If and when the choice for a cash alternative (e.g. a profit-sharing plan) is sacrificed, then the liability would be reclassified to equity. If, instead, the option for the cash alternative is exercised, then we believe that the equity component would be treated as cancelled because the equity right had to be surrendered in order to receive the cash alternative (see [Example 8.2.5](#)).



**Example 8.2.6 – Payment with mutually exclusive share-based payment and profit-sharing components in which the cash payment is fixed**

On 1 January Year 1, Company B grants a share-based payment to its five executive board directors, subject to a one-year service condition. At the end of the service period, each director will receive a bonus of 200 if B's Year 1 profits are above 5.2 million. Each director can choose to receive:

- cash; or
- equity instruments to the value of 150% of the cash amount.

If the directors choose to receive shares instead of a cash payment, then they are required to work for B until the end of Year 4 for the award to vest.

At grant date, B expects the non-market performance condition to be met. The fair value of the cash payment under the requirements for short-term benefits in IAS 19 is 1,000 (5 x 200). For the same reasons as set out in Example 8.2.3, the total grant-date fair value of the equity component is 500 ((1,000 x 150%) - 1,000) – i.e. 100 for each director.

B expects all directors to remain employed until the end of Year 4, when all vesting conditions would be met.

The directors can exercise their rights only on 29 January Year 2. Four directors choose the cash payment and one chooses the equity payment and remains employed over the required additional service period – i.e. until 31 December Year 4.

B accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	125	
Equity		125
<i>To recognise expenses under equity component for five directors (100 x 5 x 1/4)</i>		
Expenses	1,000	
Liability		1,000
<i>To recognise expenses under liability component (200 x 5)</i>		
<b>Year 2</b>		
Liability	800	
Cash		800
<i>To recognise settlement of liability for four directors (200 x 4)</i>		
Expenses	300	
Equity		300
<i>To recognise expenses for remaining equity component for four directors who cancelled their equity component (100 x 4 - (100 x 4 x 1/4))</i>		
Liability	200	
Equity		200
<i>To recognise reclassification of liability for director who chose equity settlement</i>		

	<i>Debit</i>	<i>Credit</i>
Expenses	25	
Equity		25
<i>To recognise expense for equity component for one director (100 x 1 x 1/4)</i>		
<b>Year 3</b>		
Expenses	25	
Equity		25
<i>To recognise expense for equity component for one director (100 x 1 x 1/4)</i>		
<b>Year 4</b>		
Expenses	25	
Equity		25
<i>To recognise expense for equity component for one director (100 x 1 x 1/4)</i>		
<b>Cumulative effects</b>		
Expenses ((200 + 100) x 5)	1,500	
Equity ((100 x 5) + 200)		700
Cash (200 x 4)		800

The credit to equity reflects the recognition of the equity component of 500 plus the reclassification of the proportion of the liability for the director who has chosen the equity payment of 200.



#### Example 8.2.7 – Payment with mutually exclusive share-based payment and profit-sharing components in which cash payment is variable

Assume the same facts as in [Example 8.2.6](#), except that the cash payment alternative is variable: the fixed bonus of 200 is increased to 300 if the Year 1 profit exceeds 5.5 million. The value of the cash alternative is remeasured under IAS 19 to the estimated amount payable under the plan. In continuation of the approach illustrated in [Example 6.7.1](#), which illustrates a grant with a non-market performance condition and a variable number of equity instruments, the value of the equity component is based on the most likely outcome of the achievement of the profit target with true-up to the actual outcome.

If, for example, B estimates at grant date that it will achieve profits of approximately 5.4 million, then the equity alternative equals 150% of 1,000 (5 x 200), resulting in an equity component of 500. The estimate of the equity component will be trueed up to the actual outcome at the vesting date because the number of equity instruments granted varies with the achievement of a non-market performance target (see [6.7.20](#)).

## 8.3 Share-based payment transactions in which entity has choice of settlement

### 8.3.10 Introduction

IFRS 2.41–43

If the entity rather than the employee has the choice of settlement, then the entity accounts for the transaction either as cash-settled or as equity-settled in its entirety. The entity determines whether it has a present obligation to settle in cash. If it has a present obligation to settle in cash, then it accounts for the transaction as cash-settled; otherwise, it is accounted for as equity-settled.

Whether the entity has a present obligation to settle in cash depends on an assessment of:

- the entity's intent, if any, to settle in cash or in equity instruments;
- the entity's past practice, if any, of settling in cash or in equity instruments; and
- the entity's ability to settle in equity instruments.

IFRS 2.41, BC265

If the entity has the *stated intent to settle in equity instruments*, then the entity does not have a present obligation to settle in cash, unless it has a past practice of settling in cash or no ability to settle in equity instruments. The entity has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance – e.g. if the entity is legally prohibited from issuing or buying and re-issuing shares. Therefore, to classify the share-based payment as equity-settled the entity has to have the ability to settle in shares. Otherwise, the entity classifies the share-based payment as cash-settled.

IFRS 2.BC267

If the entity has the *stated intent to settle in cash*, then the entity has a present obligation to settle in cash, regardless of any past practice.

IFRS 2.41, BC265

If the entity does *not have a stated intent*, then it classifies the transaction as cash-settled if it has either a past practice of settling in cash or no ability to settle in equity instruments; otherwise, the transaction is classified as equity-settled.

IFRS 2.BC266

The basis of classification of share-based payments if the issuer has a choice of settlement differs from the classification criteria in the financial instruments standards, which focus more narrowly on whether the issuer has an obligation without considering its intent.

IFRS 2 does not consider whether the basis of classification of a share-based payment in which the entity has a choice of settlement can or should be reconsidered after grant date if there is a change in circumstances (see 8.3.40).

### 8.3.20 Settlement accounting if share-based payment is accounted for as cash-settled

IFRS 2.42

If the entity accounts for the transaction as cash-settled, then the entity applies the requirements for cash-settled share-based payments until settlement – i.e. the liability is remeasured to its fair value at each reporting date and ultimately at settlement date and the cash payment settles the liability (see 7.2.20).

### 8.3.30 Settlement accounting if share-based payment is accounted for as equity-settled

IFRS 2.43

Settlement accounting may be more complex if the entity accounts for the transaction as equity-settled but elects to settle in cash.

IFRS 2.43

The accounting depends on whether the entity elects to settle in cash or in equity and whether it chooses the higher or lower fair value if there is a difference between the value of the equity or cash alternative.

IFRS 2.43(a)–(b)

If the entity has classified the transaction as equity-settled and elects the type of settlement with the lower fair value at the settlement date, then the accounting is as follows.

- If the entity settles in cash, then the cash payment is recognised as a deduction from equity, reflecting a repurchase of equity instruments.
- If the entity settles in equity as expected, then the settlement does not require any more accounting entries, other than a possible transfer from one equity component to another.

IFRS 2.43(c), BC268

If the entity chooses the type of settlement with the higher fair value at settlement date, then the entity recognises an additional expense for the excess value given. In our view, this expense represents the difference between the values of the equity alternative and the cash alternative at settlement date, rather than the difference from the grant-date fair value.



### Example 8.3.1 – Accounting for settlement if entity has choice of settlement without present obligation to settle in cash

On 1 January Year 1, Company P grants a share-based payment to its employee, subject to a one-year service condition. On 1 January Year 2, P can choose to settle in cash or in equity instruments. P has no present obligation (intent or past practice) to settle in cash and therefore accounts for the transaction as equity-settled.

The grant-date fair value of the cash alternative is 1,000. The grant-date fair value of the equity alternative is 1,200. Subsequently, the values develop as follows.

#### Scenario A – Fair value of equity instruments at settlement date is lower than cash alternative

	Equity instruments	Liability
1 January Year 1	1,200	1,000
1 January Year 2	1,400	1,500

#### Scenario B – Fair value of equity instruments at settlement date is higher than cash alternative

	Equity instruments	Liability
1 January Year 1	1,200	1,000
1 January Year 2	1,550	1,500

P accounts for the transaction as follows.

	Debit	Credit
<b>Year 1 (under both scenarios)</b>		
Expenses	1,200	
Equity		1,200
<i>To recognise grant-date fair value of equity alternative, because share-based payment is classified as equity-settled</i>		
<b>Scenario A (equity value lower than cash value)</b>		
Assumption: P settles in lower (equity) value		
Expenses	-	
Equity		-
<i>No journal entries required</i>		

	<i>Debit</i>	<i>Credit</i>
Assumption: P settles in higher cash value		
Expenses	100	
Equity	1,400	
Cash		1,500
<i>To recognise additional expense for difference between fair value of shares and cash alternative at settlement (1,500 and 1,400)</i>		
<b>Scenario B (equity value higher than cash value)</b>		
Assumption: P settles in lower cash value		
Equity	1,500	
Cash		1,500
Assumption: P settles in higher equity value		
Expenses	50	
Equity		50
<i>To recognise additional expense for difference between 1,550 and 1,500</i>		

### 8.3.40

IFRS 2.IG1

### Reassessment of classification

The classification of an arrangement in which the entity has the choice of settlement as equity- or cash-settled is initially determined at grant date. In our view, an entity should reassess whether it has a present obligation to settle in cash if there is a change in circumstances before settlement date. Examples of changes in circumstances that would indicate that a reassessment of the classification is appropriate include a change in an entity's stated intent or a change in an entity's practice of settlement. In our view, whether the change in circumstances would lead to a change in classification of the share-based payment should be assessed based on the specific facts and circumstances of each arrangement.

In our view, a change in circumstances that results in a change in classification of a transaction in which the entity has a choice of settlement should be accounted for prospectively. We believe that the change in intent of the entity should be treated as a change in the terms of the award; therefore, the change in intent should be treated as a modification that changes the classification of the arrangement (see 9.2.30).

### Initial accounting as equity-settled

IFRS 2.BC267

The communication of a change in the entity's intent from settling in equity to settling in cash is a change in circumstances that we believe should result in a reassessment of the classification of outstanding transactions, assuming that transactions were previously accounted for as equity-settled share-based payments.

**Example 8.3.2 – Change from stated intent to settle in equity to intent to settle in cash with communication**

Company O has the stated intent and ability to settle share-based payment transactions in equity and has a past practice of doing so; therefore, at grant date a new share-based payment transaction is classified as equity-settled. Subsequently, O changes its intent to settle in cash and communicates this to employees.

After communicating its intention to settle in cash, O would have a present obligation to settle in cash; therefore, we believe that O should reclassify the share-based payment transaction prospectively as cash-settled. For how to account for a change in classification, see [9.2.30](#).

If the entity continues to have a stated policy of settlement in equity but subsequently settles a transaction in cash, then the question arises whether the cash settlement results in the entity having a present obligation to settle other transactions in cash. In our view, if the entity's intention is to continue to settle in equity and the cash settlement was limited to an isolated circumstance (e.g. because of an illness in the employee's family), then equity-settled classification may continue to be appropriate. In this case, the isolated circumstance of cash settlement would not generally constitute a change in practice and would not generally result in the employees having an expectation that their awards will be settled in cash in the future. However, if the entity settles a number of transactions in cash, then we believe that it is more likely that the change in settlement should result in the share-based payment transaction being reclassified to cash-settled. This is because a past practice of settling in cash will have been established.

**Initial accounting as cash-settled**

In our view, if the share-based payment is classified at grant date as cash-settled, then it may be more difficult to support a conclusion that a change in circumstances results in the entity no longer having a present obligation to settle in cash. This is because the employees may have an expectation that the previous practice of settlement in cash will continue to be followed until a practice of settlement in equity is established. This is more difficult if the employee's ability to obtain cash by selling the equity instruments received in the share-based payment transaction would not be as easy as cash settlement by the entity – e.g. if there is not an active and liquid market available to the employees in which to sell the equity instruments of the entity. We believe that, before establishing a practice of settlement in equity, the entity should continue to classify such share-based payments as cash-settled.

**Example 8.3.3 – Change from past practice of settling in cash to an intent to settle in equity instruments**

Company P has a past practice of settling in cash and, without communicating any change in policy to employees, the entity changes its intent such that it will settle future awards in equity.

We believe that before establishing a practice of settlement in equity, P should continue to classify the share-based payment transaction as cash-settled. This is because, in the absence of a change in practice, the employees will continue to have an expectation that the awards will be settled in cash and therefore P continues to have a present obligation to settle in cash.

# 9 Modifications and cancellations of employee share-based payment transactions

## Overview

- The accounting for a modification depends on whether the modification changes the classification of the arrangement and whether the changes are beneficial to the employee.
- As a minimum, the original grant-date fair value of the equity instruments granted is recognised under modification accounting.
- Modifications that increase the fair value of the grant result in recognition of the incremental fair value measured at the modification date.
- Modifications that increase the number of equity instruments granted result in recognition of the fair value of the additional equity instruments, measured at the modification date.
- Other beneficial modifications – e.g. changes to service conditions or non-market performance conditions – are taken into account in applying the modified grant-date method.
- Modifications that are not beneficial for the employee do not affect the total share-based payment cost.
- Cancellations by the employee or by the entity result in accelerated vesting.
- Compensation payments made for cancellations by the employer are recognised as a repurchase of equity interests. To the extent that a compensation payment exceeds the fair value of the equity instruments granted at the repurchase date, it is recognised as an expense.
- Replacement awards need to be identified as such by the employer at the date when the new award is granted.
- Replacement awards are accounted for by applying the principles of modification accounting, rather than as a separate new award and cancellation of the unvested old award.

## 9.1 Scope of this section

*IFRS 2.26*

This section contains guidance on modifications, cancellations and replacements of share-based payment transactions with employees. There are no specific requirements for cash-settled share-based payments that are modified or cancelled because cash-settled share-based payments are remeasured to the ultimate cash payment (see [7.2.20](#)). Therefore, this section focuses on equity-settled share-based payments.

*IFRS 2.26*

The cancellation, modification and replacement requirements also apply to share-based payment transactions with parties other than employees that are measured indirectly – i.e. with reference to the fair value of the equity instruments granted (see [11.2.30](#)). In this case, any reference to grant date is read as a reference to the applicable measurement date under those transactions – i.e. the date when the goods or services are received.

*IFRS 2.27*

As a basic principle, IFRS 2 *Share-based Payment* requires an entity to recognise, as a minimum, the original grant-date fair value of the equity instruments granted unless those equity instruments do not vest because of failure to meet any service and non-market performance conditions under the original terms and conditions.

*IFRS 2.27*

In addition to the original grant-date fair value, an entity recognises the effects of modifications that increase the fair value of the equity instruments granted or are otherwise beneficial to the employee.

*IFRS 2.BC237*

In other words, the entity cannot reduce the share-based payment cost that would be recognised under the original terms and conditions by modifying or cancelling a share-based payment. However, the timing of recognition of the cost of a share-based payment may change as a result of modifications.

For further discussion of modifications see [Chapter 9.2](#), for further discussion of cancellations see [Chapter 9.3](#) and for further discussion of replacements [Chapter 9.4](#).

## 9.2 Modifications

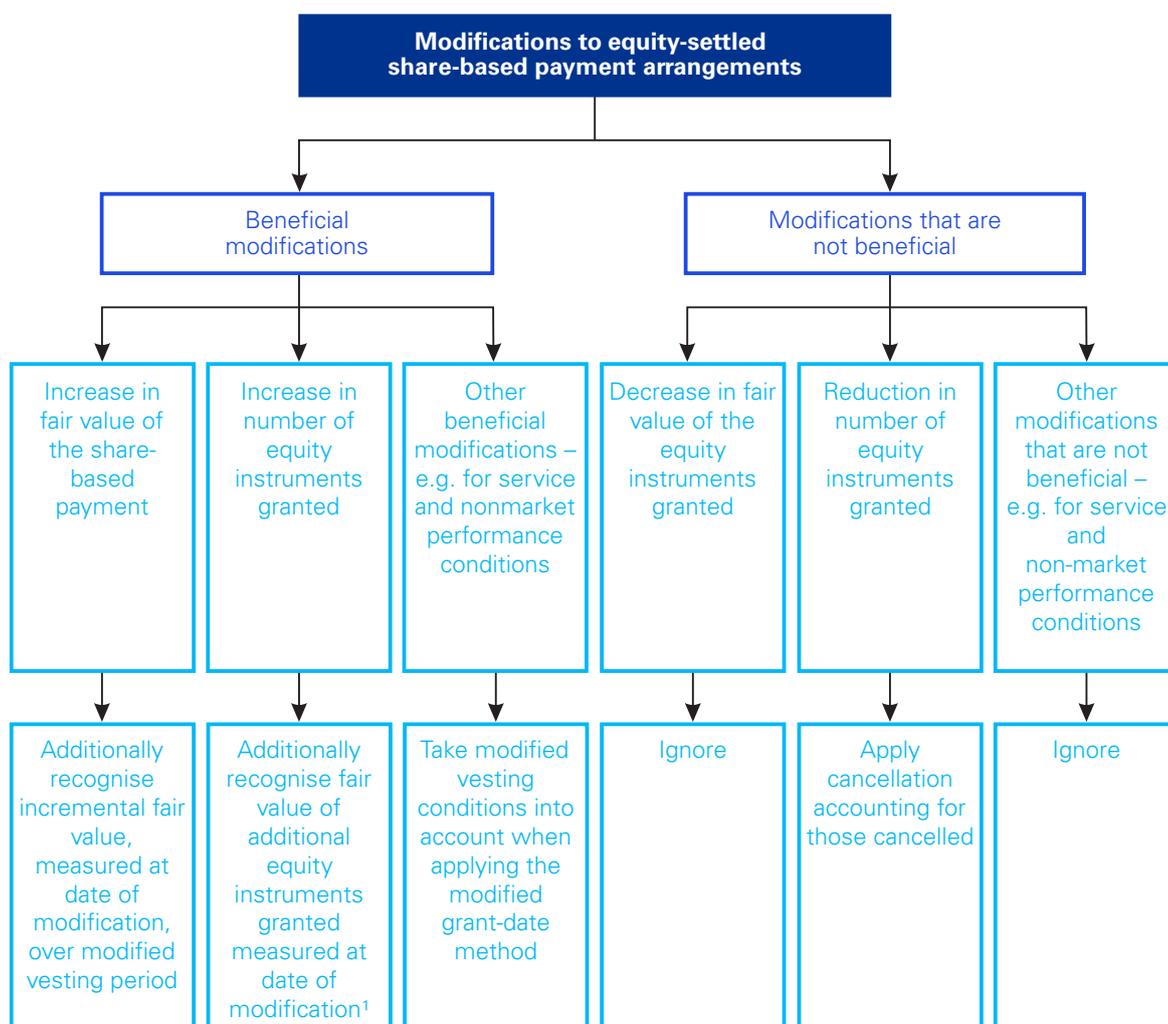
### 9.2.10 Introduction

The accounting for a modification depends on whether the modification changes the classification of the arrangement and whether the changes are beneficial to the counterparty.

### 9.2.20 Modifications that do not change classification of arrangement

IFRS 2.B42–B44

IFRS 2 distinguishes between different types of beneficial and non-beneficial modifications. The following flowchart provides an overview of the categories discussed and the respective accounting consequences, assuming that the modification does not affect the classification of the share-based payment.



**Note**

1. Over the period from modification date to the end of the vesting period of the additional equity instruments.

## Increases in fair value of share-based payment

### Increases in fair value of equity instruments granted

IFRS 2.B43(a),  
IG.Ex 7

Sometimes a modification increases the fair value of the equity instruments granted – e.g. by reducing the exercise price of a share option granted. In these cases, the incremental fair value is recognised over the remaining modified vesting period, whereas the balance of the original grant-date fair value is recognised over the remaining original vesting period.

IFRS 2.B43

The 'incremental fair value' is the difference between the fair value of the modified share-based payment and that of the original share-based payment, both measured at the date of the modification – i.e. the fair values as measured immediately before and after the modification.



#### Example 9.2.1 – Reduction of exercise price during the vesting period

On 1 January Year 1, Company C grants 1,000 share options to each of its five board members, subject to a four-year service condition. The share options can be exercised at any date in Year 5.

The current share price at grant date is 100 and the exercise price is also 100. The grant-date fair value of an option is determined to be 20.

In Year 2, C's share price declines significantly to 40 and the option is deeply out-of-the-money. To re-establish the motivational effect of the share options on the employees, C re-prices the share options by modifying the exercise price to 40 on 1 September Year 2. Simultaneously, the service condition is prolonged to four years from the modification date. The fair value of a share option immediately before the modification is 0.1 and immediately after the modification is 9.7; the incremental fair value is therefore 9.6 per option.

At the modification date, C estimates that all five board members will remain in service over both the original vesting period and the modified vesting period. However, one board member leaves in Year 4.

C recognises share-based payment expenses and corresponding increases in equity in accordance with the following table.

Original grant-date fair value	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense at end of period	Expense in current period
Year 1	5,000	100,000 <sup>1</sup>	25,000 <sup>3</sup>	25,000
Year 2	5,000	100,000 <sup>1</sup>	50,000 <sup>4</sup>	25,000
Year 3	5,000	100,000 <sup>1</sup>	75,000 <sup>5</sup>	25,000
Year 4	4,000	80,000 <sup>2</sup>	80,000 <sup>6</sup>	5,000
Year 5	-	-	-	-

#### Notes

- 5 x 1,000 x 20.
- 4 x 1,000 x 20.
- 100,000 x 1/4.
- 100,000 x 2/4.
- 100,000 x 3/4.
- 80,000 x 4/4.

Incremental fair value	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense at end of period	Expense in current period
Year 1	-	-	-	-
Year 2	5,000	48,000 <sup>1</sup>	4,000 <sup>3</sup>	4,000
Year 3	5,000	48,000 <sup>1</sup>	16,000 <sup>4</sup>	12,000
Year 4	4,000	38,400 <sup>2</sup>	22,400 <sup>5</sup>	6,400
Year 5	4,000	38,400 <sup>2</sup>	32,000 <sup>6</sup>	9,600
Year 6	4,000	38,400 <sup>2</sup>	38,400 <sup>7</sup>	6,400

**Notes**

1.  $5 \times 1,000 \times 9.6$ .
2.  $4 \times 1,000 \times 9.6$ .
3.  $48,000 \times 4/48$ .
4.  $48,000 \times 16/48$ .
5.  $38,400 \times 28/48$ .
6.  $38,400 \times 40/48$ .
7.  $38,400 \times 48/48$ .

Although the modified fair value of a share option is 9.7, which is less than the grant-date fair value of 20, there is an incremental fair value to account for because the incremental fair value is the difference between the fair value immediately before and after the modification. In total, C recognises share-based payment expenses of 118,400 ( $4 \times 1,000 \times (20 + 9.6)$ ) or (80,000 + 38,400).

In [Example 9.2.1](#), the attribution of the incremental fair value to the remaining modified vesting period has been illustrated based on a monthly approximation rather than on a calculation based on days. In our experience, such approximations are used in practice and may be appropriate if their use does not lead to significantly different outcomes.

### Determining whether there is an increase in fair value of share-based payment

In our view, when determining fair value at the modification date, the same requirements as for determining the grant-date fair value apply – i.e. service conditions and non-market performance conditions are not taken into account in determining the fair value (see [6.2.10](#)). If, for example, a share-based payment arrangement with a non-market performance condition is modified such that only the non-market performance target is modified, and all other terms and conditions remain the same, then the incremental fair value is zero. This is because the fair value measured on an IFRS 2 basis – i.e. without adjustments for service and non-market performance conditions – is the same before and after the modification. For a discussion of the accounting for such modifications, see [9.2.20](#).

*IFRS 2.B43(a)*

If, in contrast, a market condition or a non-vesting condition is reduced or eliminated, then this beneficial modification may result in an incremental fair value. This is because under the modified grant-date method, market and non-vesting conditions are reflected in the fair value of an equity-settled share-based payment (see [6.2.10](#)).

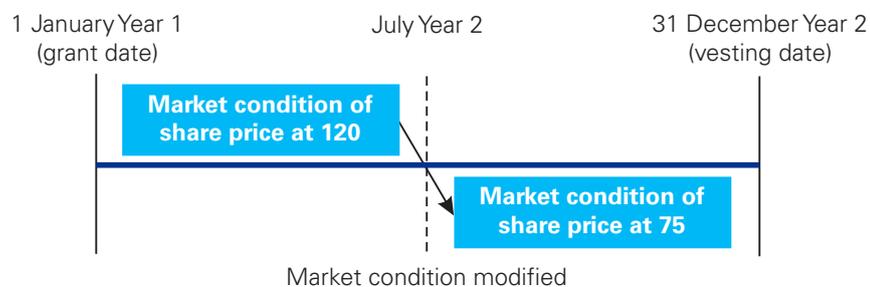
If an award that contains a market condition is modified by an entity to make the market condition easier to meet, or if a market condition is eliminated, then this is a modification of a vesting condition that is beneficial to employees. The original market condition is taken into account in estimating the fair value of the original grant at the modification date. If it is unlikely that the original market condition will be met at the modification date, then the fair value of the original award at the modification date may be significantly lower than the fair value of the original award as determined at grant date.



### Example 9.2.2 – Beneficial modification of market condition

On 1 January Year 1, Company D grants 1,000 shares for no consideration to its CEO, subject to a two-year service condition and the share price achieving a target of 120. At grant date, the share price is 100 and the grant-date fair value of the equity instrument granted, including consideration of the possibility of not meeting the share price target, is 80.

In July Year 2, the share price decreases to 70 and D now estimates that it is highly unlikely that the share price target will be met. To motivate the CEO, the market condition is reduced to a share price target of 75. The fair value of equity instrument granted considering the market condition immediately before the modification is 1 and immediately after the modification is 56; the incremental fair value is therefore 55 per share.



D recognises the grant-date fair value of the equity instruments granted of 80,000 ( $1,000 \times 80$ ) over Year 1 and Year 2 in respect of the original grant. Additionally, D recognises the incremental fair value of 55,000 ( $1,000 \times 55$ ) in Year 2, assuming that the CEO fulfils the service requirement. The total compensation cost that will be recognised of 135,000 is greater than the fair value of the modified award of 56,000.

### Increases in number of equity instruments granted

IFRS 2.B43(b)

If a modification increases the number of equity instruments granted, then the entity recognises the fair value of the additional equity instruments measured at the modification date. The additional share-based payment cost is attributed over the period from the modification date to the end of the vesting period of the additional equity instruments.

A common example of increases in the number of equity instruments granted is when an entity issues additional shares due to a decline in the share price to maintain the economic position of the share-based payment holder.



### Example 9.2.3 – Increase in number of equity instruments granted

On 1 January Year 1, Company E grants 1,000 shares for no consideration to its CEO, subject to a three-year service condition. At grant date, the fair value of the shares is 15.

In Year 1, the share price decreases significantly. Although E has no obligation to do so under the current share-based payment arrangement and there are no other indications (e.g. past practice) that such an obligation exists, on 1 January Year 2, when the share price is 5, E modifies the share-based payment to restore the economic position of the CEO. E grants an additional 2,000 shares for no consideration, worth 10,000, compensating the CEO for the price fall of 10 per share on the original grant of 1,000 shares.

E recognises a share-based payment expense of 15,000 (1,000 x 15) evenly over the original three-year vesting period, and an additional share-based payment expense of 10,000 (2,000 x 5) evenly over Year 2 and Year 3.

Although the intention of the modification is to restore the economic position of the employee, E recognises a total share-based payment expense of 25,000 (15,000 + 10,000), which is significantly higher than the modification-date value of the two grants.

### Beneficial modifications of service and non-market performance conditions

IFRS 2.B43(c)

If the modification changes a service or a non-market performance condition in a manner that is beneficial to the employee – e.g. by reducing the vesting period or by modifying or eliminating a non-market performance condition – then the remaining grant-date fair value is recognised using the revised expectations with true-up to actual outcomes (see 6.2.10).

#### Modification of service condition

IFRS 2.B43(c)

If a service period is reduced, then the entity uses the modified vesting period when applying the requirements of the modified grant-date method.



#### Example 9.2.4 – Reduction of service period

On 1 January Year 1, Company F grants 1,000 share options to one of its employees, subject to a five-year service condition. The grant-date fair value of a share option is 10 and the employee is expected to remain in service. In the middle of Year 3, the service period is reduced to four years; the employee remains employed.

In this case, ignoring interim financial reporting requirements, F uses the modified vesting period (i.e. the four-year service period) when applying the requirements of the modified grant-date method. F calculates the cumulative amount to be recognised at the end of Year 3 based on the new vesting period, which results in an additional share-based payment expense in Year 3, and to a lesser extent also in Year 4, so that the cumulative amounts recognised at the end of Year 3 and Year 4 mirror the pattern of services as they are rendered under the new vesting period.

Original grant-date fair value	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense at end of period	Expense in current period
Year 1	1,000	10,000 <sup>1</sup>	2,000 <sup>2</sup>	2,000
Year 2	1,000	10,000 <sup>1</sup>	4,000 <sup>3</sup>	2,000
Year 3	1,000	10,000 <sup>1</sup>	7,500 <sup>4</sup>	3,500
Year 4	1,000	10,000 <sup>1</sup>	10,000 <sup>5</sup>	2,500
Year 5	-	-	-	-

#### Notes

- 1,000 x 10.
- 10,000 x 1/5.
- 10,000 x 2/5.
- 10,000 x 3/4.
- 10,000 x 4/4.

### Acceleration of vesting in response to termination of employment by the employee

*IFRS 2.27, B42, B43(c)*

If an employee leaves before vesting date, then an entity may respond by amending the terms of the share-based payment or granting a new award such that the award vests despite the employee not having completed the service period originally required. This fact pattern could be seen as a forfeiture of the original award and a grant of a new award. Forfeiture resulting from voluntary termination of employment by the employee would result in a true-up to zero of the original award. A grant of a new award would result in recognition of the new grant-date fair value immediately because no further services are provided.

*IFRS 2.B43(c)*

In our view, if on termination of employment by either the employee or the employer, the employer accelerates the vesting period such that the employee receives the award despite not having completed the requisite service period, then this is a modification of the award and not a forfeiture of the original award (forfeiture would result in true-up to zero) and a grant of a new unrelated award, (which would result in recognising the new grant-date fair value immediately because no further services are provided). This is because IFRS 2 illustrates an acceleration of the vesting period as an example of a modification that is beneficial to an employee. The accounting would be the same if the acceleration of vesting were treated as the forfeiture of the original grant and a grant of a replacement award. This is because the grant of a replacement award is also treated as a modification (see [Chapter 9.4](#)).

*IFRS 2.27–28*

Under modification accounting, there is an incremental fair value to account for only if the fair value has changed because of the modification, which is not the case when only a service condition is modified (e.g. waived on employee resignation). Therefore, under modification accounting, the grant-date fair value of the original award is recognised immediately because at a minimum the original grant-date fair value is recognised over the revised vesting period of the share-based payment.



#### Example 9.2.5 – Acceleration of service condition on termination of employment

Company G awards a share-based payment similar to that in [Example 9.2.4](#), but the employee leaves at the end of Year 2. Although under the terms and conditions of the arrangement the employee forfeits their right to receive the share-based payment, G voluntarily accelerates the vesting date to the end of Year 2, so that the employee has met the modified service condition.

In this case, G recognises the remaining share-based payment expenses of 8,000 (10,000 - 2,000) in Year 2.

### Acceleration of vesting in response to termination of employment by entity

An entity may terminate the employment of an employee so that the employee cannot provide the required services. Although the share-based payment does not contain a good leaver clause (see below), the entity nevertheless does not want the employee to lose entitlement to the share-based payment. In this case, the entity may amend the terms of the share-based payment or grant a new award to accelerate vesting.

As a reminder, if vesting is not accelerated as set out above, then we believe that termination of employment by the entity may be accounted for as forfeiture or as a cancellation, as explained in [6.9.10](#). For the accounting consequences of cancellation accounting, see [Chapter 9.3](#).

*IFRS 2.27*

If vesting is accelerated, then the accounting treatment as a beneficial modification should be the same as the case in which the employee cancels the share-based payment (i.e. immediate recognition of the unrecognised amount (see [9.3.20](#))). This is regardless of which accounting treatment is applied for failure to provide required service due to termination when vesting is not accelerated (see [6.9.10](#)).

### Acceleration of vesting as part of the arrangement

In contrast to [Example 9.2.5](#), if the share-based payment arrangement contains a good leaver clause under which the employee would qualify for accelerated vesting if G terminates their employment, then the entity would not need to modify the arrangement for the share-based payment to vest. Under the original terms of the share-based payment, the acceleration would result in recognition of the balance of the share-based payment cost. For further discussion on leaver clauses, see [5.5.10](#).

### Modification of non-market performance condition

IFRS 2.B43(c)

Like modifications of a service condition (see above), a modification of a non-market performance condition does not affect the modification date fair value of the share-based payment. The entity determines whether the modification is beneficial to the employee and, if it is, then the modified vesting conditions are taken into account in determining when to recognise the share-based payment cost (see [9.2.20](#)).



#### Example 9.2.6 – Modification of non-market performance condition

On 1 January Year 1, Company H grants 1,000 share options to an employee, subject to a four-year service condition and the company achieving a cumulative profit target of 100 million at the end of the service period. The grant-date fair value of a share option is 10.

At grant date, the employee is expected to stay employed and the profit target is also expected to be met. However, in Year 2 the profit target is no longer expected to be met. Therefore, in Year 3 H reduces the profit target to 80 million (a beneficial modification), which at the time of the modification is expected to be met. At the end of Year 4, the revised profit target is not met.

H accounts for the transaction as follows.

Original grant-date fair value	Instruments for which it is expected that service and NMP <sup>1</sup> condition will be satisfied	Expected total expense	Cumulative expense through the end of the period	Expense in current period
Year 1	1,000	10,000 <sup>2</sup>	2,500 <sup>3</sup>	2,500
Year 2	-	-	-	(2,500)
Year 3	1,000	10,000 <sup>2</sup>	7,500 <sup>4</sup>	7,500
Year 4	-	-	-	(7,500)

#### Notes

1. Non-market performance.
2. 1,000 × 10.
3. 10,000 × 1/4.
4. 10,000 × 3/4.

Judgement may be necessary to decide whether a change in the non-market performance conditions of a share-based payment arrangement should be considered a modification. A change in the method of computation may not be a modification, but rather could be a predetermined adjustment that is not accounted for as a modification. As discussed in [6.3.60](#), we believe that a predetermined adjustment to a share-based payment would not result in modification accounting as described above.

**Example 9.2.7 – Predetermined adjustment of non-market performance condition**

Company P grants employees a share-based payment, the vesting of which depends on the company's relative position within a comparator group of companies. P's relative position within this comparator group is based on market share determined with respect to revenue (i.e. a non-market performance condition). The agreement specifies that, should one of the comparator group companies need to be deleted from the list for reasons outside P's control – e.g. de-listing of a competitor such that financial information is no longer available – then it will be replaced by the next company in a predetermined list. The agreement specifies that the objective of the clause is to ensure that the top five competitors by market share are included in the comparator group.

We believe that any substitution in the comparator group in accordance with the original terms is not a modification because the composition of the group and the objective of the clause were clearly stated and defined in advance as part of the terms and condition of the original grant – i.e. the change was predetermined (see 6.3.60).

**Example 9.2.8 – No predetermined adjustment of non-market performance condition**

Assume the same facts as in Example 9.2.7, except that the agreement does not specify the objective of the clause or how a company in the comparator group will be replaced and the revision to the comparator group is a free choice or the change is made at the discretion of the entity. In this case, we believe that this should be accounted for as a modification because of the subjectivity involved (see 6.3.60).

**Non-beneficial modifications***IFRS 2.27, B44(a)*

Modifications to equity-settled share-based payment transactions that *decrease* the fair value of the grant are generally ignored. The fair value of the share-based payment decreases when the fair value immediately after the modification is lower than the fair value immediately before the modification. In determining the fair value, we believe that the same principles apply as when determining the grant-date fair value (see 6.2.10).

*IFRS 2.27, B44(b)*

If the modification reduces the number of equity instruments granted, then that reduction is accounted for as a cancellation (see Chapter 9.3).

*IFRS 2.27, B44(c)*

If the entity modifies the vesting conditions in a manner that is not beneficial to the employee – e.g. by increasing the vesting period or by increasing or adding a non-market performance condition – then this modification is also ignored (i.e. the grant-date fair value of the equity instruments granted is recognised over the original vesting period) if the original service and non-market performance conditions are met. That is, if an employee leaves before the end of the original vesting period, then this forfeiture results in a true-up of the original compensation expense. If, in contrast, the employee leaves after the original vesting date, but before the later modified vesting date, then this is not treated as a forfeiture.



### Example 9.2.9 – Modification of a service and non-market performance condition

Company X grants share options to senior executives. Vesting occurs if X reduces its annual Scope 1 emissions by 50% at the end of six years and the senior executive remains in service for that period; the base year for measuring reductions is Year 1.

At the end of Year 2, X adjusts the Scope 1 emissions reduction target to 80% at the end of eight years. The senior executive is also required to remain in service for that period. No other terms are changed and it is assumed that the fair value of the award is the same immediately before and after the modification.

This increased emissions target and the extended service period are non-beneficial modifications. Therefore, X continues to recognise the grant-date fair value of the award over the original service period if the employee stays in service for that period and the non-market performance condition is met – i.e. X recognises the grant-date fair value of the award over six years if the original non-market performance condition is met, regardless of whether the revised target is met.

Conversely, if at the end of Year 2 X had adjusted the Scope 1 emissions reduction target to 40% at the end of four years, then the decrease in the emissions target and the reduced service period would be beneficial modifications. In this case, X would recognise the grant-date fair value of the award over the modified vesting period, applying the modified vesting conditions.

### Give-and-take modifications

A package of modifications might include several changes to the terms of a grant that affect its total fair value, some of which are favourable to the employee whereas other changes are not. For example, a share option grant can be modified by reducing the exercise price (give) and simultaneously reducing the number of granted options (take). In our view, it is appropriate to net the effects of both modifications, provided that they are agreed as part of a package. This is because the employee realises the net change rather than being able to earn the enhanced benefit of the reduction of the exercise price without suffering the loss in the total number of options. If the net effect is beneficial, then we believe that this net effect should be accounted for by applying the requirements for beneficial modifications to the net change.



### Example 9.2.10 – Give-and-take modifications

On 1 January Year 1, Company M grants 1,000 share options to its CEO, subject to a three-year service condition. The grant-date fair value of a share option is 10 and the total grant-date fair value is 10,000.

At the beginning of Year 3, the following modifications are carried out in a single arrangement:

- the fair value of the option granted is increased from 7 to 11 by reducing the exercise price; and
- the number of equity instruments is reduced from 1,000 to 800.

The net effect of the package of modifications is beneficial to the employee, because the total fair value of 1,000 units before modification of 7,000 (1,000 x 7) is lower than the total fair value of 800 units after modification of 8,800 (800 x 11).

We believe that M should account for the package of modifications as one net beneficial modification that increases the fair value of the equity instruments granted as follows.

Original grant-date fair value	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense through the end of the period	Expense in current period
Year 1	1,000	10,000 <sup>1</sup>	3,333 <sup>3</sup>	3,333
Year 2	1,000	10,000 <sup>1</sup>	6,666 <sup>4</sup>	3,333
Year 3	1,000 } 800 }	10,000 <sup>1</sup> } 1,800 <sup>2</sup> }	10,000 <sup>5</sup> } 1,800 <sup>6</sup> }	3,334 } 1,800 }

In total, M recognises share-based payment expenses of 11,800 (10,000 grant-date fair value of the equity instruments granted of 10,000 + an incremental value of 1,800).

#### Notes

1. 1,000 x 10.
2. 800 x 11 - 1,000 x 7.
3. 10,000 x 1/3.
4. 10,000 x 2/3.
5. 10,000 x 3/3.
6. 1,800 x 1/1.

## 9.2.30

### Modifications that change classification of arrangement

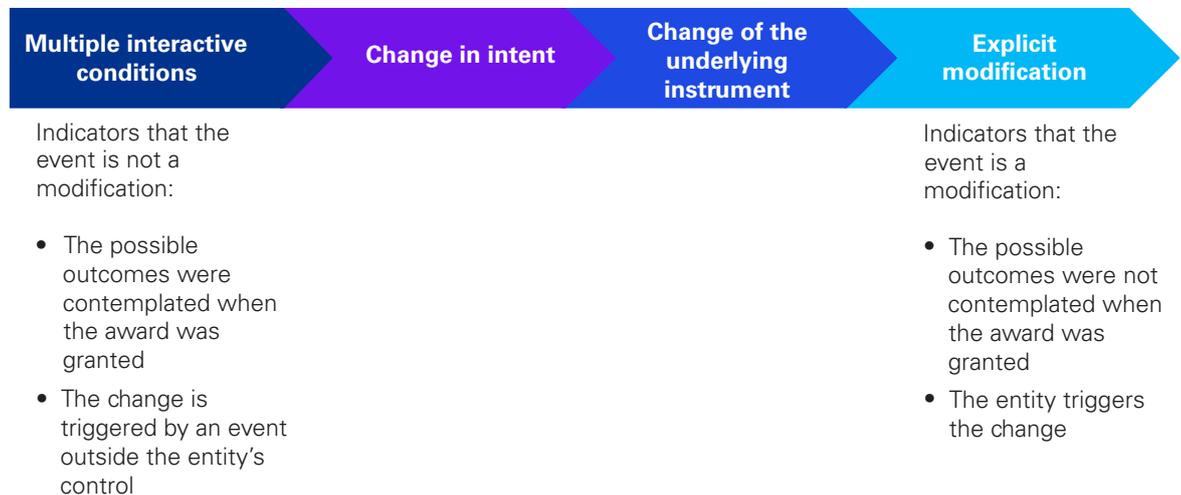
#### When change in classification should be treated as modification

Not all changes to the classification of a share-based payment arrangement are modifications. In some cases, changes to the classification of an arrangement that contains multiple interactive vesting conditions may result from a change in the most likely outcome (see 4.6.10). In this case, in our view a switching approach (see 6.8.30) should be followed for the change in classification.

There are also cases in which judgement is needed to determine whether modification accounting should be applied to the change in classification. In our view, the factors to consider in determining whether the change is a modification include the following:

- whether the different possible outcomes were contemplated when the award was granted; and
- whether the change is triggered by the entity or by an event that is outside the entity's control.

The diagram below illustrates how we believe that these factors should be taken into account.



 **Example 9.2.11 – Change is triggered by an event outside entity's control (switching approach)**

Company N is an income trust under the relevant tax legislation in its jurisdiction. On 1 January Year 1, N grants an award to its employees that is redeemable at the option of the holder. N classifies the award as a cash-settled award because the units issued to its employees will ultimately result in a cash payment by N to its employees.

On 1 January Year 2, new tax legislation is enacted that requires all income trusts to be converted into traditional corporate structures. As a result, N's unit-based awards classified as a cash-settled share-based payment will become an equity-settled share-based payment.

We believe that this change in classification should not be treated as a modification, because the change is triggered by an event outside the entity's control. In this case, we believe that a switching approach should be followed for the change in classification.

 **Example 9.2.12 – Change in classification treated as modification**

Company O has granted an award that gives it the choice of cash or equity settlement. O's original intent was equity settlement, and this has been its practice, but it changes its policy and begins to settle in cash; therefore, O reclassifies its outstanding share-based payments from equity-settled to cash-settled. We believe that this change in classification should be treated as a modification because O triggered the change (see 8.3.40).

### Modifications altering manner of settlement

A share-based payment may sometimes be modified to alter its manner of settlement; as a result, a share-based payment that was classified as equity-settled at grant date may be modified to become cash-settled, or vice versa. IFRS 2 contains guidance on accounting for modifications that result in a change from cash-settled to equity-settled but no explicit guidance on the accounting for modifications that result in a change from equity-settled to cash-settled.

The modification date fair value of the original share-based payment may increase, decrease or remain equal compared with its grant-date fair value. In addition, the terms of the modified share-based payment may grant incremental fair value to its recipient.

### Change from equity-settled to cash-settled arising from modification

*IFRS 2.27, IG.Ex9*

A change from equity-settled to cash-settled arising from a modification would occur if, for example, a cash alternative at the employee's discretion is subsequently added to an equity-settled share-based payment that results in a reclassification as a financial liability. Such a modification leads to a reclassification, at the modification date, of an amount equal to the fair value of the liability from equity to liabilities.

*IFRS 2.IG.Ex9*

If the amount of the liability recognised on the modification date is less than the amount previously recognised as an increase in equity, then no gain is recognised for the difference between the amount recognised to date in equity and the amount reclassified for the fair value of the liability; that difference remains in equity. Subsequent to the modification, the entity continues to recognise the grant-date fair value of equity instruments granted as the cost of the share-based payment. However, any subsequent remeasurement of the liability (from the modification date until settlement date) is also recognised in profit or loss.

*IFRS 2.IG15Ex9*

The implementation guidance to IFRS 2 illustrates the accounting subsequent to the reclassification in such a case. First, the grant-date fair value of the equity instruments granted continues to be recognised as a share-based payment cost as if no modification had occurred. The amount is credited partially to the liability and partially to equity. The amount that is credited to the liability is the amount that equals the annual proportion of the fair value of the liability at the modification date, without taking into account any subsequent changes in the value of the liability. The remainder is credited to equity. Second, the liability is remeasured by applying the usual requirements for remeasurement of a cash-settled share-based payment (see 7.2.20). In effect, this means that the cumulative amount recognised in profit or loss over the life of the award is the grant-date fair value plus or minus any subsequent changes in fair value after the change in classification. Therefore, the cumulative amount may be less than the original grant-date fair value.

If the amount of the liability recognised on the modification date is greater than the amount previously recognised as an increase in equity, then in our view two approaches are acceptable for recognising the excess liability. We believe that an entity should choose an accounting policy, to be applied consistently, to recognise either:

- the excess as an expense in profit or loss at the modification date (Alternative A); or
- the entire liability as a reclassification from equity and not recognise any loss in profit or loss (Alternative B).

The approach under Alternative A in 9.2.30 of recognising the excess as an expense in profit or loss in effect transfers an amount recognised in equity in respect of the share-based payment to a liability and then remeasures that amount, through profit or loss, to its current fair value.

*IU 11-06, IAS 32.33, AG.32*

The approach under Alternative B in 9.2.30 of recognising the entire amount of the liability as a reduction in equity is consistent with the treatment applied when the liability is less than the amount recognised in equity, in that no gain is recognised for the difference between the amount recognised to date in equity and the initial fair value of the liability. In our view, it is appropriate for no gain or loss to be recognised when a change in the terms of a compound instrument leads to reclassification as a financial liability provided that the liability at the modification date is not greater than the fair value of the original equity-settled award at the modification date. This is because under IFRS Accounting Standards an entity does not recognise a gain or loss when it buys, sells, issues or cancels its own equity instruments – e.g. when treasury shares are repurchased for amounts greater than their issue cost.



**Example 9.2.13A – Change from equity-settled to cash-settled, liability higher than equity, no incremental fair value**

On 1 January Year 1, Company K grants 1,000 share options to its CEO, subject to a four-year service condition. The grant-date fair value of a share option is 8 and the total grant-date fair value is 8,000.

At the end of Year 2, K adds a cash alternative to the arrangement, under which the employee can choose a cash payment that equals the fair value of the share options. The fair value of a share option at the date of the modification is 9. Accordingly, the total fair value of the liability is 9,000. The proportion of the liability at the end of Year 2 is 4,500 (9,000 x 2/4), which is higher than the cumulative amount recognised in equity of 4,000 (8,000 x 2/4).

The fair value of a share option and, accordingly, of the liability for the cash alternative, develops as follows (assuming that the fair value of the share option remains at 9 until the end of Year 4).

End of	Fair value of a share option	Cumulative amount of expenses to be recognised in equity if no cash alternative were added	Recognition of the liability based on its fair value at modification date	Fair value of the liability	Expense in current period
Year 1	N/A	2,000 <sup>1</sup>	-	-	2,000
Year 2	9.00	4,000 <sup>2</sup>	4,500 <sup>5</sup>	4,500 <sup>5</sup>	2,500 (Alternative A)  2,000 (Alternative B)
Year 3	9.00	6,000 <sup>3</sup>	6,750 <sup>6</sup>	6,750 <sup>6</sup>	2,250 <sup>8</sup>
Year 4	9.00	8,000 <sup>4</sup>	9,000 <sup>7</sup>	9,000 <sup>7</sup>	2,250 <sup>9</sup>
Totals					9,000 (Alternative A)  8,500 (Alternative B)

**Notes**

1. 1,000 x 8 x 1/4.
2. 1,000 x 8 x 2/4.
3. 1,000 x 8 x 3/4.
4. 1,000 x 8 x 4/4.
5. 1,000 x 9 x 2/4.
6. 1,000 x 9 x 3/4.
7. 1,000 x 9 x 4/4.
8. 6,750 - 4,500.
9. 9,000 - 6,750.

K accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Alternative A – Profit or loss</b>		
<b>Year 1</b>		
Expenses	2,000	
Equity		2,000
<i>To recognise expense for equity-settled share-based payment for Year 1</i>		
<b>Year 2</b>		
Expenses	2,000	
Equity		2,000
<i>To recognise expense for equity-settled share-based payment for Year 2</i>		
Expenses	500	
Equity	4,000	
Liability		4,500
<i>To reclassify amount of liability from equity to liability at modification date, with excess of liability recognised in profit or loss</i>		
<b>Year 3</b>		
Expenses	2,250	
Liability		2,250
<i>To recognise expense for cash-settled share-based payment for Year 3 (6,750 - 4,500). This entry combines initial recognition of 2,000 with remeasurement of 250</i>		
<b>Year 4</b>		
Expenses	2,250	
Liability		2,250
<i>To recognise expense for cash-settled share-based payment for Year 4 (9,000 - 6,750). This entry combines initial recognition of 2,000 with remeasurement of 250</i>		
<b>Cumulative effects</b>		
Expenses	9,000	
Equity	-	
Liability		9,000
<b>Alternative B – Equity</b>		
<b>Year 1</b>		
Expenses	2,000	
Equity		2,000
<i>To recognise expense for equity-settled share-based payment for Year 1</i>		
<b>Year 2</b>		
Expenses	2,000	
Equity		2,000
<i>To recognise expense for equity-settled share-based payment for Year 2</i>		

	<i>Debit</i>	<i>Credit</i>
Equity (excess of liability)	500	
Equity	4,000	
Liability		4,500
<i>To reclassify amount of liability from equity to liability at modification date, with excess of liability recognised in equity</i>		
<b>Year 3</b>		
Expenses	2,250	
Liability		2,250
<i>To recognise expense for cash-settled share-based payment for Year 3 (6,750 - 4,500). This entry combines initial recognition of 2,000 with remeasurement of 250</i>		
<b>Year 4</b>		
Expenses	2,250	
Liability		2,250
<i>To recognise expense for cash-settled share-based payment for Year 4 (9,000 - 6,750). This entry combines initial recognition of 2,000 with remeasurement of 250</i>		
<b>Cumulative effects</b>		
Expenses	8,500	
Equity	500	
Liability		9,000



#### **Example 9.2.13B – Modification from equity-settled to cash-settled: Subsequent decrease in fair value of liability**

In this example, all the facts and circumstances are the same as [Example 9.2.13A](#) except that between the end of Years 3 and 4 the fair value of the option decreases from 9 to 7.

In this case, Company K recognises the remaining portion of the modification date fair value of 2,250 (9,000/4) in Year 4. In addition, it recognises a credit to profit or loss of 2,000 to remeasure the liability to its fair value of 7,000 (1,000 x 7) at the end of Year 4.

Due to the remeasurement of liability, the total amount recognised is less than the grant-date fair value of the original award.

K accounts for the transaction in Year 4 as follows.

End of	Fair value of a share option	Cumulative amount of expenses to be recognised in equity if no cash alternative were added	Recognition of the liability based on its fair value at modification date	Fair value of the liability	Expense in current period
Year 1	N/A	2,000 <sup>1</sup>	-	-	2,000
Year 2	9.00	4,000 <sup>2</sup>	4,500 <sup>5</sup>	4,500 <sup>5</sup>	2,500 (Alternative A)  2,000 (Alternative B)
Year 3	9.00	6,000 <sup>3</sup>	6,750 <sup>6</sup>	6,750 <sup>6</sup>	2,250 <sup>9</sup>
Year 4	7.00	8,000 <sup>4</sup>	9,000 <sup>7</sup>	7,000 <sup>8</sup>	250 <sup>10</sup>
Expense totals					7,000 (Alternative A)  6,500 (Alternative B)

**Notes**

1. 1,000 × 8 × 1/4.
2. 1,000 × 8 × 2/4.
3. 1,000 × 8 × 3/4.
4. 1,000 × 8 × 4/4.
5. 1,000 × 9 × 2/4.
6. 1,000 × 9 × 3/4.
7. 1,000 × 9 × 4/4.
8. 1,000 × 7 × 4/4.
9. 6,750 - 4,500.
10. 7,000 - 6,750.

K accounts for the transaction as follows.

	Debit	Credit
<b>Note:</b> Years 1 to 3 are accounted for as illustrated in <a href="#">Example 9.2.13A</a> .		
<b>Year 4</b>		
Expenses	250	
Liability		250
<i>To recognise expense for cash-settled share-based payment expense for Year 4 (7,000 - 6,750). This entry combines recognition of the remaining modification date fair value of the cash-settled share-based payment of 2,250 with the liability remeasurement of 2,000.</i>		
<i>The Year 4 entry is the same for both Alternative A and Alternative B.</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Alternative A – Cumulative effects</b>		
Expenses	7,000	
Equity	-	
Liability		7,000
<b>Alternative B – Cumulative effects</b>		
Expenses	6,500	
Equity	500	
Liability		7,000

### Change from cash-settled to equity-settled arising from modification

A change from cash-settled to equity-settled arising from a modification would occur if, for example, a new equity-settled share-based payment arrangement is identified as a replacement of a cash-settled share-based payment arrangement.

IFRS 2.B44A–B44C,  
IG.Ex.12C

At the modification date an entity:

- derecognises the liability for the cash-settled share-based payment;
- measures the equity-settled share-based payment at its fair value as at the modification date and recognises in equity that fair value to the extent that the services have been rendered up to that date; and
- immediately recognises in profit or loss the difference between the carrying amount of the liability and the amount recognised in equity.



#### Example 9.2.14 – Change from cash-settled to equity-settled with incremental fair value

In January Year 1, Company M grants 100 SARs to its CFO, subject to a four-year service condition. The grant-date fair value of a SAR is 1; the total grant-date fair value is 100. The share price at the end of Year 1 is unchanged.

At the end of Year 2, the original grant has a fair value of 120. M cancels the grant and in its place grants 100 share options at a fair value of 1.32 each – i.e. the fair value of the new grant is 132 instead of 120, resulting in an incremental fair value of 12.

The new equity-settled grant is identified as a replacement for the original cash-settled grant and is therefore accounted for as a modification.

End of	Liability			Equity	
	Current period expense			In current period	
	Recognition of grant-date fair value	Remeasurement	Cumulative	Expense	Cumulative
Year 1	25 <sup>1</sup>	-	25	-	-
Year 2	25 <sup>1</sup>	10 <sup>2</sup>	60 <sup>3</sup>	→ 6 <sup>4</sup>	66 <sup>5</sup>
Year 3	-	-	-	33	99
Year 4	-	-	-	33	132

**Notes**

1.  $25 = 100 \times 1/4$ .
2.  $10 = 100 \times 120/100 \times 2/4 - 50$ .
3. The liability for the original cash-settled grant is derecognised.
4. The difference between the amount recognised in equity for the new equity-settled grant and the liability derecognised.
5. The fair value of new equity-settled grant is recognised in equity to the extent that services have been received –  $66 ((132 / 4) \times 2)$ .

M accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	25	
Liability		25
<i>To recognise 1/4 of grant-date fair value of liability; no remeasurement</i>		
<b>Year 2</b>		
Expenses	35	
Liability		35
<i>To recognise 1/4 of grant-date fair value of liability of 25 and remeasurement of 10</i>		
Liability	60	
Expenses	6	
Equity		66
<i>To recognise effect of modification</i>		
<b>Year 3</b>		
Expenses	33	
Equity		33
<i>To recognise 1/2 of unrecognised fair value of replacement of 66 (132 less 66)</i>		
<b>Year 4</b>		
Expenses	33	
Equity		33
<i>To recognise 1/2 of unrecognised fair value of replacement of 66 (132 less 66)</i>		
<b>Cumulative effects</b>		
Expenses	132	
Equity		132
Liability		-

## 9.2.40 Modifications that change nature of arrangement

A modification may change the nature of an arrangement from a share-based payment arrangement to an employee benefit in the scope of IAS 19 *Employee Benefits*.

In our view, the accounting for modifications that change the classification of an equity-settled share-based payment arrangement to a cash-settled share-based payment arrangement should be applied by analogy to account for an IAS 19 employee benefit that is identified as a replacement of an equity-settled share-based payment arrangement. However, some adjustments should be made to reflect the fact that the new award is not a cash-settled share-based payment but an IAS 19 employee benefit – e.g. it may be necessary to change from a straight-line attribution method to a projected unit credit method. The employee benefit should be measured and recognised based on the general requirements of IAS 19 applicable to the type of employee benefit issued.



### Example 9.2.15 – Modification changing the nature of the arrangement from equity-settled share-based payment to employee benefit

On 1 January Year 1, Company S issues an equity-settled share-based payment to its employees in the form of shares. The shares vest at the end of Year 4.

On 31 December Year 2, S is acquired by Company X for an acquisition price of 60 per share.

On 31 December Year 2, X modifies the share-based payment arrangement such that employees no longer receive shares on vesting but a fixed cash amount of 60 for each share they would have received under the original arrangement. The cash payment will be settled by S and there is no recharge to X for amounts paid under the modified arrangement. No other changes were made to the award.

The cash amount is based on the fair value of S's shares at the modification date. However, it is a fixed amount that does not increase or decrease with changes in S's share price over the remaining two-year vesting period. Therefore, it is not considered a payment based on the value of S's equity instruments and no longer meets the definition of a share-based payment.

In our view, X accounts for replacing the equity-settled share-based payment with an IAS 19 employee benefit arrangement by analogy to the guidance for modifications that change the classification of a share-based payment from equity-settled to cash-settled (see 9.2.40).

In this case, the liability recognised on the modification date is accounted for as another long-term benefit under IAS 19. This is because the service period of the replacement employee benefit arrangement is two years and payments are made only on completion of the two-year period – i.e. at the end of Year 4.

**Note:** If the cash payment based on S's share price at the date of acquisition was made only shortly after the modification date, then the arrangement may still be considered a share-based payment. In this case, X would account for it as a cash-settled share-based payment.


**Example 9.2.16 – Modification that changes the nature of the arrangement from equity-settled to employee benefit, no incremental value**

In January Year 1, Company X grants 1,000 share options to its executives subject to a three-year service condition. The grant-date fair value of a share option is 21; the total grant-date fair value is 21,000.

During Years 1 and 2, X's share price declines significantly and the share options are significantly out-of-the-money at the end of Year 2. At the end of Year 2, X modifies the arrangement to a cash bonus of 8,000 on vesting of the service condition. The cash bonus to be paid represents the fair value of the options at the modification date.

The cash amount is based on the fair value of the options at the modification date. It is a fixed amount that does not increase or decrease with changes in the value of X's equity instruments over the remaining one-year vesting period. Therefore, it is not considered to be based on the value of X's equity instruments and no longer meets the definition of a share-based payment. X accounts for the modification as a change in the nature of the arrangement from an equity-settled share-based payment to an IAS 19 employee benefit arrangement.

In our view, X accounts for replacing the equity-settled share-based payment with an IAS 19 employee benefit arrangement by analogy to the guidance for modifications that change the classification of a share-based payment from equity-settled to cash-settled (see 9.2.40).

At the modification date, X reclassifies an amount of 5,300 ( $8,000 \times 2/3$ ) from equity to an employee benefit liability. In this case, the fair value of the employee benefit liability is less than the amount previously recognised as an increase in equity of 14,000 ( $21,000 \times 2/3$ ) but no gain is recognised for the difference.

After the modification, X accounts for the reclassified amount as an employee benefit arrangement under IAS 19. In addition, X continues to recognise the grant-date fair value of the original award not reclassified as an employee benefit liability of 4,300 ( $7,000 - 2,700$ ) as an expense, with a corresponding credit to equity.

In this case, there is no change in the value of the liability between the end of Year 2 and Year 3.

X accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	7,000	
Equity		7,000
<i>To recognise expense for equity-settled share-based payment for Year 1</i>		
<b>Year 2</b>		
Expenses	7,000	
Equity		7,000
<i>To recognise expense for equity-settled share-based payment for Year 2</i>		
Equity	5,300	
Employee benefit liability		5,300
<i>To reclassify amount from equity to liability at modification date</i>		
<b>Year 3</b>		
Expenses	2,700	
Employee benefit liability		2,700
<i>To recognise the expense for the arrangement under IAS 19 (8,000 - 5,300)</i>		

	<i>Debit</i>	<i>Credit</i>
Expenses	4,300	
Equity		4,300
<i>To recognise as an expense the unrecognised portion of the original grant-date fair value of the equity-settled share-based payment not reclassified at the modification date (7,000 - 2,700)</i>		
<b>Cumulative effects</b>		
Expenses	21,000	
Equity		13,000
Employee benefit liability		8,000

### Modified awards that are forfeited

As discussed in 6.9.10, the equity-settled share-based payment cost is estimated and trued up for forfeiture because of an employee failing to provide services or failing to satisfy a non-market performance condition.

There is no specific guidance regarding the amount to be reversed because of an employee failing to meet a non-market performance condition after a share-based payment has been modified. Therefore, a question arises about whether the amount to be reversed includes the amount that was recognised in respect of the original award (the grant-date fair value).

In our view, if the employee meets the original condition but fails to meet a non-market performance condition that was added as part of the modification, then the amount to be reversed because of forfeiture is limited to any compensation cost recognised in respect of the modification. Therefore, if the original service condition (and non-market performance condition, if there is any) is met, then the entity should still recognise as the cost of the share-based payment the original grant-date fair value of the equity instruments granted.

IFRS 2.27

We believe that this is the appropriate treatment because IFRS 2 states that “the entity shall recognise, as a minimum, the services received measured at the grant-date fair value of the equity instruments granted, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date.” IFRS 2 goes on to state that “this applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments”.



#### Example 9.2.17 – Modified awards with a non-market performance condition that are forfeited

On 1 January Year 1, Company C grants 1,000 share options to each of its five board members, subject to a four-year service condition. The share options can be exercised at any date in Year 5.

The current share price at grant date is 100 and the exercise price is also 100. The grant-date fair value of an option is determined to be 20.

In Year 2, C’s share price declines significantly to 40 and the option is deeply out-of-the-money. To re-establish the motivational effect of the share options on the employees, C re-prices the share options by modifying the exercise price to 40 on 1 September Year 2. Simultaneously, a non-market performance condition is added that requires a profit target of 1 million to be met by 31 December Year 4. The fair value of a share option immediately before the modification is 0.1 and immediately after the modification is 9.7; the incremental fair value is therefore 9.6 per option.

At the modification date, C estimates that all five board members will remain in service over both the original vesting period and the modified vesting period. However, one board member leaves in Year 4. The non-market performance condition is not met by 31 December Year 4; therefore, the award is forfeited.

C recognises share-based payment expenses and corresponding increases in equity as follows.

Original grant-date fair value	Instruments for which it is expected that the service condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	5,000	100,000 <sup>1</sup>	25,000 <sup>3</sup>	25,000
Year 2	5,000	100,000 <sup>1</sup>	50,000 <sup>4</sup>	25,000
Year 3	5,000	100,000 <sup>1</sup>	75,000 <sup>5</sup>	25,000
Year 4	4,000	80,000 <sup>2</sup>	80,000 <sup>6</sup>	5,000

**Notes**

1.  $5 \times 1,000 \times 20$ .
2.  $4 \times 1,000 \times 20$ .
3.  $100,000 \times 1/4$ .
4.  $100,000 \times 2/4$ .
5.  $100,000 \times 3/4$ .
6.  $80,000 \times 4/4$ .

Incremental fair value	Instruments for which it is expected that the non-market performance condition will be satisfied	Expected total expense	Cumulative expense until end of period	Expense in current period
Year 1	-	-	-	-
Year 2	5,000	48,000 <sup>1</sup>	6,857 <sup>2</sup>	6,857
Year 3	5,000	48,000 <sup>1</sup>	27,428 <sup>3</sup>	20,571
Year 4	0	0 <sup>4</sup>	0	(27,428) <sup>5</sup>

**Notes**

1.  $5 \times 1,000 \times 9.6$ .
2.  $48,000 \times 4/28$ .
3.  $48,000 \times 16/28$ .
4.  $4 \times 0 \times 9.6$ .
5.  $0 - (6,857 + 20,571)$ .

Although the modified fair value of a share option is 9.7, which is less than the grant-date fair value of 20, there is an incremental fair value to account for because the incremental fair value is the difference between the fair values immediately before and after the modification.

The grant-date fair value of the original award is recognised for those awards for which the service condition is satisfied, even if the award has since been forfeited because the non-market performance condition added as part of the modification was not satisfied.

## 9.2.50

IFRS 2.B43

### Modifications after vesting date

In contrast to the general principle that no adjustment is made to the accounting for equity-settled share-based payments after the vesting date (see 6.2.10), an adjustment is recognised for modifications occurring after the vesting date. In this case, any incremental fair value is recognised immediately or over the new service period, if there is one.



#### Example 9.2.18 – Reduction of exercise price after the vesting period

On 1 January Year 1, Company D grants 1,000 share options to each of its five board members, subject to a four-year service condition. The share options can be exercised at any date in Year 5.

The current share price at grant date is 100 and the exercise price is also 100. The grant-date fair value of an option is 20.

Beginning in Year 4, D's share price declines significantly. In Year 5 – i.e. after the end of the vesting period – D re-prices the share options by modifying the exercise price to 60 on 1 February Year 5, which is the then-current share price. No share options have been exercised by 1 February Year 5. The fair value of a share option immediately before the modification is 2 and immediately after the modification is 9; the incremental fair value is therefore 7 per option.

D estimates that all five employees will remain in service until the vesting date, and they ultimately do.

D recognises a share-based payment expense of 100,000 ( $1,000 \times 5 \times 20$ ) over the vesting period in respect of the original grant. Additionally, D recognises the incremental fair value of 35,000 (Year 1 to Year 4) ( $1,000 \times 5 \times 7$ ) immediately on 1 February Year 5, because the modification occurred after the options had vested.

## 9.3

### Cancellations or settlements during the vesting period

#### 9.3.10

IFRS 2.28(a),  
IG15A.Ex9A

#### Introduction

Cancellations or settlements of equity instruments during the vesting period by the entity or by the counterparty are accounted for as accelerated vesting, and therefore the amount that would otherwise have been recognised for services received is recognised immediately.

#### 9.3.20

IFRS 2.28A, BC237B

#### Cancellation by employee

Cancellations by the employee can occur because the employee waives the share-based payment for their own reasons. In our experience, this does not occur often in practice (see Example 9.3.1). Cancellations will occur more often as a consequence of the employee choosing not to meet a non-vesting condition that is part of the share-based payment arrangement (see Example 9.3.2). Failure to meet such a non-vesting condition is treated as a cancellation.

**Example 9.3.1 – Voluntary cancellation by employee**

On 1 January Year 1, Company B grants 1,000 share options to its CEO, subject to a three-year service condition. A share option has a grant-date fair value of 10. B expects the CEO to satisfy the service condition, which they do.

In Year 2, the CEO waives the entitlement to share options in difficult economic times.

B accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	3,333	
Equity		3,333
<i>To recognise 1/3 of grant-date fair value of 10,000 (1,000 x 10)</i>		
<b>Year 2</b>		
Expenses	6,667	
Equity		6,667
<i>To recognise unrecognised amount of grant-date fair value of 10,000, as if vesting were accelerated</i>		

The example illustrates that the principle of accelerated vesting applies even if the employee voluntarily cancels an unvested share-based payment.

**Example 9.3.2 – Cancellation by employee due to failure to meet non-vesting condition**

On 1 January Year 1, Company C grants 1,000 shares for no consideration to one employee, subject to a three-year service condition and a requirement for the employee to acquire and hold another 1,000 shares until vesting date (a non-vesting condition; 'participation shares'). If the employee sells the participation shares during the vesting period, then they do not receive the share-based payment. The grant-date fair value of the equity instruments granted considering the effect of the non-vesting condition is 10.

In Year 2, the employee sells the participation shares.

C accounts for the share-based payment in the same way as for [Example 9.3.1](#) – i.e. the unrecognised grant-date fair value is recognised in Year 2.

**Cancellation by entity**

*IFRS 2.BC233*

If the entity cancels a grant of a share-based payment, then employees may expect compensation for the cancellation.

*IFRS 2.28(b), 29*

Payments made in exchange for the cancellation are accounted for as repurchases of an equity interest to the extent that the payment does not exceed the fair value of the equity instruments granted, measured at the repurchase date.

*IFRS 2.28(b), 29*

If the payment made in exchange for the cancellation exceeds the fair value of the equity instruments granted, then the excess is recognised as an expense. The same principles apply to a repurchase of vested equity instruments.



**Example 9.3.3 – Cancellation by employer with compensation payment**

On 1 January Year 1, Company D grants 1,000 share options to an employee, subject to a three-year service condition. The grant-date fair value of a share option is 9.

At the end of Year 2, when the fair value of a share option is 18, D offers to cancel the arrangement by paying a pro rata cash compensation based on the current fair value that reflects the proportion of the services provided to the services required under the plan. The offer amounts to 12,000 (1,000 x 18 x 2/3) and the employee accepts; payment is made immediately.

D accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	3,000	
Equity		3,000
<i>To recognise 1/3 of grant-date fair value of 9,000 (1,000 x 9)</i>		
<b>Year 2</b>		
Expenses	6,000	
Equity		6,000
<i>To recognise unrecognised amount of grant-date fair value of 9,000 – i.e. accelerate vesting</i>		
Equity	12,000	
Cash		12,000
<i>To recognise compensation payment</i>		

In this case, there is no additional expense to account for when the payment is made because the payment of 12,000 does not exceed the fair value of the equity instruments granted measured at repurchase date of 18,000 (1,000 x 18).

For a discussion of a failure to provide service because of the termination of an employee’s employment by the employer, see 6.9.10.

**Accelerated amount**

IFRS 2.28(a)

As indicated in 9.3.10, the amount recognised when a share-based payment is cancelled is the amount that would otherwise have been recognised over the remainder of the vesting period if the cancellation had not occurred. The accounting standard is not clear about what is meant by “the amount that otherwise would have been recognised for services received over the remainder of the vesting period” – i.e. whether it refers to the number of instruments that could have vested or that were expected to vest.

IFRS 2.27

In our view, an entity should choose an accounting policy, to be applied consistently, to follow either of the following approaches.

- The share-based payment is recognised as if the service and the non-market performance conditions were met for the cancelled awards – i.e. those not forfeited already. This approach is supported by the wording in IFRS 2 that requires recognition for those equity instruments that were granted unless those equity instruments do not vest (Approach A).

- The amount that would have been recognised is based on an estimate on the date of cancellation – i.e. estimating how many instruments are expected to vest at the original (future) vesting date. This approach is based on the view that on an ongoing basis the entity would have recognised only the grant-date fair value of those instruments that were expected to vest (Approach B).



### Example 9.3.4 – Cancellation of share-based payment with non-market performance condition

On 1 January Year 1, Company E grants 1,000 share options to each of its five employees, subject to a three-year service condition and a profit target. The grant-date fair value of a share option is 10. At grant date, E expects all five employees to stay employed and the profit target to be met.

At the end of Year 2, one employee has already left and three of the remaining four employees are expected to remain employed. However, E no longer expects the profit target to be met and cancels the share-based payment.

E accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Approach A</b>		
<b>Year 1</b>		
Expenses	16,666	
Equity		16,666
<i>To recognise expense for equity-settled share-based payment for Year 1 (1,000 x 5 x 10 x 1/3)</i>		
<b>Year 2</b>		
Expenses	23,334	
Equity		23,334
<i>To recognise expense for equity-settled share-based payment for Year 2 (1,000 x 4 x 10 - 16,666)</i>		

Under Approach A, the grant-date fair value of the equity instruments granted is recognised, except for those granted to the employee who has already left.

	<i>Debit</i>	<i>Credit</i>
<b>Approach B</b>		
<b>Year 1</b>		
Expenses	16,666	
Equity		16,666
<i>To recognise expense for equity-settled share-based payment for Year 1 (1,000 x 5 x 10 x 1/3)</i>		
<b>Year 2</b>		
Equity	16,666	
Expenses		16,666
<i>To recognise expense for equity-settled share-based payment for Year 2 (0 - 16,666)</i>		

Under Approach B, the previously recognised portion of the grant-date fair value of the equity instruments is reversed, because no equity instruments would have been expected to meet the non-market performance condition under the original terms, estimated at the date of cancellation. Because E estimates at the cancellation date that the share-based payment would have been forfeited, the share-based payment expense is trued up to an estimate of zero.

## 9.4 Replacements

*IFRS 2.28(c), BC233*

Sometimes a share-based payment is granted as a replacement for another share-based payment that is cancelled. In this case, the principles of modification accounting are applied. The basis for conclusions to IFRS 2 explains that the reason for permitting a cancellation and a new grant to be accounted for as a modification is that the IASB could not see a difference between those two transactions and a re-pricing, being a change in the exercise price.

*IFRS 2.28(c)*

To apply modification accounting, the entity identifies the new equity instruments granted as a replacement for cancelled equity instruments on the date on which the new equity instruments are granted.

*IFRS 2.28(c)*

If the entity does not identify a new equity-settled plan as a replacement for a cancelled equity-settled plan, then the two plans are accounted for separately. For example, if a new equity-settled share-based payment is offered and an old equity-settled share-based payment is cancelled, but the new plan is not identified as a replacement plan for the cancelled plan, then the new grant is recognised at its grant-date fair value and the original grant is accounted for as a cancellation.

*IFRS 2.28(c)*

IFRS 2 specifies that identification of a new grant as a replacement award is required on the date of the new grant. However, the accounting standard is silent on the question of whether the cancellation should also be on the same date as the new grant. Judgement is required to determine whether the facts and circumstances demonstrate that the arrangement is a modification if time has passed between the cancellation and the identification of a new grant.

*IFRS 2.28(c)*

When modification accounting is applied, the entity accounts for any incremental fair value in addition to the grant-date fair value of the original award. In the case of a replacement, the incremental fair value is the difference between the fair value of the replacement award and the net fair value of the cancelled award, both measured at the date on which the replacement award is issued. The 'net fair value' is the fair value of the cancelled award measured immediately before the cancellation, less any payment made to the employees on cancellation.



### Example 9.4.1 – Replacement award with incremental fair value

On 1 January Year 1, Company R grants 1,000 share options to its CEO, subject to a four-year service condition. The grant-date fair value of a share option is 8; the total grant-date fair value of the award is 8,000.

At the end of Year 2, the fair value of the share options has decreased to 3. To restore the economic position of the employee, R cancels the original award and grants a new award: 1,000 share options with a fair value at the date of replacement of 8, subject to a remaining service period until 31 December Year 4 (i.e. two years of service after the replacement date are required). R identifies the new award as a replacement award for the original award. The incremental fair value per equity instrument is 5 (8 - 3).

R accounts for the transaction based on the following amounts.

End of	Expense for the original award	Expense for the incremental fair value of the replacement award	Total expense
Year 1	2,000 <sup>1</sup>	-	2,000
Year 2	2,000 <sup>1</sup>	-	2,000
Year 3	2,000 <sup>1</sup>	2,500 <sup>2</sup>	4,500
Year 4	2,000 <sup>1</sup>	2,500 <sup>2</sup>	4,500
Total	8,000	5,000	13,000

**Notes**

- 1,000 × 8 × 1/4.
- 1,000 × 5 × 1/2.

The total expense reflects the grant-date fair value of the original award of 8,000 plus the incremental fair value of the replacement award of 5,000.

If R does not identify the new grant as a replacement award, then it would apply cancellation accounting for the original award in Year 2 and the normal requirements for equity-settled share-based payments for the new award.

End of	Expense for the original award	Expense for the new award	Total expense
Year 1	2,000 <sup>1</sup>	-	2,000
Year 2	6,000 <sup>2</sup>	-	6,000
Year 3	-	4,000 <sup>3</sup>	4,000
Year 4	-	4,000 <sup>3</sup>	4,000
Total	8,000	8,000	16,000

**Notes**

- 1,000 × 8 × 1/4.
- 1,000 × 8 × 3/4.
- 1,000 × 8 × 1/2.

The total expense reflects the grant-date fair value of the original award of 8,000 plus the grant-date fair value of the second award of 8,000.

An entity may create a new, more beneficial share-based payment plan as a replacement for an old plan, but not formally cancel the old plan – e.g. because it would be disadvantageous for tax purposes to do so. Employees are expected to, and do, cancel their participation in the old plan and join the new one. Together, the entity and the employees are able to identify the new plan as a replacement, but the issue is whether it is eligible to be accounted for as a replacement if the old plan continues to exist. If there is sufficient evidence to establish a clear link between the employees' cancellation of participation in the old plan and acceptance of the share-based payment under the new plan and of the entity's expectation and intent for the new plan to replace the old plan, then in our view it is acceptable to apply replacement accounting. If the new plan is not identified as a replacement of the old plan, then cancellation accounting for the old plan would be applied.



#### Example 9.4.2 – New plan without cancelling old plan

Company S establishes a plan on 1 January Year 1. Under the plan, an employee is required to participate in a savings plan to be eligible to buy shares at a discount to the grant-date price of the share. The share-based payment is in substance a share option with a non-vesting condition, being the requirement to save. In April Year 2, due to a decrease in the fair value of the equity instruments granted, S establishes a new more beneficial plan offered to the employees participating in the old plan and indicates to employees that this is intended to be a replacement. S does not close or cancel the old plan because otherwise the employees would lose tax benefits related to amounts already saved in the old savings plan. Employees can participate in either of the plans up to a cumulative savings amount of 200 per month.

In April Year 2, Employee E notifies S that it has stopped contributing to the old plan and will start contributing to the new plan from May Year 2.

In this case, we believe that it is appropriate to account for the share-based payment *for this employee* applying the principles of replacement accounting, even though the employer did not cancel the old plan because in a single communication the employee has cancelled their participation in the old scheme and identified the new scheme as a replacement.

For the accounting for replacement awards issued in a business combination, see [Section 12](#).

# 10 Group share-based payments

## Overview

- IFRS 2 *Share-based Payment* applies not only to transactions involving an entity's own shares but also to transactions involving the shares of another group entity (a group share-based payment).
- In a group share-based payment:
  - the 'receiving entity' is the entity that receives goods or services in a share-based payment transaction;
  - the 'settling entity' is the entity that has the obligation to settle the share-based payment transaction; and
  - the 'reference entity' is the entity whose equity instruments are granted or on whose equity instruments a cash payment is based.
- A share-based payment in which the receiving entity, the settling entity and the reference entity are in the same group from the perspective of the ultimate parent is a group share-based payment in the scope of IFRS 2 from the perspective of both the receiving and the settling entities.
- A share-based payment that is settled by an external shareholder is also in the scope of IFRS 2 from the perspective of the receiving entity, as long as the reference entity is in the same group as the receiving entity.
- A receiving entity without any obligation to settle the transaction classifies a share-based payment transaction as equity-settled.
- A settling entity classifies a share-based payment transaction as equity-settled if it is obliged to settle in its own equity instruments, and otherwise as cash-settled.
- The normal recognition and measurement requirements for equity-settled and cash-settled share-based payment transactions apply.
- Recharge arrangements do not affect the classification of the share-based payment.
- In our view, if the recharge is clearly linked to the share-based payment, then it should be accounted for separately from the share-based payment, but as an adjustment to the capital contribution recognised in respect of the share-based payment.
- If the recharge is not clearly linked to the share-based payment, then it is also accounted for separately from the share-based payment, and the entity considers whether it is in the scope of another accounting standard.

## 10.1 Scope of this section

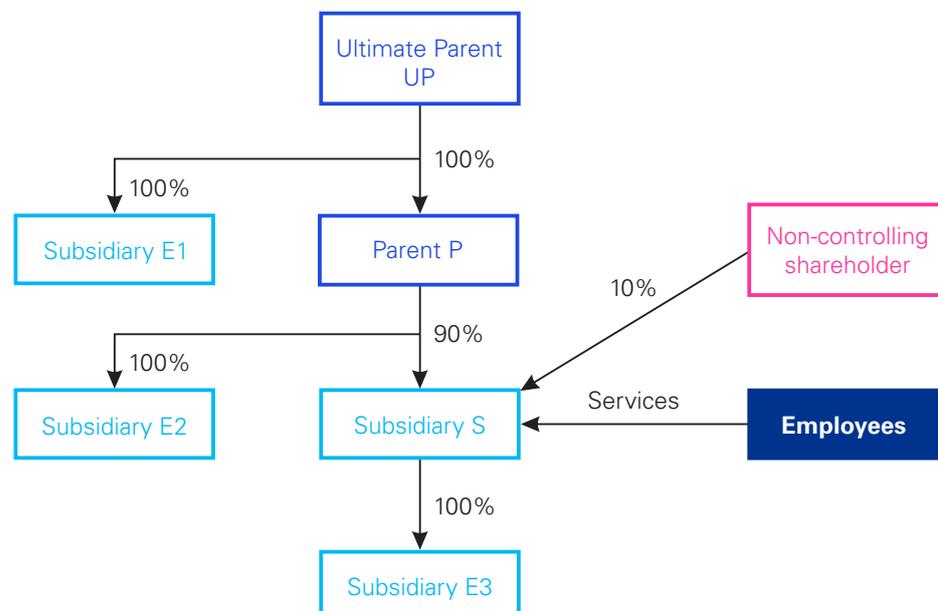
### 10.1.10 Background

IFRS 2.2, 3A

A share-based payment transaction in a group context may involve more than one entity in delivering the benefit to the group employees providing services. For example, a parent may grant its own equity instruments to employees of its subsidiary. From the perspective of the parent's consolidated financial statements, this transaction is a share-based payment in the scope of IFRS 2 (see Chapter 3.1). As discussed in this section, the transaction is also a share-based payment in the scope of IFRS 2 from the perspective of the parent's separate financial statements, even though it is the subsidiary that receives the services from the employees. It is also a share-based payment in the scope of IFRS 2 from the perspective of the subsidiary's financial statements, even though it is the parent that has the obligation to settle the transaction and it is not the subsidiary's own shares that are granted to the employees. The requirements for group share-based payments apply to the separate, individual and consolidated financial statements of a group entity. This section focuses on the requirements in the separate financial statements of the parent and in the financial statements of the subsidiary for arrangements meeting the definition of a group share-based payment.

In this section, when reference is made to the financial statements of an entity, it includes any separate financial statements, individual financial statements of the entity and consolidated financial statements that it might prepare of the subgroup of which it is the parent, unless otherwise noted. An entity that has no subsidiaries, but which has an investment in an associate and/or an interest in a joint arrangement, may prepare individual financial statements.

### 10.1.20 Definition and scope



Using this diagram, examples of a share-based payment arrangement that involves two entities include:

- Parent P grants its own equity instruments or a cash payment based on its own equity instruments to the employees of Subsidiary S; and
- S grants equity instruments of P or a cash payment based on the equity instruments of P to its own employees.

P is not part of the reporting entity when S prepares its financial statements. Share-based payment arrangements that involve entities outside the reporting entity are referred to as ‘group share-based payment arrangements’, if the other entity is, from the perspective of Ultimate Parent UP, in the same group as the reporting entity.

*IFRS 2.3A*

If, for example, a shareholder grants equity instruments of the reporting entity, or a cash payment based on those equity instruments, to parties that have supplied goods or services to the reporting entity, then such a transaction is a share-based payment transaction in the scope of IFRS 2 from the perspective of the reporting entity. Similarly, if the shareholder grants equity instruments, or a cash payment based on those equity instruments, of the reporting entity’s parent or another entity in the same group as the reporting entity to parties that have supplied goods or services to the reporting entity, then that grant is a group share-based payment transaction.

*IFRS 2.B52(b)*

If a reporting entity, rather than, for example, the shareholder, grants equity instruments of its parent or equity instruments of another entity in the same group as the reporting entity (or a cash payment based on those equity instruments) to parties that have supplied goods or services to the reporting entity, then such a transaction is a share-based payment transaction in the scope of IFRS 2 from the perspective of the reporting entity.

*IFRS 2.2A*

When considering the application of IFRS 2 to group share-based payments, the definition of a share-based payment arrangement may appear to be narrow. If in the definition the term ‘entity’ is read as the reporting entity, then a payment in cash or other assets of another group entity or a shareholder would not be covered because the definition reads (emphasis added): “... to receive (a) cash or other assets *of the entity* for amounts that are based on the price (or value) of equity instruments (including shares or share options) *of the entity* or another group entity, or (b) equity instruments ...” In our view, the term ‘entity’ as emphasised in the definition should be read as including other group entities and shareholders. We believe that this broader reading is appropriate based on the IASB’s stated objective for the group cash-settled share-based payment transactions amendment to IFRS 2.

As explained in [Chapter 3.1](#), this handbook distinguishes between the following types of share-based payment transactions:

1. share-based payment transactions that involve only the supplier of goods or services and the reporting entity – i.e. the reporting entity receives the goods or services and settles the transaction in its own equity instruments or in a cash payment based on the price (or value) of its own equity instruments; and
2. share-based payment transactions that involve the supplier, the reporting entity and at least one other group entity or a shareholder of any group entity (group share-based payment transactions).

Scope issues for the first type of share-based payment transactions are discussed in [Section 3](#). Additional scope issues that arise in group share-based payment transactions, including shareholder transactions, are discussed in this section.

In some cases, group share-based payment transactions involve the supplier of the goods and services and more than one group entity. The relevant entities in a group share-based payment transaction can be described as follows:

- a ‘receiving entity’ is the entity that receives goods or services in a share-based payment transaction; and
- a ‘settling entity’ is the entity that has the obligation to settle the share-based payment transaction.

In some group share-based payments, intermediate entities are involved – e.g. when an entity’s parent grants a share-based payment to a subsidiary of that entity. For further discussion, see [10.6.10](#).

Additionally, group share-based payments may involve equity instruments of another entity within the group or a cash payment based on the value of that other group entity's instruments. To help describe the scope and classification of group share-based payments, in this handbook the term 'reference entity' is used to describe the entity whose equity instruments are granted or on whose equity instruments the transfer of cash or other assets is based.

Using these terms, we believe that most group share-based payment transactions discussed in this section can be described as follows.

A group share-based payment transaction is one in which the receiving entity and the reference entity are in the same group from the perspective of the ultimate parent and which is settled either by an entity in that group or by an external shareholder of any entity in that group.

In the definition above, the receiving entity, settling entity and reference entity can be three different entities. Alternatively, two entities may be the same as long as the third entity is a different entity in order to meet the definition of a group share-based payment. If all three entities are the same, then the share-based payment is in the scope of [Sections 3 and 4](#).

#### *IFRS 2.BC19–BC21*

Settlements by a shareholder are included in the scope of group share-based payments because they can be seen in substance as two transactions: (1) the entity has reacquired equity instruments for no consideration; and (2) the entity has received services as consideration for equity instruments issued to the employees. The second transaction is a share-based payment transaction.

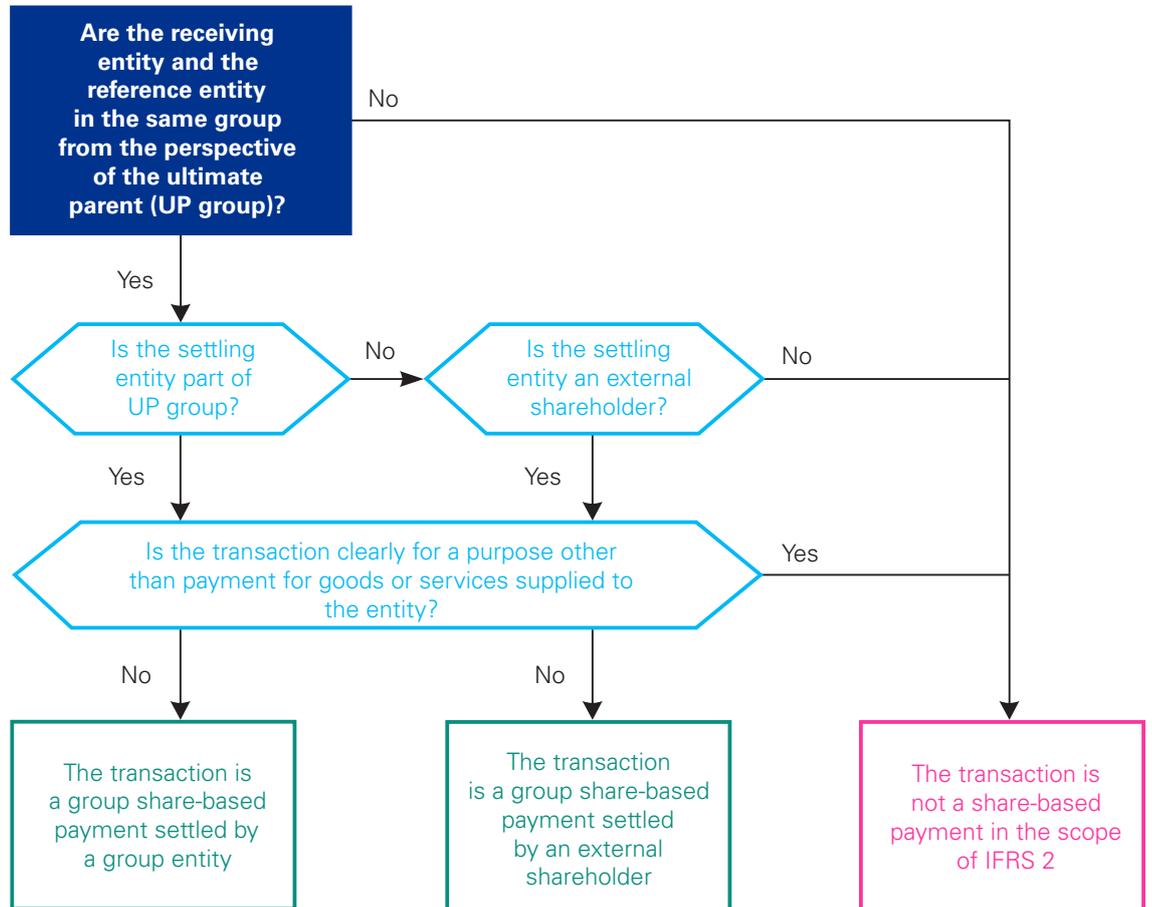
Because the consequences are different for the settling entity (see [10.1.30](#) and [40](#)), a distinction is made between:

- group share-based payment transactions that are settled by a group entity; and
- group share-based payment transactions that are settled by an external shareholder.

In this handbook, the term 'external shareholder' is used to denote any shareholder that is outside the group but is a shareholder of any entity in the group.

If the share-based payment is consideration for services, then in some cases it might be difficult to determine whether it is the entity or the entity's shareholders that receive the service. For example, an entity's shareholder grants a share-based payment to members of the entity's management. The non-market performance condition is completion of a pending sale of the entity. In our view, management's services are received by the entity rather than received only by the shareholders, because it is one of management's normal duties to act in the best interest of the entity's shareholders. The entity might also benefit from the sale in other ways – e.g. additional sources of financing, enhanced liquidity and access to new markets. Therefore, this share-based payment should be reflected in the financial statements of the entity.

The following flowchart summarises the requirements for determining whether a share-based payment that involves different entities is a group share-based payment.



**10.1.30**

**Group share-based payment transactions settled by group entity**

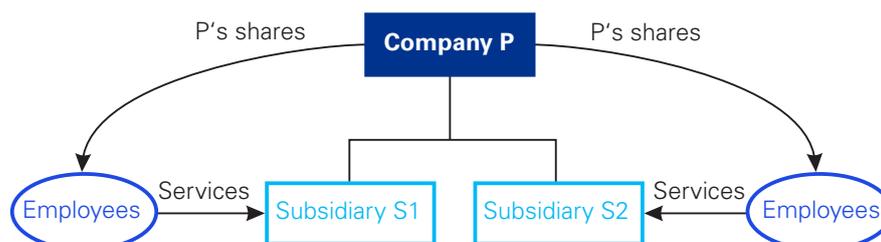
*IFRS 2.43A–43C*

In all scenarios in which the receiving entity, the reference entity and the settling entity are in the same group from the perspective of the ultimate parent, the share-based payment transaction is in the scope of IFRS 2 in the financial statements of the receiving and the settling entity. A group entity that is only a reference entity does not account for the transaction, because it is not a party to the arrangement.

A common example of a group share-based payment transaction is one in which the parent grants its own shares to employees of its subsidiaries, as illustrated in the following example.

**Example 10.1.1 – Parent grants its own shares to employees of its subsidiaries**

Parent P grants its own shares to the employees of Subsidiaries S1 and S2. The grant is subject to the condition that the employees stay in service within P's group for a specified period.



From the perspective of P's consolidated financial statements, only the employees and one entity are involved; P, as the reporting entity, receives the services and settles the transaction in its own equity instruments. Accordingly, from this perspective, the transaction is a share-based payment transaction without considering the additional group share-based payment features and therefore is in the scope of IFRS 2. For a simplified description of a share-based payment without group share-based payment features, see [Chapter 3.1](#).

From the perspective of the separate financial statements of P, and from the perspective of the financial statements of S1 and S2, the definitions including the features for group share-based payment transactions should be considered because, from their perspectives, multiple entities are involved.

- From the perspective of the financial statements of S1 and S2, the transaction is a share-based payment transaction in the scope of IFRS 2, even though S1 and S2 do not have an obligation to settle the transaction. This is because the receiving entities (S1 and S2) are in the same group as the reference entity (P) and the settling entity (P) is also in that group.
- From the perspective of the separate financial statements of P, the transaction is a share-based payment in the scope of IFRS 2, even though P does not receive the services directly. This is because the settling entity P is also the reference entity and in the same group as the receiving entities.

The analyses and conclusions are the same irrespective of whether P grants shares of S1 or S2.

The analysis in Example 10.1.1 is the same if the transaction is settled in cash or in equity, as long as the cash payment is based on the price (or value) of an equity instrument of a group entity. See [Chapter 4.2](#).

**Example 10.1.2 – Parent grants a cash payment based on its own shares to employees of its subsidiaries**

Modifying [Example 10.1.1](#), the share-based payment is settled in cash rather than in equity. The scope conclusions are the same, because the receiving entities, the reference entity and the settling entity are in the same group – i.e. it does not matter whether the transaction is settled in equity instruments or in cash based on equity instruments.

The transaction is a share-based payment in the scope of IFRS 2 from the perspective of:

- P's consolidated financial statements;
- P's separate financial statements; and
- S1's and S2's financial statements.

The analyses and conclusions are the same irrespective of whether the cash payment is based on S1's or S2's shares.

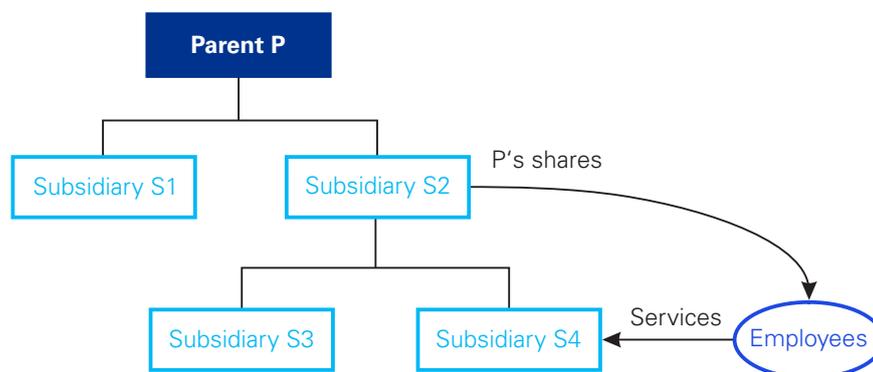
IFRS 2.A

In determining whether the receiving entity, the reference entity and the settling entity are in the same group, an evaluation is made from the perspective of the ultimate parent.



### Example 10.1.3 – Intermediate holding company grants ultimate parent’s shares to employees of its subsidiary

Subsidiary S2 grants shares of its Parent P to the employees of its Subsidiary S4. The grant is subject to the condition that the employees stay in service within S2’s group for a specified period.



From the perspective of P’s consolidated financial statements, the transaction is in the scope of IFRS 2, because the reporting entity (P group) receives services and settles the transaction in its own equity instruments.

From the perspective of S2’s consolidated financial statements, the transaction is also in the scope of IFRS 2, because the receiving entity (S2’s group), the reference entity (P) and the settling entity (S2’s group) are in the same group from the perspective of the ultimate parent (P). In other words, the evaluation of whether the entities involved are in the same group is *not* made from the perspective of the reporting entity for which the financial statements are being considered – i.e. the S2 group.

From the perspective of S2’s separate financial statements, it is also a transaction in the scope of IFRS 2, because the receiving entity (S4), the reference entity (P) and the settling entity (S2) are in the same group from the perspective of the ultimate parent (P).

The same analysis and conclusion apply to the financial statements of S4.

For a discussion of the scope question relating to intermediate entities that are not part of the arrangement – e.g. if P rather than S2 had the obligation to settle, see [10.6.10](#).

IFRS 2.A

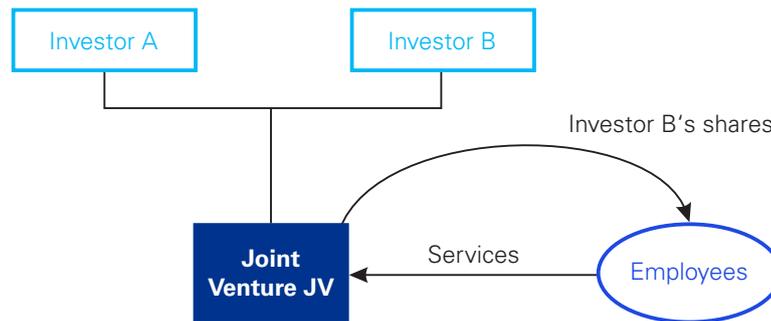
The requirement to treat transactions involving instruments of another entity as a share-based payment applies only to transactions involving the equity instruments of a group entity. The determination of whether another entity is a group entity is based on the definition of a group – i.e. a parent and all of its subsidiaries – from the perspective of the ultimate parent.

Therefore, a transaction in which the entity receives services from its employees and the employees receive equity instruments of a non-group shareholder is outside the scope of IFRS 2 from the perspective of the reporting entity (see [Example 10.1.4](#)).



### Example 10.1.4 – Joint venture grants shares of investor to its employees

Joint Venture JV, a joint venture of Investor A and Investor B, grants shares of B to its employees. The grant is subject to the condition that the employees stay in service with JV for a specified period.



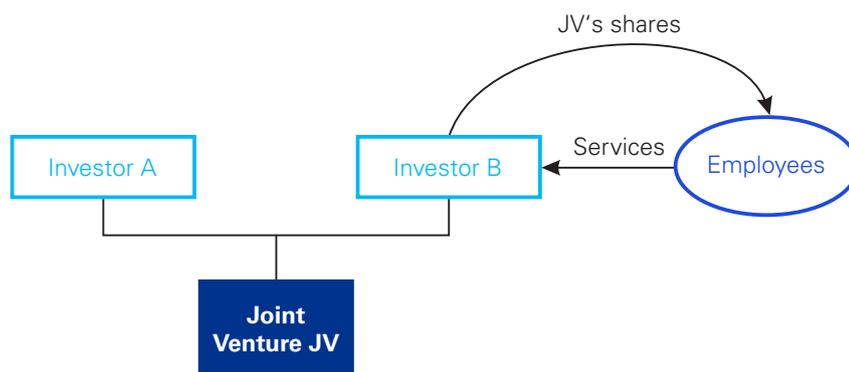
In this example, the grant is not a share-based payment in the scope of IFRS 2 from the perspective of the reporting entity (JV), because the receiving entity (JV) and the reference entity (B) are not in the same group.

Also, a transaction in which the reporting entity receives services from its employees and the employees receive equity instruments of a joint venture or associate is outside the scope of IFRS 2 from the perspective of the reporting entity (see [Example 10.1.5](#)).



### Example 10.1.5 – Investor grants shares of the joint venture to its employees

Investor B, a shareholder of Joint Venture JV, grants shares of JV to B's employees. The grant is subject to the condition that the employees stay in service with B for a specified period.



In this example, the grant of shares is not a share-based payment in the scope of IFRS 2 from the perspective of the reporting entity (B) because the receiving entity (B) and the reference entity (JV) are not in the same group.

However, when a grant of equity instruments of a joint venture or of an associate is provided by the reporting entity directly to its employees, then in our view the transaction is an employee benefit in the scope of IAS 19 *Employee Benefits* to be accounted for by the reporting entity.

## 10.1.40

### Group share-based payment transactions settled by external shareholder

*IFRS 2.3A*

A group share-based payment transaction also includes transactions settled by a party that is an external shareholder, as long as the receiving entity and the reference entity are under common control by the same ultimate parent and are therefore in the same group. An 'external shareholder' is any shareholder that is outside that group but is a shareholder of any entity in the group. Examples of external shareholders include parties holding non-controlling interests in subsidiaries of the group or any shareholder of the ultimate parent.

*IFRS 2.3A, B50*

Group share-based payment transactions that are settled by an external shareholder are in the scope of IFRS 2 from the perspective of the receiving entity if the reference entity is in the same group as the receiving entity.

IFRS 2 does not clearly address the perspective of the settling shareholder. Transactions settled by an external shareholder, depending on specific circumstances, can be in the scope of IFRS 2 in either the receiving entity or the settling entity, but not in both at the same time. Which entity accounts for the transaction in the scope of IFRS 2 depends on whether the reference entity belongs to the group of the receiving entity or to the group of the settling external shareholder. Therefore, as discussed in the next few paragraphs, identification of the reference entity is a key factor in determining whether a transaction is in the scope from the perspective of the settling entity.

### Settlement by external shareholder when reference entity is in same group as receiving entity

*IFRS 2.3A*

If a shareholder that is not a group entity settles by granting equity instruments of the receiving entity (or a cash payment based on those equity instruments), then the transaction is in the scope of IFRS 2 from the perspective of the receiving entity.

*IFRS 2.3A(b), B50*

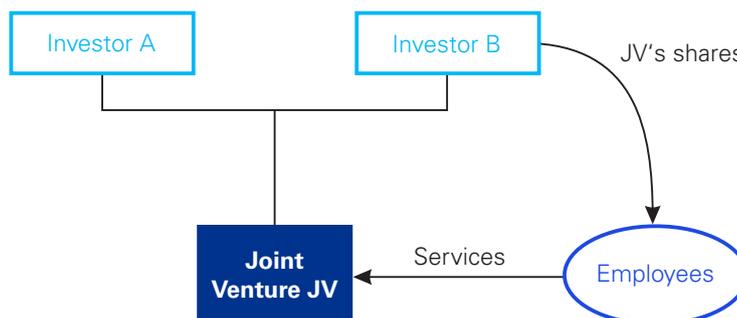
However, in our view such a transaction is not a share-based payment in the scope of IFRS 2 from the perspective of the shareholder. This is because the reference entity is not in the same group as the shareholder settling the transaction.

If the reporting entity receives services from its employees and the employees receive equity instruments of a shareholder that is not a group entity, but the number of equity instruments received by the employees is based on the value of the reporting entity's equity instruments, then the transaction is in the scope of IFRS 2 from the perspective of the reporting entity. This is because, in such a case, the reporting entity is identified as the reference entity because the employees receive assets – the shareholder's equity instruments – based on the value of the reporting entity's equity instruments. The transaction is also in the scope of IFRS 2 from the perspective of the shareholder.



### Example 10.1.6 – External shareholder settles transaction in group shares

Investor B grants shares of Joint Venture JV to the employees of JV. The grant is subject to the condition that the employees stay in service with JV for a specified period.



From the perspective of B's financial statements, the grant is not in the scope of IFRS 2 because the reference entity (JV) is not in the same group as the settling entity (B).

From the perspective of JV's financial statements, the grant is a share-based payment in the scope of IFRS 2. This is because the reference entity (JV) is in the same group as the receiving entity (JV) and the transaction is settled by an external shareholder (B) – i.e. a shareholder of the group entity (JV).

### Settlement by external shareholder when reference entity is in shareholder's group

IFRS 2.2(a), 13A

If an external shareholder settles in or based on its own equity instruments, rather than in the receiving entity's equity instruments, which is addressed above, then the transaction is in the scope of IFRS 2 from the perspective of the shareholder. This is because the shareholder grants its own shares or a cash payment based thereon in return for receiving services. The fact that the shareholder receives the services only indirectly – i.e. via its investment, rather than directly – does not change this conclusion because the requirement to recognise unidentifiable goods or services applies.

IAS 8.10–12

From the perspective of the receiving entity in which the shareholder invests, the transaction is not generally in the scope of IFRS 2. This is because the receiving entity and the reference entity are not in the same group, because the reference entity is an external shareholder. The receiving entity will therefore apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and use its judgement to develop an appropriate accounting policy for the transaction.

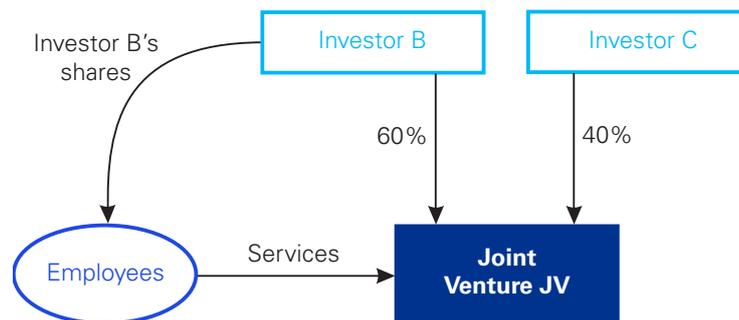
IFRS 2.2

IFRS 2 also applies to transactions in which the reporting entity grants equity instruments of the entity's parent or another entity in the same group as the reporting entity to parties that have supplied goods or services to another party in the group.



### Example 10.1.7 – External shareholder settles transaction in own shares

On 1 January Year 1, Investor B grants its own shares to the employees of Joint Venture JV. The grant is subject to the employees staying in service with JV for one year. B owns 60% of JV and Investor C holds the remaining 40%. The grant date of the award is 1 January Year 1 and its fair value at that date is 600.



In contrast to [Example 10.1.6](#), from the perspective of B's financial statements the transaction is a share-based payment in the scope of IFRS 2 (see above).

From the perspective of JV's financial statements, the grant of shares is not a share-based payment in the scope of IFRS 2. This is because the reference entity (B) is outside the group to which the receiving entity (JV) belongs. As no specific accounting standard addresses the transaction, JV applies IAS 8 and uses its judgement to develop an appropriate accounting policy.

Applying IAS 8, JV develops an accounting policy based on the requirements of IFRS 2. JV has no obligation to settle the transaction with its employees and therefore accounts for the transaction as an equity-settled -settled share-based payment transaction. JV recognises an expense over the vesting period (see [10.2.10](#)).

During Year 1, JV recognises the grant-date fair value of equity instruments granted over the vesting period. The cumulative effect of the entry is as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses	600 <sup>1</sup>	
Equity <sup>2</sup>		600
<i>To recognise the grant-date fair value of equity instruments granted over the vesting period</i>		

#### Notes

- Grant-date fair value of 600.
- For a discussion of presentation of the credit entry in equity, see [6.10.20](#).

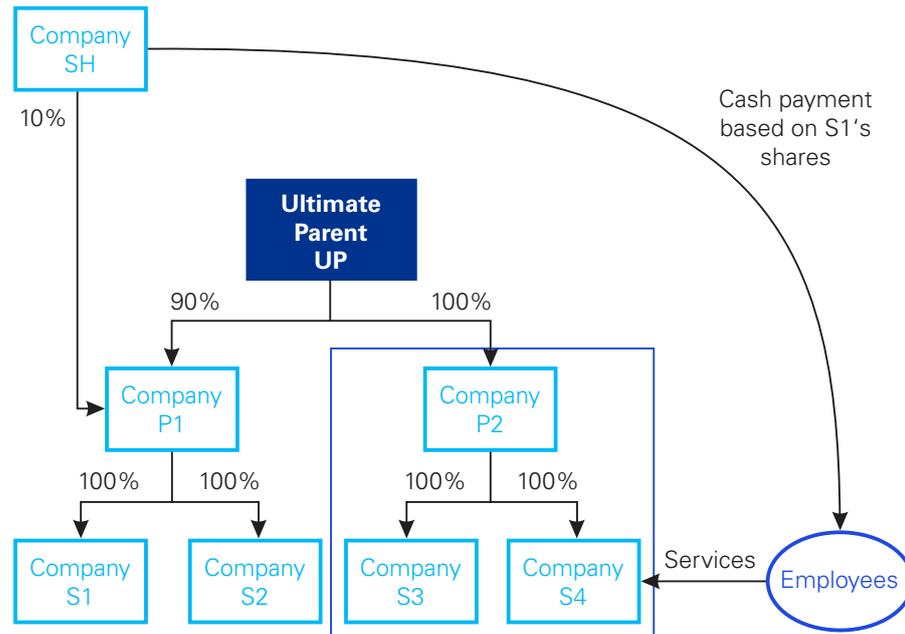
## Indirect relationships

The following example illustrates the consequences of the scope requirements for group share-based payments. It demonstrates that both the settling entity and the reference entity can have indirect relationships with the employee and the entity receiving services in the legal and operating structure, but the transaction would still be in the scope of IFRS 2. That is, the settling entity is not required to be the immediate or ultimate parent or shareholder of the entities that receive services from employees and the reference entity can be an entity other than the settling entity or the receiving entity.



### Example 10.1.8 – Indirect relationships and group share-based payments

Company SH, a shareholder of Company P1 with a 10% equity interest in P1, grants a cash payment based on Company S1's shares to the employees of Company S4.



The transaction is a share-based payment transaction in the scope of IFRS 2 in the consolidated financial statements of Company P2 because:

- the reference entity (S1) is part of the group of the ultimate parent of the receiving entity (P2 group); and
- the settling entity (SH) is a shareholder of an entity in that group (UP group).

The transaction is also a share-based payment transaction in the scope of IFRS 2 in the financial statements of S4 because:

- the reference entity (S1) is part of the group of the ultimate parent of the receiving entity (S4); and
- the settling entity (SH) is a shareholder of an entity in that group (UP group).

The transaction is not a share-based payment transaction in the scope of IFRS 2 in the financial statements of SH (see [Example 10.1.7](#)).

The transaction is also not a share-based payment in the scope of IFRS 2 in the financial statements of Companies P1, S1, S2 or S3, because they are neither receiving nor settling entities.

For a discussion of the scope question relating to the separate financial statements of P2 – i.e. an intermediate entity – see [10.6.10](#).

## 10.2 Classification of group share-based payment arrangements

### 10.2.10 Classification principles

Once an entity has determined that a share-based payment transaction is in the scope of IFRS 2 (see [Chapter 10.1](#)), it then determines the classification of the transaction.

*IFRS 2.43A–43C*

Classification of the share-based payment transaction depends on the nature of the award granted and whether the entity has an obligation to settle the transaction. If the entity has either an obligation to settle in its own equity instruments or no obligation to settle at all, then the transaction is accounted for as equity-settled. A settling entity that is not a receiving entity classifies a share-based payment transaction as equity-settled if it settles in its own equity instruments; otherwise, it classifies the transaction as cash-settled.

*IFRS 2.43A, B45–B61*

A share-based payment transaction is classified from the perspective of each reporting entity rather than by making a single classification determination. In a typical group share-based payment transaction involving the parent and the subsidiary, separate classification assessments are made for a single transaction from the following three perspectives:

- the consolidated financial statements of the parent;
- the separate financial statements of the parent; and
- the consolidated and separate financial statements of the subsidiary.

Therefore, a single share-based payment transaction could be classified as equity-settled in the financial statements of a subsidiary that receives the services and cash-settled in the group's consolidated financial statements, or vice versa.

### Equity instruments of another group entity – Own equity instruments vs cash or other assets

*IFRS 2.B50*

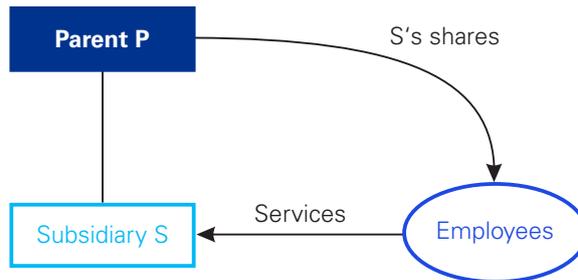
It is important to consider the perspective of the reporting entity and whether it is the separate entity or a consolidated group that is reporting when there is an obligation to settle the transaction in equity instruments of another group entity. This is because classification can differ between the separate and consolidated financial statements (see [Example 10.2.1](#)) and can also differ between the various consolidated financial statements in a multiple-level group structure (see [Example 10.2.2](#)).

From the perspective of the separate financial statements of the reporting entity, equity instruments of another entity in the group are classified as 'cash or other assets'. In contrast, from the group perspective, equity instruments of an entity within the reporting entity's group are considered to be own equity instruments. This is because the shares in a subsidiary form part of the non-controlling interests in the ultimate parent's consolidated financial statements and are therefore considered to be equity for the purposes of the consolidated financial statements of the group.



**Example 10.2.1 – Equity instruments viewed from the perspective of separate and consolidated financial statements**

Parent P grants a share-based payment to the employees of Subsidiary S. The payment will be settled in equity instruments of S.



In P's separate financial statements, S's equity instruments are those of another group entity and are therefore classified as cash or other assets.

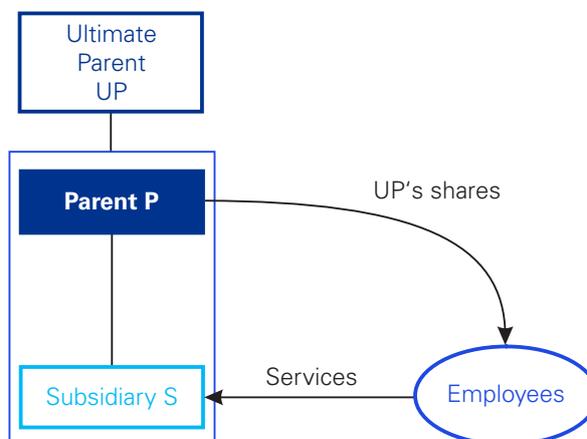
In contrast, in P's consolidated financial statements S's equity instruments are considered to be own equity instruments. This is because equity instruments of an entity that is part of the reporting entity – i.e. P Group – qualify as own equity instruments.

As explained above, equity instruments of an entity within the reporting entity's group are considered to be own equity instruments. However, from the perspective of the consolidated financial statements of an entity other than the ultimate parent, equity instruments of another entity in the group of that ultimate parent may or may not qualify as own equity instruments, depending on the level in the group at which the consolidated financial statements under consideration are prepared.



**Example 10.2.2 – Equity instruments viewed from different levels of consolidated financial statements**

Parent P grants a share-based payment to the employees of Subsidiary S. The payment will be settled in equity instruments of Ultimate Parent UP.



In UP's consolidated financial statements, UP's equity instruments qualify as own equity instruments.

In contrast, in P's consolidated financial statements, UP's equity instruments are classified as cash or other assets because UP is outside P's group.

The scope assessment differs from the classification assessment. In the scope assessment, it matters whether the reference entity is in or outside the group of the *ultimate parent*. In the classification assessment, it matters whether the equity instruments are those of a reference entity in or outside the group of the *reporting entity*.

## Classification in financial statements of settling entity

### Determining the settling entity

Identifying the settling entity in a group share-based payment is not always straightforward. For example, Parent P issues its own shares to Subsidiary S and S uses those shares to settle a share-based payment granted by Subsidiary B to its employees. In our view, determining which of P and S is the settling entity depends on the facts and circumstances. We believe that if S is an operating entity managing its own cash flows, then it is likely that S is the settling entity. Conversely, we believe that if S fully depends on P for its financing and has no operating activity (e.g. it is an entity that is used only to settle this transaction), then it is likely that S is only an agent acting on P's behalf and that P is the settling entity.

### Settling entity is also receiving entity

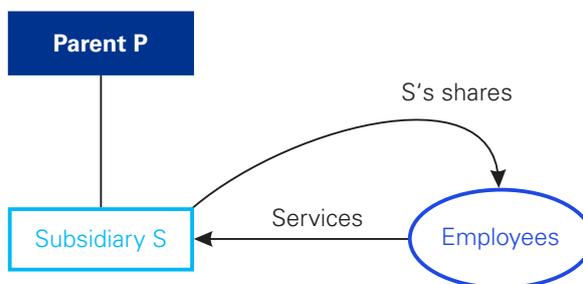
IFRS 2.43B(a)

A receiving entity classifies a group share-based payment transaction as equity-settled if it has an obligation to settle in its own equity instruments (for basic principles for classification, see [Chapter 4.2](#)).



#### Example 10.2.3 – Subsidiary grants own shares

Subsidiary S grants a share-based payment to its employees, which will be settled in equity instruments of S. As the receiving entity, S has an obligation to settle in its own equity instruments.



S accounts for the transaction in its financial statements as equity-settled. From S's perspective, this example is not a group arrangement, because only the counterparty and one entity are involved. Therefore, the classification can be assessed without reference to the classification requirements for group share-based payments.

However, from the perspective of the consolidated financial statements of Parent P this transaction is considered to be a group share-based payment transaction. Therefore, P also accounts for the transaction as equity-settled in its consolidated financial statements, because, from the perspective of P Group, it has an obligation to settle in equity instruments of the group.

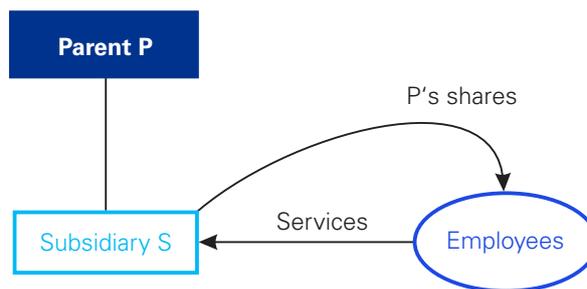
IFRS 2.43B

A receiving entity classifies a group share-based payment transaction as cash-settled if it has an obligation to settle in cash or other assets. 'Other assets' include the equity instruments of another group entity, including subsidiaries in the separate financial statements of the receiving entity.



**Example 10.2.4 – Subsidiary grants parent’s shares**

Subsidiary S grants a share-based payment to its employees, which will be settled in equity instruments of Parent P. This transaction is a group share-based payment, because the reference entity is not the same as the receiving entity and the settling entity, but is in the same group as those entities.



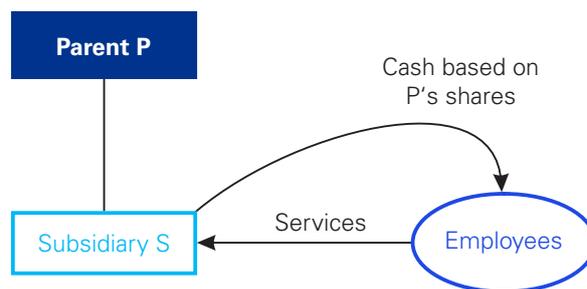
S, as the receiving entity, has an obligation to settle in cash or other assets because the equity instruments are not S's equity instruments. Therefore, S classifies the transaction in its financial statements as cash-settled.

P accounts for the transaction as equity-settled in its consolidated financial statements, because, from the perspective of P Group, it has an obligation to settle in its own equity instruments.



**Example 10.2.5 – Subsidiary grants cash payment based on parent’s shares**

Subsidiary S grants a share-based payment to its employees, which will be settled in cash based on Parent P's shares.



As the receiving entity, S has an obligation to settle in cash or other assets. Therefore, S classifies the transaction in its financial statements as cash-settled.

P also accounts for the transaction as cash-settled in its consolidated financial statements, because, from the perspective of P Group, it has an obligation to settle in cash or other assets.

The analysis and conclusion are the same irrespective of whether S granted a cash payment based on its own shares.

In [Examples 10.2.3, 4 and 5](#), P does not account for the transaction in its separate financial statements because P is neither a receiving entity nor a settling entity.

### Settling entity is not receiving entity

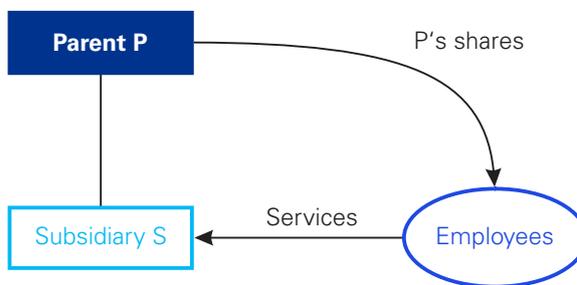
IFRS 2.43C

A settling entity classifies a group share-based payment transaction as equity-settled if it has the obligation to settle in its own equity instruments. If it has the obligation to settle in cash or other assets, then it classifies the transaction as cash-settled. From the perspective of the separate financial statements of the settling entity, other assets include the equity instruments of another group entity.



#### Example 10.2.6 – Parent grants own shares

Parent P grants a share-based payment to the employees of Subsidiary S, which will be settled in equity instruments of P.

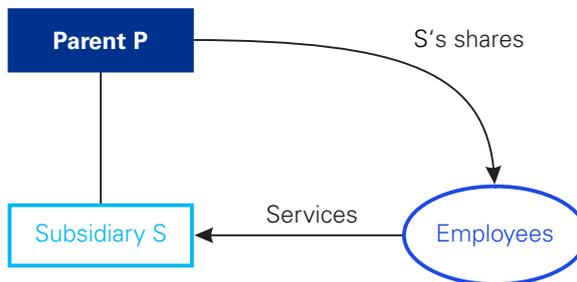


As the settling entity, P has the obligation to settle the payment in own equity instruments. P classifies the transaction as equity-settled in its separate and consolidated financial statements.



#### Example 10.2.7 – Parent grants subsidiary's shares

Parent P grants a share-based payment to the employees of Subsidiary S, which will be settled in equity instruments of S.

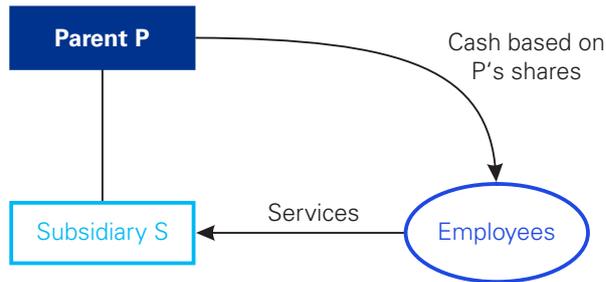


P classifies the transaction as cash-settled in its separate financial statements and as equity-settled in its consolidated financial statements (see [Example 10.2.1](#)).



**Example 10.2.8 – Parent grants cash payment based on own shares or on subsidiary’s shares**

Parent P grants a share-based payment to the employees of Subsidiary S, which will be settled in cash based on P’s shares.



From the perspective of P’s consolidated and separate financial statements, P as the settling entity has an obligation to settle in cash or other assets. Therefore, P classifies the transaction as cash-settled in its separate and consolidated financial statements.

The analysis and conclusion would be the same if P granted a cash payment based on S’s shares.

**Classification in financial statements of receiving entity without obligation to settle**

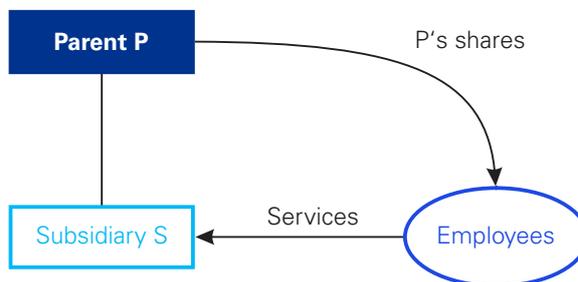
IFRS 2.43B(b)

A receiving entity classifies a group share-based payment transaction as equity-settled if it has no obligation to settle the transaction.



**Example 10.2.9 – Subsidiary receives services with no obligation to settle**

Parent P grants a share-based payment to the employees of Subsidiary S, which will be settled in equity instruments of P.



As the receiving entity, S has no obligation to settle the payment. S classifies the transaction in its financial statements as equity-settled.

The analysis does not change if P grants S’s shares or a cash payment based on P’s shares or on S’s shares, because in all scenarios the receiving entity (S) has no obligation to settle the transaction.

For a discussion of the classification from the perspective of the settling entity (P), see [Example 10.2.6](#).

*IFRS 2.43D*

If the receiving entity has no obligation to settle the transaction, then the settling entity may require the receiving entity to reimburse it for settling the transaction with the counterparty. Such an intra-group payment arrangement is often referred to as a 'recharge arrangement'. The existence of a recharge arrangement between the settling entity and the receiving entity does not change the character of the share-based payment transaction, and therefore would not affect the classification of the share-based payment transaction as equity-settled or cash-settled. For a discussion of the accounting for recharge arrangements, see [Chapter 10.4](#).

**Scope and classification conclusions illustrated**

The following diagrams summarise the scope question and classification of share-based payment transactions in eight standard scenarios.

**Equity instruments granted**

**Cash granted**

<p>P's shares</p> <p>S ← Services ← Employees</p>	<p>Based on P's shares</p> <p>S ← Services ← Employees</p>
P's consolidated financial statements <b>es</b> P's separate financial statements <b>es</b> S's financial statements <b>es</b>	P's consolidated financial statements <b>CS</b> P's separate financial statements <b>CS</b> S's financial statements <b>es</b>

<p>S's shares</p> <p>S ← Services ← Employees</p>	<p>Based on S's shares</p> <p>S ← Services ← Employees</p>
P's consolidated financial statements <b>es</b> P's separate financial statements <b>CS</b> S's financial statements <b>es</b>	P's consolidated financial statements <b>CS</b> P's separate financial statements <b>CS</b> S's financial statements <b>es</b>

<p>P's shares</p> <p>S ← Services ← Employees</p> <p>P → Services → Employees</p>	<p>Based on P's shares</p> <p>S ← Services ← Employees</p> <p>P → Services → Employees</p>
P's consolidated financial statements <b>es</b> P's separate financial statements <b>-</b> S's financial statements <b>CS</b>	P's consolidated financial statements <b>CS</b> P's separate financial statements <b>-</b> S's financial statements <b>CS</b>

<p>S's shares</p> <p>S ← Services ← Employees</p> <p>P → Services → Employees</p>	<p>Based on S's shares</p> <p>S ← Services ← Employees</p> <p>P → Services → Employees</p>
P's consolidated financial statements <b>es</b> P's separate financial statements <b>-</b> S's financial statements <b>es</b>	P's consolidated financial statements <b>CS</b> P's separate financial statements <b>-</b> S's financial statements <b>CS</b>

<b>es</b>	Equity-settled share-based payment transaction
<b>CS</b>	Cash-settled share-based payment transaction
<b>-</b>	No share-based payment transaction

## 10.3 Recognition and measurement

### 10.3.10 Accounting for group share-based payment transaction

IFRS 2.43A

After determining the classification of the share-based payment in the financial statements of the reporting entity (see [Chapter 10.2](#)), the recognition and measurement of the share-based payment transaction follows the accounting requirements for equity-settled share-based payments (see [Section 6](#)) or for cash-settled share-based payments (see [Section 7](#)).

Obligation to settle?	Nature of the award	Own equity instruments	Cash or other assets
		Yes	Equity-settled
No		Equity-settled	Equity-settled

#### Consequences of different classification in different financial statements

IFRS 2.43A

The amounts recognised for a single transaction in the financial statements of the receiving entity and the settling entity will usually differ if the classification of the transaction is different in the financial statements of the receiving entity and the settling entity, or different in the consolidated financial statements at different levels within the group.

Equity-settled share-based payments involving employees are measured once at grant date and the number of instruments is adjusted only to reflect the number of instruments for which any service and non-market performance conditions are satisfied. Neither changes in the fair value of the equity instruments nor changes between the estimated and actual outcome of any market or non-vesting conditions affect the accounting (see [Section 6](#)).

In contrast, the liability arising from a cash-settled share-based payment is adjusted to reflect changes in the fair value of the underlying equity instruments as well as in the estimated and actual outcome of vesting and non-vesting conditions, so that the liability is remeasured to equal the amount ultimately paid (see [Section 7](#)).

#### Accounting by receiving entity with no obligation to settle

IFRS 2.B53

A receiving entity that has no obligation to settle the transaction with the counterparty to the share-based payment transaction accounts for the transaction as equity-settled and recognises an expense, unless the goods or services received qualify for recognition as an asset, and an increase in its equity as a contribution from the parent.

#### Accounting by direct parent that settles

A settling entity recognises the credit entry in equity or liabilities, depending on the classification of the share-based payment transaction. However, there is no explicit guidance on how a settling entity that is different from a receiving entity accounts for the debit entry.

#### Equity-settled transactions

IFRS 2.13A

If a parent grants rights to its equity instruments to employees of a subsidiary, then the identifiable consideration received by the parent from the perspective of its separate financial statements for the equity instruments may be zero. If the identifiable consideration received is less than the fair value of the equity instruments granted (or liability incurred), then this typically indicates that other consideration – i.e. unidentifiable goods or services – has been or will be received.

In our view, if a parent grants rights to its own equity instruments to employees of a subsidiary, then the parent receives goods or services indirectly through the subsidiary in the form of an increased investment in the subsidiary. This is because the subsidiary receives services from employees that are paid for by the parent, thereby increasing the value of the subsidiary. Therefore, we believe that the parent should recognise in equity the equity-settled share-based payment, with a corresponding increase in its investment in the subsidiary in its separate financial statements. The amount recognised as an additional investment is based on the grant-date fair value of the share-based payment. In our view, the increase in investment and corresponding increase in equity for the equity-settled share-based payment should be recognised by the parent over the vesting period of the share-based payment. In recognising these amounts, the normal requirements for accounting for equity-settled share-based payments with employees should be applied (see [Chapter 6.9](#)).



### Example 10.3.1 – Illustration of parent and subsidiary accounting

On 1 January Year 1, Parent P grants 100 options over its own shares to an employee in Subsidiary S, subject to a one-year service condition. The grant-date fair value of a share option is 10.

The employee is expected to remain employed and ultimately does.

P classifies the share-based payment to S's employee as equity-settled and accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Cost of investment in S	1,000	
Equity		1,000
<i>To recognise grant-date fair value of equity instruments granted (100 x 10)</i>		

S classifies the share-based payment as equity-settled, because S receives the services without having an obligation to settle the transaction. S accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	1,000	
Equity (capital contributed from parent)		1,000
<i>To recognise services received</i>		

### Cash-settled transactions

Accounting for a share-based payment transaction that has been classified as cash-settled in a parent's separate financial statements is more complex than if it were classified as an equity-settled share-based payment (see above), as illustrated in the next paragraph.

Assuming that an investment in a subsidiary is not different from any other asset measured on a cost basis, the same principles of recognition of the increase in the carrying amount of the asset for the services received in a cash-settled share-based payment apply. As demonstrated in the guidance in [7.2.20](#) illustrating the effect of capitalising and remeasuring the cost of a cash-settled share-based

payment, a parent would capitalise the grant-date fair value of the liability. The effects of changes in the estimated and actual outcome of service and non-market conditions would adjust the grant-date fair value cost of the investment. Other remeasurements of the grant-date fair value would be recognised in profit or loss.

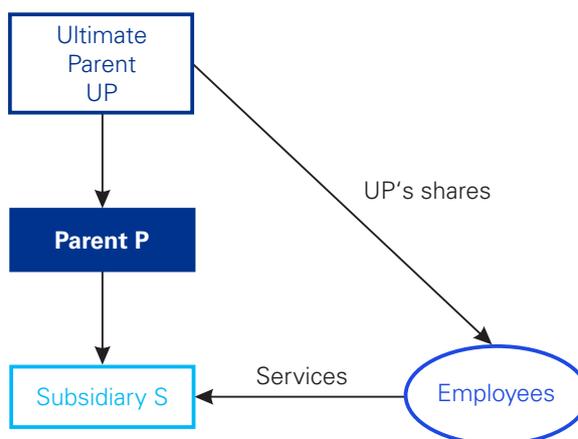
### Accounting by ultimate parent that settles

In some cases, the ultimate parent grants a share-based payment to a subsidiary in the group. As discussed above, the settling entity – in this case, the ultimate parent – recognises an increase in equity or liabilities depending on the classification of the share-based payment transaction. However, there is no explicit guidance in IFRS 2 regarding the debit entry. In our view, the grant of a share-based payment by an ultimate parent to a group subsidiary increases the value of the ultimate parent's direct or indirect investment in the subsidiary. Therefore, we believe that the ultimate parent should recognise the cost of the share-based payment as a cost of the investment in the subsidiary.



#### Example 10.3.2 – Ultimate parent settling transaction

Ultimate Parent UP grants a share-based payment to the employees of Subsidiary S and will settle the transaction in UP's own equity instruments. S is held indirectly by UP via Parent P.



In our view, P, as an intermediate parent, should choose an accounting policy regarding whether to recognise a share-based payment in its separate financial statements (see 10.6.10). We believe that, regardless of whether P recognises the transaction, the value of UP's investment in P increases by granting the share-based payment arrangement to S's employees, and therefore UP should recognise the cost of the share-based payment as a cost of investment in P.

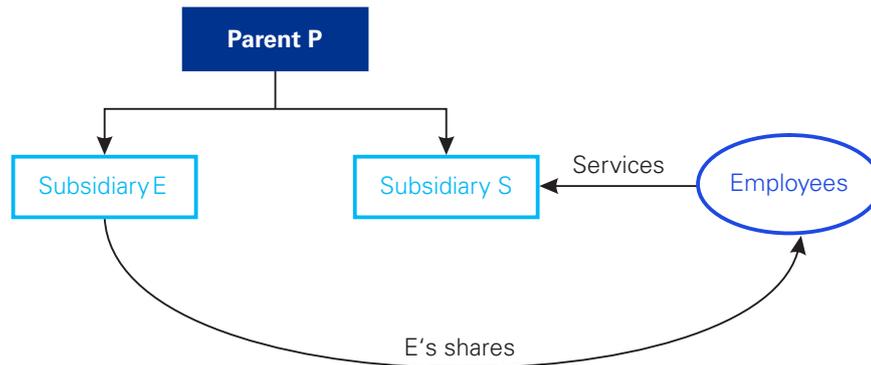
### Accounting by another group entity that settles

In our view, a settling entity with no direct or indirect investment in the entity receiving the services in a group share-based payment transaction should recognise the cost of the share-based payment in equity as a distribution to its parent over the vesting period. This is because the entity can be seen to be settling the transaction on behalf of its parent.



### Example 10.3.3 – Other group entity settling transaction

Parent P has Subsidiaries E and S. E grants a share-based payment to the employees of S and will settle the transaction in E's own equity instruments.



Because E neither receives services nor has an investment in S, we believe that E should recognise the cost of the share-based payment in equity as a distribution to P over the vesting period.

### Accounting for transfers of employees

Employees may transfer within the group during the vesting period of a share-based payment arrangement. In some circumstances, the share-based payment may lapse or vest on such a transfer and the employee may be offered a new share-based payment. In such cases, the normal requirements for employees leaving and joining share-based payment arrangements apply from the perspective of each entity (for a discussion of the accounting for forfeitures, see [Chapter 6.9](#)).

*IFRS 2.B59, B61*

In other circumstances, a parent (or another group entity) may grant to employees of a subsidiary rights to its equity instruments that are conditional on the employee providing service within the group, rather than to a specific entity. In such arrangements, the transfer of the employee will have no effect on the vesting of the share-based payment from the employee's point of view. Accordingly, IFRS 2 provides guidance relating to transfers within the group when the service requirement is subject to group-wide services (see the next paragraph).

*IFRS 2.B60–B61*

If the subsidiaries have no obligation to settle the transaction with their employees, then the transaction is accounted for as equity-settled. Each subsidiary measures the services received from the employee with reference to the parent's grant-date fair value of the equity instruments. If an employee subsequently fails to satisfy a vesting condition other than a market condition, such that there is a true-up of the share-based payment at the group level, then each subsidiary adjusts the amount previously recognised in its financial statements. If the employee transfers between two group entities during the vesting period, then this is not deemed to be a forfeiture from the perspective of the financial statements of the former employer or a new grant by the new employer.



### Example 10.3.4 – Transfer of employees when subsidiaries have no obligation to settle

On 1 January Year 1, Parent P grants 100 options over its own shares to an employee, subject to a three-year service condition within P's group. P's group comprises Subsidiaries S1, S2 and S3.

The grant-date fair value of a share option is 9. The employee is employed in S1 from 1 January Year 1 to 31 December Year 1. On 1 January Year 2, the employee is transferred to S2. On 31 May Year 3, the employee leaves S2 and the group and therefore does not meet the service condition.

P classifies the share-based payment to the employee as equity-settled and accounts for the transactions in its separate financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Cost of investment in S1	300	
Equity		300
<i>To recognise grant-date fair value of equity instruments granted (9 x 100 x 1/3)</i>		
<b>Year 2</b>		
Cost of investment in S2	300	
Equity		300
<i>To recognise grant-date fair value of equity instruments granted ((9 x 100 x 2/3) - 300)</i>		
<b>Year 3</b>		
Equity	600	
Cost of investment in S1		300
Cost of investment in S2		300
<i>To recognise true-up for failure to meet service condition</i>		

S1 classifies the share-based payment as equity-settled because it receives the services without having an obligation to settle the transaction. It accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	300	
Equity (capital contribution from parent)		300
<i>To recognise grant-date fair value of equity instruments granted for proportion of vesting period that employee served with S1 (9 x 100 x 1/3)</i>		

In Year 2 – i.e. when the employee leaves S1 – S1 does not adjust any previous entries, nor does it recognise any further expenses.

After the employee transfers to S2, S2 also classifies the share-based payment as equity-settled and accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Expenses	300	
Equity (capital contribution from parent)		300
<i>To recognise grant-date fair value of equity instruments granted for proportion of vesting period that employee served with S2 (9 x 100 x 1/3)</i>		

S2 does not recognise any catch-up on 1 January Year 2 for the cumulative expenses to date, because these have already been recognised by S1.

In Year 3, when the employee leaves the group, S1 and S2 each recognise a true-up for the failure to meet the service condition.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Equity (capital contribution from parent)	300	
Expenses		300
<i>To recognise subsidiary-specific true-up for failure to meet service condition</i>		

*IFRS 2.B60*

If the subsidiaries have an obligation to settle the transaction in cash or other assets, including in the equity instruments of a parent or another group entity, then each subsidiary:

- measures the services received with reference to the grant-date fair value of the equity instruments granted and for the proportion of the vesting period served with each subsidiary; and
- recognises any change in the fair value of the equity instruments during the employment period of the employees with each subsidiary, because the award is classified as cash-settled from the perspective of the subsidiaries.

In our experience, a group-wide service condition is less likely to be included in share-based payments in which the subsidiaries have an obligation to settle than in share-based payments in which the parent has the obligation to settle. IFRS 2 provides the high-level principles outlined above but no explicit guidance on how to apply them in practice. It also does not address the attribution to the subsidiaries of the changes in fair value occurring from vesting date to settlement date.

## 10.4 Recharge arrangements

### 10.4.10 Introduction

When a parent grants a share-based payment to employees of a subsidiary, the parent may require the subsidiary to make a payment to reimburse it for granting the share-based payment.

A common type of intra-group payment arrangement, or 'recharge arrangement', is when the amount recharged is equal to the difference between the exercise price of the options granted and the market price of the shares on the exercise date (i.e. exercise-date intrinsic value recharge arrangement) and it is settled in cash. However, in practice many types of recharges may exist.

*IFRS 2.43D, B45,  
IU 05-13*

IFRS Accounting Standards do not specifically address the accounting for recharge arrangements related to share-based payment transactions involving group entities or external shareholders. A receiving entity with no obligation to settle the transaction classifies the share-based payment in accordance with the normal classification requirements, regardless of any recharge arrangement. Therefore, the existence of a recharge arrangement between a parent and a subsidiary does not mean that in substance it is the subsidiary that has the obligation to the employees.

See [10.4.20–80](#) for the accounting in the financial statements of the subsidiary and the parent for recharge arrangements levied in respect of share-based payment transactions that are classified as equity-settled in both the consolidated financial statements of the parent and the financial statements of the subsidiary.

The guidance may also be applied by analogy to other share-based payment transactions – e.g. to those that are classified as cash-settled in the consolidated financial statements of the parent.

In our experience, recharges from the parent settling the transaction to the subsidiary receiving the services are usually settled in cash. For a discussion of the requirements when the recharge is settled by the subsidiary in shares of the parent rather than in cash, see [10.4.60](#); and for discussion of the requirements when the recharge is settled by the subsidiary either in cash or in the subsidiary's own shares, see [10.4.70](#).

### 10.4.20 Determining 'clearly linked' recharge arrangements

Determining the appropriate accounting treatment for a recharge arrangement will require judgement based on the terms and conditions of each arrangement. In our view, if the recharge is clearly linked to the share-based payment (see [10.4.30](#)), then it should be accounted for separately from the share-based payment, but as an adjustment of the capital contribution recognised in respect of the share-based payment.

In our view, in assessing whether a recharge is clearly linked to the share-based payment, the primary determinant should be whether the amount of the payment is based on the value of the share-based payment. The following are examples of situations in which we believe that a recharge would generally be considered to be clearly linked to the share-based payment:

- a payment based on the grant-date fair value of the equity-settled share-based payment (IFRS 2 charge);
- a payment based on the cost of the treasury share programme of the parent (parent's cost of acquiring the shares to settle its obligation to the employees of the subsidiary); and
- a payment based on the difference between the exercise price of the options and the market price of the shares on exercise date (intrinsic value recharge).

We believe that a recharge that is clearly linked to the share-based payment arrangement could also include, for example, some stated proportion of these bases.

In addition, if a recharge that is based on the value of a share-based payment is also based on the number of awards that vest or are exercised, then we believe that this provides additional evidence that the recharge is clearly linked to the share-based payment.

In our view, the timing of a recharge payment should not be a primary determinant of whether it is clearly linked to the share-based payment arrangement. However, if the parent articulates in advance of or at the same time as the grant that a recharge that is based on the value of the share-based payment is in respect of the share-based payment transaction, then we believe that this provides evidence that the recharge is clearly linked. If a parent levies a recharge well after the grant date (e.g. only when the options are exercised), with no prior communication of this intent and the parent having no history of having done so, then the timing of the recharge may weaken its link to the share-based payment.

*IFRS 9.2.1(h)*

If a recharge arrangement that is clearly linked to a share-based payment is a contractual (oral or written) arrangement, then in our view the recharge transaction should be recognised and measured by analogy to the requirements for cash-settled share-based payment transactions (see [Section 7](#)). We believe that accounting for a contractual recharge by analogy to cash-settled share-based payments is appropriate because:

- IFRS 2 applies to expenses relating to share-based payments; and
- IFRS 9 *Financial Instruments* does not apply to contractual expenses that are accounted for under IFRS 2.

Because the subsidiary recognises a capital contribution as part of the share-based payment arrangement, we believe that it is also appropriate for the subsidiary to recognise its reimbursement of the capital contribution to the parent as an adjustment of that capital contribution. The subsidiary should therefore recognise a recharge liability and a corresponding adjustment (debit) in equity for the capital contribution recognised in respect of the share-based payment. Similarly, because the parent recognises its capital contribution to the subsidiary as an increase in its investment in the subsidiary (see [10.3.10](#)), we believe that it is appropriate for the parent to account for the reimbursement by the subsidiary of this capital contribution by analogy to the requirements for cash-settled share-based payment transactions. The parent should therefore recognise a recharge asset and a corresponding adjustment (credit) to the carrying amount of the investment in the subsidiary.

### 10.4.30

#### **Recognition and measurement of 'clearly linked' recharge arrangements accounted for by analogy to IFRS 2**

For recharges accounted for by analogy to the requirements for cash-settled share-based payments (see [10.4.20](#)), we believe that the recharge should be accounted for from the time when the parent and the subsidiary have a shared understanding of the terms and conditions of the contract; this will often be before the subsidiary makes a payment to the parent to settle its obligation under the recharge arrangement. We believe that the subsidiary and the parent should measure the fair value of the recharge liability and asset initially at the date on which a shared understanding of the arrangement is established and, similar to the treatment of a share-based payment, the initial measurement of the recharge should be recognised as the services are provided in respect of the share-based payment.

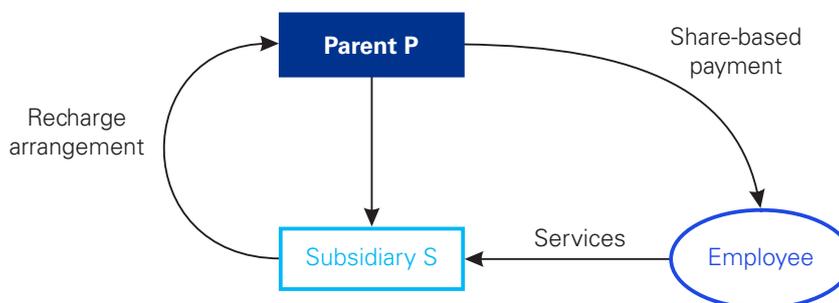
## Fixed recharges



### Example 10.4.1 – Recharges based on grant-date fair value

On 1 January Year 1, Parent P grants 10 share options to an employee of Subsidiary S, subject to a one-year service condition. The share-based payment is classified as equity-settled by P and S.

At grant date of the share-based payment, P and S enter into a recharge arrangement equal to the grant-date fair value of the share-based payment. The recharge is to be paid immediately after the vesting date. The recharge arrangement is considered to be clearly linked to the share-based payment.



Assume that the grant-date fair value of a share option is 5 and the total fair value of the share-based payment is 50; the employee is expected to provide the required service. Therefore, the measurement of the recharge asset and the recharge liability is measured at 50 as long as the employee is expected to satisfy the performance condition.

The employee remains employed until vesting date. In January Year 2, S pays the recharge to P. In February Year 2, the employee exercises the options at an exercise price of 30 when the share price is 34.

P accounts for the transactions in its separate financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Cost of investment in S	50	
Equity		50
<i>To recognise share-based payment transaction</i>		
Due from S (recharge asset)	30	
Cost of investment in S		30
<i>To recognise recharge arrangement as adjustment to cost of investment</i>		
<b>Year 2</b>		
Cash	50	
Due from S		50
<i>To recognise receipt of recharge payment</i>		
Cash	300	
Equity		300
<i>To recognise receipt of exercise price (10 x 30)</i>		

S accounts for the transactions in its financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	50	
Equity (capital contribution from parent)		50
<i>To recognise share-based payment expense as capital contribution from P</i>		
Equity (contribution from parent)	50	
Due to P (recharge liability)		50
<i>To recognise recharge arrangement as adjustment to contribution from parent</i>		
<b>Year 2</b>		
Due to P	50	
Cash		50
<i>To recognise recharge payment</i>		

Another consequence of applying share-based payment accounting by analogy in [Example 10.4.1](#) is that the initial measurement of the recharge should also be recognised over the same period as the share-based payment – i.e. spread over the vesting period, if there is any.

### Varying recharges

Additional complexities arise with regard to the accounting for a recharge in which the amount of the recharge varies – e.g. the amount recharged under an exercise-date intrinsic value recharge arrangement varies with changes in share price. Continuing to apply the guidance for cash-settled share-based payments by analogy, if such a recharge that is clearly linked to a share-based payment should be recognised before the subsidiary makes a cash payment to the parent to settle its obligation, then we believe that the asset and the liability arising from the recharge arrangement should be remeasured at the reporting date and ultimately at settlement date for changes in fair value (see [7.2.20](#)).

In our view, changes in the fair value of a linked recharge that is accounted for by analogy to the requirements for cash-settled share-based payments should not be recognised through profit or loss. This is because we believe that it is the nature of the payment that should determine the accounting treatment. We believe that the nature of a linked recharge is that of a reimbursement of a capital transaction and therefore that changes in the fair value of the recharge liability and asset from initial recognition to settlement should be treated as a true-up of the initial estimate of the net capital contribution.



#### Example 10.4.2 – Recharges smaller than share-based payment expense

On 1 January Year 1, Parent P grants 10 share options to an employee of its subsidiary, subject to a one-year service condition. The share-based payment is classified as equity-settled by the parent and the subsidiary. The exercise price of each option is 30.

The options can be exercised in February Year 2. The employee provides the required service and exercises the options in February Year 2.

At grant date of the share-based payment, P and S enter into a recharge arrangement equal to the intrinsic value of the share options at the date on which the employee exercises the options. The recharge arrangement is clearly linked to the share-based payment.

The fair values develop as follows.

	Shares	Share options
1 January Year 1	30	5
31 December Year 1	32	3
February Year 2 (Exercise date)	34	4 <sup>1</sup>

**Note**

1. Intrinsic value.

The total grant-date fair value of the share-based payment is 50. Therefore, the initial measurement of the recharge (asset and liability) is also 50.

P accounts for the transactions in its separate financial statements as follows.

	Debit	Credit
<b>Year 1</b>		
Cost of investment in S Equity <i>To recognise share-based payment transaction</i>	50	50
Due from S (recharge asset) Cost of investment in S <i>To recognise recharge arrangement as adjustment to cost of investment, based on fair value of share option at 31 December Year 1. This entry combines initial recognition and remeasurement through to 31 December Year 1</i>	30	30
<b>Year 2</b>		
Due from S (recharge asset) Cost of investment in S <i>To recognise remeasurement of recharge asset to exercise date</i>	10	10
Cash Due from S <i>To recognise receipt of recharge payment</i>	40	40
Cash Equity <i>To recognise receipt of exercise price (10 x 30)</i>	300	300

S accounts for the transactions in its financial statements as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses Equity (contribution from parent) <i>To recognise share-based payment expense as capital contribution from P</i>	50	50
Equity (contribution from parent) Due to P (recharge liability) <i>To recognise recharge arrangement as adjustment to contribution from parent, based on fair value of share option at 31 December Year 1. This entry combines initial recognition and remeasurement through to 31 December Year 1</i>	30	30

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Equity (contribution from parent)	10	
Due to P (recharge liability)		10
<i>To recognise remeasurement of recharge liability</i>		
Due to P	40	
Cash		40
<i>To recognise payment of recharge</i>		

If a recharge liability is denominated in a currency that is not the functional currency of the subsidiary, then in our view IAS 21 *The Effects of Changes in Foreign Exchange Rates* should be applied. As a result, foreign exchange gains and losses that result from changes in the exchange rate should be recognised in profit or loss.

#### 10.4.40 Recognition and measurement of 'clearly linked' non-contractual recharge arrangements

In some cases, a well-established past practice or stated policy of applying recharges related to share-based payments may result in a recharge expense being considered a non-contractual constructive obligation. In our view, an entity should choose an accounting policy, to be applied consistently, to account for a constructive obligation for a non-contractual recharge either:

- by analogy to a cash-settled share-based payment in the scope of IFRS 2 (see 10.4.30); or
- as a constructive obligation in the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

IAS 37.14

Under IAS 37, a provision is recognised for a constructive obligation when:

- a past event gives rise to a present obligation;
- it is probable that there will be an outflow of resources required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

IAS 37IE.Ex6-7

In our view, a present obligation for a non-contractual recharge arises when the related share-based payment has vested (vesting date). In determining whether an outflow of resources is probable, the following factors may be relevant:

- whether a share-based payment award is in-the-money;
- the volatility of the share price; and
- the tax consequences to the holder of exercising the share-based payment award.

Once a provision has been recognised, it is remeasured at each reporting date and ultimately at settlement date. As discussed in 10.4.20, if the recharge is determined to be clearly linked to the share-based payment, then the initial recognition and subsequent remeasurement of the provision should be recorded as an adjustment of the capital contribution recognised in respect of the share-based payment.

**Example 10.4.3 – Non-contractual recharges**

On 1 January Year 1, Parent P grants 10 share options to an employee of its subsidiary, subject to a one-year service condition. The share-based payment is classified as equity-settled by the parent and the subsidiary. The exercise price of each option is 30.

P has a well-established past practice of charging its subsidiaries for the intrinsic value of the award on the date of exercise for share options. Although there is no contractual agreement between P and the subsidiaries, P's recharge practice is well established and understood by its subsidiaries, such that there is an ongoing expectation among the subsidiaries that the recharge will continue to occur in accordance with the historical practice.

The options can be exercised in February Year 2. The options are in-the-money at the vesting date and the employee provides the required service and exercises the options in February Year 2.

The fair values develop as follows.

	Shares	Share options
1 January Year 1	30	5
February Year 2 (exercise date)	34	4 <sup>1</sup>

**Note**

1. Intrinsic value; share price - exercise price (34 - 30).

The total grant-date fair value of the share-based payment is 50.

P accounts for the transactions in its separate financial statements as follows.

	Debit	Credit
<b>Year 1</b>		
Cost of investment in S	50	
Equity		50
<i>To recognise share-based payment transaction</i>		
<b>Year 2</b>		
Due from S (recharge asset)	40	
Cost of investment in S		40
<i>To recognise recharge arrangement as adjustment to cost of investment, based on intrinsic value of option in February Year 2</i>		
Cash	40	
Due from S		40
<i>To recognise receipt of recharge payment</i>		
Cash	300	
Equity		300
<i>To recognise receipt of exercise price (10 x 30)</i>		

S accounts for the transactions in its financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	50	
Equity (contribution from parent)		50
<i>To recognise share-based payment expense as capital contribution from P</i>		
<b>Year 2</b>		
Equity (contribution from parent)	40	
Due to P (recharge liability)		40
<i>To recognise recharge arrangement as adjustment to contribution from parent, based on intrinsic value of share option in February Year 2</i>		
Due to P	40	
Cash		40
<i>To recognise payment of recharge</i>		

## 10.4.50

### Excess recharges

The amount recharged may be greater than the increase in the investment recognised by the parent in respect of the share-based payment. In our view, the excess should be treated by the subsidiary as a net capital distribution. In our view, in the absence of specific guidance in the IFRS Accounting Standards, more than one approach to the accounting by the parent for the excess may be acceptable. We believe that the parent should choose an accounting policy, to be applied consistently, with respect to the treatment of the excess of a recharge over the capital contribution recognised in respect of the share-based payment in its separate financial statements. The following are examples of accounting policies that we believe are acceptable.

#### Approach 1 – Adjustment of capital contribution

Under this approach, the entire amount of the recharge, including the excess, is treated by the parent as an adjustment of the capital contribution to the subsidiary.

If the recharge is greater than the recognised investment in the subsidiary, then we believe that the amount of the recharge in excess of the capital contribution recognised in respect of a share-based payment that is clearly linked to the recharge could be recognised as a return of capital. Under this approach, the initial recognition and subsequent remeasurement of that recharge would both be recognised as a reduction in the cost of the investment in the subsidiary and the excess of the recharge would cause a reduction in the net investment in the subsidiary.

**Example 10.4.4 – Excess recharge treated as adjustment to capital contribution by subsidiary and as reduction in cost of investment by parent**

On 1 January Year 1, Parent P grants 10 share options to an employee of Subsidiary S, subject to a one-year service condition. The share-based payment is classified as equity-settled by P and S. The exercise price of each option is 30.

P expects the employee to remain employed until vesting date and to exercise the options shortly after vesting.

The fair values develop as follows.

	Shares	Share options
1 January Year 1	30	5
31 December Year 1	40	12
February Year 2 (exercise date)	50	20 <sup>1</sup>

**Note**

1. Intrinsic value.

The employee remains employed until vesting date and exercises the options in February Year 2.

P accounts for its investment in S at cost in its separate financial statements. The carrying amount of P's investment in S at grant date is 500,000.

S accounts for the transactions as follows.

	Debit	Credit
<b>Year 1</b>		
Expenses	50	
Equity (Contribution from P)		50
<i>To recognise share-based payment expense and receipt of capital contribution</i>		
Equity (Contribution from P)	50	
Due to P (recharge liability)		50
<i>To recognise initial fair value of recharge liability during Year 1</i>		
Equity (contribution from P/distribution)	70	
Due to P		70
<i>To recognise subsequent remeasurement of recognised recharge liability at end of Year 1 ((10 x 12) - 50)</i>		
<b>Year 2</b>		
Equity (contribution from P/distribution)	80	
Due to P		80
<i>To recognise subsequent remeasurement of entire recharge liability to exercise date ((10 x 20) - 50 - 70)</i>		
Due to P	200	
Cash		200
<i>To recognise payment to P to settle recharge liability (10 x 20)</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Cumulative effects of the accounting by S</b>		
Expenses	50	
Equity (net capital distribution)	150	
Cash		200

P chooses to treat any excess of the recharge over the capital contribution recognised in respect of the share-based payment as an adjustment of the investment in S and accounts for the transactions in its separate financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Cost of investment in S	50	
Equity		50
<i>To recognise equity-settled share-based payment and corresponding increase in the investment</i>		
Due from S (recharge asset)	50	
Cost of investment in S		50
<i>To recognise initial fair value of recharge asset during Year 1</i>		
Due from S	70	
Cost of investment in S		70
<i>To recognise excess of recharge asset over increase in investment, which equals subsequent remeasurement of recognised recharge asset at end of Year 1 ((10 x 12) - 50)</i>		
<b>Year 2</b>		
Due from S	80	
Cost of investment in S		80
<i>To recognise excess of recharge asset over increase in investment, which equals subsequent remeasurement of recognised recharge asset ((10 x 20) - 50 - 70)</i>		
Cash	200	
Due from S		200
<i>To recognise receipt of recharge</i>		
Cash	300	
Equity		300
<i>To recognise receipt of exercise price from employee of 300</i>		
<b>Cumulative effects of the accounting by P in its separate financial statements</b>		
Cash	500	
Equity (receipt of exercise price)		300
Equity (share-based payment)		50
Cost of investment in S (excess of recharge over share-based payment)		150

## Approach 2 – Dividend income

Under this approach, the excess is treated by the parent as dividend income.

Under Approach 2, if the recharge is greater than the increase in the investment in the subsidiary, then we believe that the amount of the recharge in excess of the capital contribution recognised in respect of the clearly linked share-based payment could be recognised as dividend income. The determination of the excess that will ultimately be recognised as dividend income should be made on a grant-by-grant, employee-by-employee basis.



### Example 10.4.5 – Excess recharge treated as dividend income by parent

The fact pattern is the same as in [Example 10.4.4](#), except that Parent P chooses to treat any excess of the recharge over the capital contribution recognised in respect of the share-based payment as dividend income.

The accounting by S is the same as in [Example 10.4.4](#).

P accounts for the transactions as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Cost of investment in S	50	
Equity		50
<i>To recognise equity-settled share-based payment and corresponding increase in investment</i>		
Due from S (recharge asset)	50	
Cost of investment in S		50
<i>To recognise initial fair value of recharge asset during Year 1</i>		
Due from S	70	
Dividend income		70
<i>To recognise excess of recharge asset over increase in investment as dividend income ((10 x 12) - 50)</i>		
<b>Year 2</b>		
Due from S	80	
Dividend income		80
<i>To recognise excess of recharge asset over increase in investment as dividend income ((10 x 20) - 50 - 70)</i>		
Cash	200	
Due from S		200
<i>To recognise receipt of recharge</i>		
Cash	300	
Equity		300
<i>To recognise receipt of exercise price from employee of 300</i>		
<b>Cumulative effects of the accounting by P in its separate financial statements</b>		
Cash	500	
Equity (receipt of the exercise price)		300
Equity (share-based payment)		50
Dividend income (excess of the recharge over the share-based payment)		150

## 10.4.60

### Alternative approaches for recharge arrangements that are to be settled by subsidiary in shares of parent

A subsidiary may settle a recharge arrangement that is clearly linked to a share-based payment using the parent's shares rather than with cash. In our view, an entity should choose an accounting policy, to be applied consistently, to account for such a recharge arrangement either:

- by analogy to cash-settled share-based payment accounting (see 10.4.30);
- by analogy to the requirements of the financial instruments standards; or
- if the arrangement is non-contractual, then in accordance with IAS 37 (see 10.4.40).

If financial instruments accounting is applied by analogy, then the subsidiary recognises a financial liability at fair value through profit or loss when the entity becomes a counterparty to the recharge agreement. Therefore, the entire fair value of the liability is recognised at once when the entity becomes a counterparty. Immediate recognition differs from the approach when a recharge arrangement is accounted for by analogy to a cash-settled share-based payment (see 10.4.30). The debit is recognised in equity as an adjustment to the capital contribution that is recognised for the share-based payment transaction.

Under the financial instruments accounting approach, subsequent changes in the fair value of the liability that are due to changes in estimates regarding employees not meeting the service or non-market performance conditions are recognised in equity. All other changes, such as unwinding the discount effect or changes in the value of the shares, are recognised in profit or loss.

If, for example, the subsidiary has bought its parent's shares at grant date in order to have an economic hedge of its exposure to changes in the value of its parent's shares, then the investment in its parent's shares is accounted for as a financial asset, classified either at fair value through profit or loss or designated as at fair value through other comprehensive income. For a financial asset classified at fair value through profit or loss, to account for changes in the liability for the recharge that arise from share price movements, any fair value changes with respect to the financial asset that are recognised in profit or loss are mirrored by a change in the value of the financial liability, which is also recognised in profit or loss. The net effect reflects the natural hedge of the transaction. If a financial asset is designated as at fair value through other comprehensive income, then this natural hedge through profit or loss will not usually be achieved, because fair value changes on the asset are recognised in other comprehensive income instead of in profit or loss.



#### Example 10.4.6 – Recharge settled in parent's shares

On 1 January Year 1, Parent P grants 100 of its own shares for no consideration to an employee of Subsidiary S, subject to a three-year service condition. The employee is expected to remain employed with S and will be entitled to dividends during the vesting period. The grant-date fair value of a share is 9.

In a recharge arrangement, S simultaneously agrees to reimburse P by tendering to P the number of shares that vest at the vesting date.

To avoid any risk of future share price increases, S immediately buys 100 shares of P for 9 each on the market.

On 31 December Year 2, the fair value of the shares decreases to 5 and it remains at 5 until vesting date.

S accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	300	
Equity (contribution from parent)		300
<i>To recognise share-based payment transaction (100 x 9 x 1/3)</i>		
Financial assets	900	
Cash		900
<i>To recognise purchase of P shares (100 x 9)</i>		
Equity (contribution from parent)	900	
Financial liability		900
<i>To recognise recharge liability</i>		
<b>Year 2</b>		
Expenses	300	
Equity (contribution from parent)		300
<i>To recognise share-based payment ((100 x 9 x 2/3) - 300)</i>		
Change in fair value of financial asset (profit or loss)	400	
Financial assets		400
<i>To recognise fair value change in financial assets to profit or loss (100 x (9 - 5)), assuming that financial asset is measured at fair value through profit or loss</i>		
Financial liability	400	
Finance income		400
<i>To recognise change in fair value of financial liability</i>		
<b>Year 3</b>		
Expenses	300	
Equity (contribution from parent)		300
<i>To recognise share-based payment transaction ((100 x 9) - 600)</i>		
Financial liability	500	
Financial asset		500
<i>To recognise transfer of P shares to P, thereby settling recharge liability</i>		
<b>Cumulative effects</b>		
Share-based payment expenses	900	
Change in fair value of financial asset (profit or loss)	400	
Cash		900
Finance income		400

### 10.4.70 Recharge arrangements that are settleable in cash or in subsidiary's own shares

If the terms of a recharge arrangement that is clearly linked to a share-based payment offer the subsidiary a choice of settling in cash or in its own shares, then in our view the guidance for the classification of a share-based payment award as either equity-settled or cash-settled (see [Section 4](#)) applies to determine the nature of the recharge obligation.

### 10.4.80 Recognition and measurement of recharge arrangements that are not clearly linked

Recharge arrangements that are not clearly linked are accounted for separately from the share-based payment. An entity considers whether such an agreement is in the scope of another accounting standard, in particular the financial instruments standards, and whether it is a transaction with a shareholder.

## 10.5 Modifications and replacements

A share-based payment between one group entity (e.g. a subsidiary) and its employees may be altered to change the settling entity to another group entity (e.g. the parent). Such alterations may also change the reference entity from the subsidiary to the parent. See [Section 12](#) for further guidance from the perspective of the financial statements of the acquirer if such an alteration occurs in the context of a business combination.

In our view, a share-based payment involving equity instruments of one group entity offered in exchange for a share-based payment arrangement of another group entity outside a business combination may be identified as a replacement plan in the consolidated financial statements of the group (for a discussion of when a replacement award can be identified, see [Chapter 9.4](#)). For example, if Company P grants options over its shares to employees of Subsidiary Q in exchange for their options over shares of Q, then we believe that the grant of replacement options, if they are identified as such, should be accounted for in the consolidated financial statements of P as a modification of the original grant of options over shares of Q. This is because the shares in Q form part of the non-controlling interest in P and are therefore considered to be equity for the purposes of the consolidated financial statements of the group.

P accounts for the replacement in its separate financial statements as an increase in the cost of investment and an increase in equity based on modification date fair value. From the modification date, Q accounts for the transaction in its separate financial statements by recognising both the original cost at grant-date fair value attributable to future services and any incremental value as a capital contribution from the parent.



#### Example 10.5.1 – Replacement of share-based payment by a group entity outside a business combination

On 1 January Year 1, Company Q, a listed subsidiary of Company P, grants 1,000 options over shares of Q to its CEO, subject to a three-year service condition. The grant-date fair value of a share option is 9.

On 1 January Year 3, P offers to replace the original share-based payment by exchanging the options over Q's shares for options over P's shares. At this date, the fair value of an option over Q's shares is 6 and the fair value of an option over P's shares is 3. To provide an incentive to accept the offer, P offers 2,500 options, amounting to a total fair value of 7,500 compared with a total fair value of 6,000 for 1,000 options over Q's shares. The CEO accepts the offer to exchange. We believe that this modification should be seen as a net beneficial modification (for our guidance on give-and-take modifications, see [9.2.20](#)).

P accounts for the transaction in its consolidated financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	3,000	
Non-controlling interests (see <a href="#">Chapter 10.7</a> )		3,000
<i>To recognise original share-based payment (1,000 x 9 x 1/3)</i>		
<b>Year 2</b>		
Expenses	3,000	
Non-controlling interests		3,000
<i>To recognise original share-based payment ((1,000 x 9 x 2/3) - 3,000)</i>		
<b>Year 3</b>		
Non-controlling interests	6,000	
Equity		6,000
<i>To recognise change from options over shares of subsidiary to options over shares of parent</i>		
Expenses	3,000	
Equity		3,000
<i>To recognise original share-based payment ((1,000 x 9) - 6,000)</i>		
Expenses	1,500	
Equity		1,500
<i>To recognise incremental fair value at modification date over remaining service period (7,500 - 6,000)</i>		

P accounts for the transaction in its separate financial statements as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
N/A		
<b>Year 2</b>		
N/A		
<b>Year 3</b>		
Cost of investment in Q	7,500	
Equity		7,500
<i>To recognise increase in investment for modification transaction and subsequent services at modification date fair value</i>		

Q accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	3,000	
Equity		3,000
<i>To recognise share-based payment as receiving-and-settling entity (1,000 x 9 x 1/3)</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Expenses	3,000	
Equity		3,000
<i>To recognise share-based payment as receiving-and-settling entity ((1,000 x 9 x 2/3) - 3,000)</i>		
<b>Year 3</b>		
Equity	6,000	
Equity (contribution from parent)		6,000
<i>To recognise change from receiving-and-settling entity to receiving entity only</i>		
Expenses	3,000	
Equity (contribution from parent)		3,000
<i>To recognise share-based payment as receiving entity ((1,000 x 9) - 6,000)</i>		
Expenses	1,500	
Equity (contribution from parent)		1,500
<i>To recognise incremental fair value at modification date over remaining service period</i>		
<b>Cumulative effects</b>		
P's consolidated financial statements		
Expenses	10,500	
Equity		10,500
P's separate financial statements		
Cost of investment in Q	7,500	
Equity		7,500
Q's financial statements		
Expenses	10,500	
Equity (contribution from parent)		10,500

The cost of investment by P in Q has increased by 7,500, and yet Q has recognised a higher credit in equity, a total of 10,500. The difference of 3,000 can be analysed as follows: in P's separate financial statements recognition is based on the modification date fair value of P's options of 7,500. Due to modification accounting, the recognition in Q's financial statements and P's consolidated financial statements is based on the higher grant-date fair value of Q's options of 9,000, plus the incremental fair value of 1,500.

## 10.6 Practice issues

### 10.6.10 Intermediate parents

A shareholder may grant a share-based payment to employees of a subsidiary that is owned through an intermediate parent. For example, the ultimate parent (UP) in a group may grant an equity-settled share-based payment to employees of Subsidiary S that is held through Holding Company P; the share-based payment is recognised by the subsidiary in its financial statements. In our view, either of the following two accounting policies can be applied in the financial statements of the intermediate parent (P) in respect of the group share-based payment transaction.

Under Alternative 1, we believe that P can conclude that it does not have a share-based payment to recognise in its separate financial statements, because P, as the intermediate parent, is neither the receiving entity nor the settling entity in respect of the share-based payment (see 10.1.20). Under this accounting policy, the share-based payment is effectively being accounted for as if UP holds the investment in S directly. P's consolidated financial statements, if it prepares any, would include the share-based payment recognised by S.

Under Alternative 2, we believe that P could recognise the share-based payment in its financial statements. Under this accounting policy, attribution is appropriate because UP has only an indirect investment in S and can realise the benefits of the contribution only via P.

*IFRS 2.43B(b)*

If P chooses to account for the transaction, then P classifies the transaction as equity-settled in its separate financial statements. This is because P directly or indirectly receives the services without having an obligation to settle the transaction. By recognising a capital contribution from UP and an increase in investment in S, P mirrors the capital contribution recognised by the subsidiary and reflects the increase in investment by UP.

For a discussion of UP's accounting, see 10.3.10.

### 10.6.20 Employee benefit trusts

#### Separate financial statements of sponsor

*IU 11-06*

A plan sponsor may transfer or sell sufficient shares to enable a trust to meet obligations under share-based payment arrangements not only for current periods but also for future periods. In our view, the transfer of shares to an employee benefit trust does not represent a share-based payment transaction. Rather, the share-based payment arrangement is the arrangement between the employer and the employees for which grant date needs to be identified. Therefore, we believe that grant date will generally be determined based on the date on which the sponsor enters into an agreement with the employees. We believe that the fact that the agreement will be satisfied by the trust, or even that, nominally, it is the trust that enters into the agreement with the employees, does not shift the grant date to the date of transfer or sale of shares to the trust. We believe that a trust that would be required to be consolidated should usually be seen as an extension of the sponsor and therefore it may be appropriate to view actions that are nominally those of the trust as actions of the sponsor.

*IU 11-06*

IFRS Accounting Standards do not provide specific guidance on the treatment in the entity's separate financial statements of transfers of cash to a trust to enable the trustee to buy shares of the entity on the market or from the entity. The share-based payment arrangement with the employee is accounted for by the entity under IFRS 2. In our view, from the perspective of the entity's separate financial statements, the entity should choose an accounting policy, to be applied consistently, as follows.

- *Treat the trust as a branch/agent of the entity:* The assets and liabilities of the trust are accounted for as assets and liabilities of the entity, on the basis that the trust is merely acting as an agent of the entity. Under this treatment, the accounting in the entity's separate financial statements is the same as the accounting in the consolidated financial statements.

- *Account for the trust as a legal entity separate from the entity but as a subsidiary of the entity:* Any loan from the reporting entity to the trust is accounted for as a loan in accordance with its terms. If the trust is funded by the reporting entity making an investment in the trust, then the entity recognises the investment in the subsidiary as an asset. The purchase of the reporting entity's shares in the market by the trust has no effect on the financial statements of the reporting entity. However, when the trust transfers those shares to employees, this is considered to be in substance two transactions: a distribution of the shares from the trust back to the reporting entity as treasury shares, followed by a distribution of those shares to the employees.

The entity's accounting policy choice should be applied consistently.

Our view that an entity should choose an accounting policy to treat the trust as a branch/agent of the entity was developed for application to arrangements in which IFRS 2 requires the sponsor to recognise an expense in relation to shares held in trust for employees and should not be applied by analogy to other trust arrangements.

### Consolidated financial statements of sponsor

Application of the criteria for consolidation often requires consolidation of a trust holding shares to meet obligations under a share-based payment arrangement by the grantor (see Example 14 in Chapter 2.5 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#)).

### Accounting by sponsor's subsidiaries

The sponsor may require a subsidiary to transfer cash to an employee benefit trust to enable the trustee to settle the subsidiary's employees' share-based payment – e.g. by buying shares in the open market. If the subsidiary does not control the trust, then the share-based payment will be classified as equity-settled in the subsidiary's financial statements because the subsidiary has no obligation to settle the share-based payment (see 10.2.10). In our view, the sponsor and the subsidiary should consider whether the cash transferred to the trust is in substance a recharge arrangement (see [Chapter 10.4](#)).

## 10.6.30

### Repurchases by the parent

A parent may be required to repurchase shares of a subsidiary that were acquired by employees of the subsidiary through a share-based payment transaction.

For example, a subsidiary issues options to its employees that it settles by issuing its own shares. On termination of employment, the parent entity is required to buy the shares of the subsidiary from the former employee.

In our view, the classification of the share-based payment in the financial statements of the subsidiary should be based on the subsidiary's perspective. We believe that the repurchase arrangement is separate from the subsidiary's arrangement with its employees and therefore should not be considered in determining the classification of the share-based payment by the subsidiary. Because the subsidiary only has an obligation to deliver its own equity instruments, we believe that the arrangement should be classified as equity-settled in its financial statements.

The arrangement should be classified as cash-settled in the consolidated financial statements of the parent, because the parent has an obligation to settle in cash based on the subsidiary's shares (see also [Example 10.2.3](#)). This approach is consistent with the requirements for accounting for redeemable shares (see [Chapter 7.5](#)).

## 10.7 Presentation

Generally, IFRS Accounting Standards do not address presentation within equity for equity-settled share-based payment transactions (see [Chapter 6.10](#)).

However, when equity instruments of a subsidiary have been granted to a counterparty that is not part of the consolidated reporting entity in a share-based payment transaction, the credit entry in equity in the consolidated financial statements of the parent is to non-controlling interests. This is because the definition of non-controlling interests in IFRS 10 *Consolidated Financial Statements* refers to the equity in a subsidiary not attributable, directly or indirectly, to a parent.

For a discussion of presentation within equity when an acquirer does not replace an equity-settled share-based payment issued by the acquiree in a business combination, see [12.5.20](#).

# 11 Share-based payment transactions with non-employees

## Overview

- The term 'employee' includes individuals who are not employees but who provide similar personal services to the entity. All other counterparties are considered non-employees.
- The requirements for equity-settled share-based payment transactions with non-employees distinguish between transactions in which the goods or services can be measured reliably and those in which they cannot be measured reliably.
- If the goods or services acquired from non-employees can be measured reliably, then the goods or services are measured directly at their fair value.
- If the goods or services acquired from non-employees cannot be measured reliably, then the goods or services are measured indirectly – i.e. with reference to the fair value of the equity instruments granted.
- When the fair value of the identifiable goods or services appears to be less than the fair value of the equity instruments granted, measurement of both the goods or services received and the equity instruments granted may be necessary in order to measure the value of any unidentifiable goods or services received.
- For both direct and indirect measurement, goods or services are measured when they are received.
- Goods or services received in cash-settled share-based payment transactions with non-employees are recognised when they are received.
- Goods or services received and the liability incurred in a cash-settled share-based payment with non-employees are generally measured at the fair value of the liability. The liability is remeasured at each reporting date and at settlement date.

## 11.1 Definition of non-employees

Although the recognition requirements are similar for share-based payment transactions with employees and share-based payment transactions with non-employees, the measurement requirements differ in many respects. Therefore, it is important to determine the nature of the counterparty.

## IFRS 2.A

IFRS 2 *Share-based Payment* does not define a non-employee. However, it does indicate what the term ‘employees or others providing similar services’ encompasses (see [Chapter 6.1](#)) and notes that this includes non-executive directors. All other counterparties – i.e. those who are not considered employees or others providing similar services – are considered non-employees.

When assessing whether an individual is rendering services in the capacity of an employee or a non-employee, in our view the substance of the relationship between the entity and the individual should be considered, rather than simply the legal form of the arrangement. For example, an entity may consider one or more of the following factors to determine whether an individual is rendering services in the capacity of an employee. This list is not intended to be exhaustive and the assessment requires judgement.

- The entity is able to direct the individual’s services in the same way as those of individuals regarded as employees for legal or tax purposes.
- The services rendered are similar to those rendered by employees.
- The service provider is able to determine when and how the services are provided.



#### Example 11.1.1 – Counterparty classified as employee

- Company B grants share options to Company Z, conditional on Z providing specified services to B. The services that Z is obliged to render are the services of an individual, W, who is covering for an employee on long-term leave. Z is a ‘one-person’ company set up by W for personal tax reasons. Although in this example Z is not an individual but a company, the services are similar to those rendered by employees, because the services comprise solely the personal services of W. Therefore, we believe that the counterparty (Z) should be classified as an employee.
- Company C receives specialised computer services from Mr K, an individual. Mr K is not a legal employee but works under a contract for services under the direction of C in the same way as individuals regarded as employees for legal or tax purposes. Mr K works one day a week for C and provides similar services to other companies in the remainder of the week. As consideration for these services, C grants to Mr K a share-based payment. In this example, C has the ability to direct Mr K’s services in the same way as those of its employees. Therefore, we believe that the counterparty (Mr K) should be classified as an employee.

In the above cases, the recognition and measurement principles for employee transactions apply to the share-based payment (see [Section 6](#)).



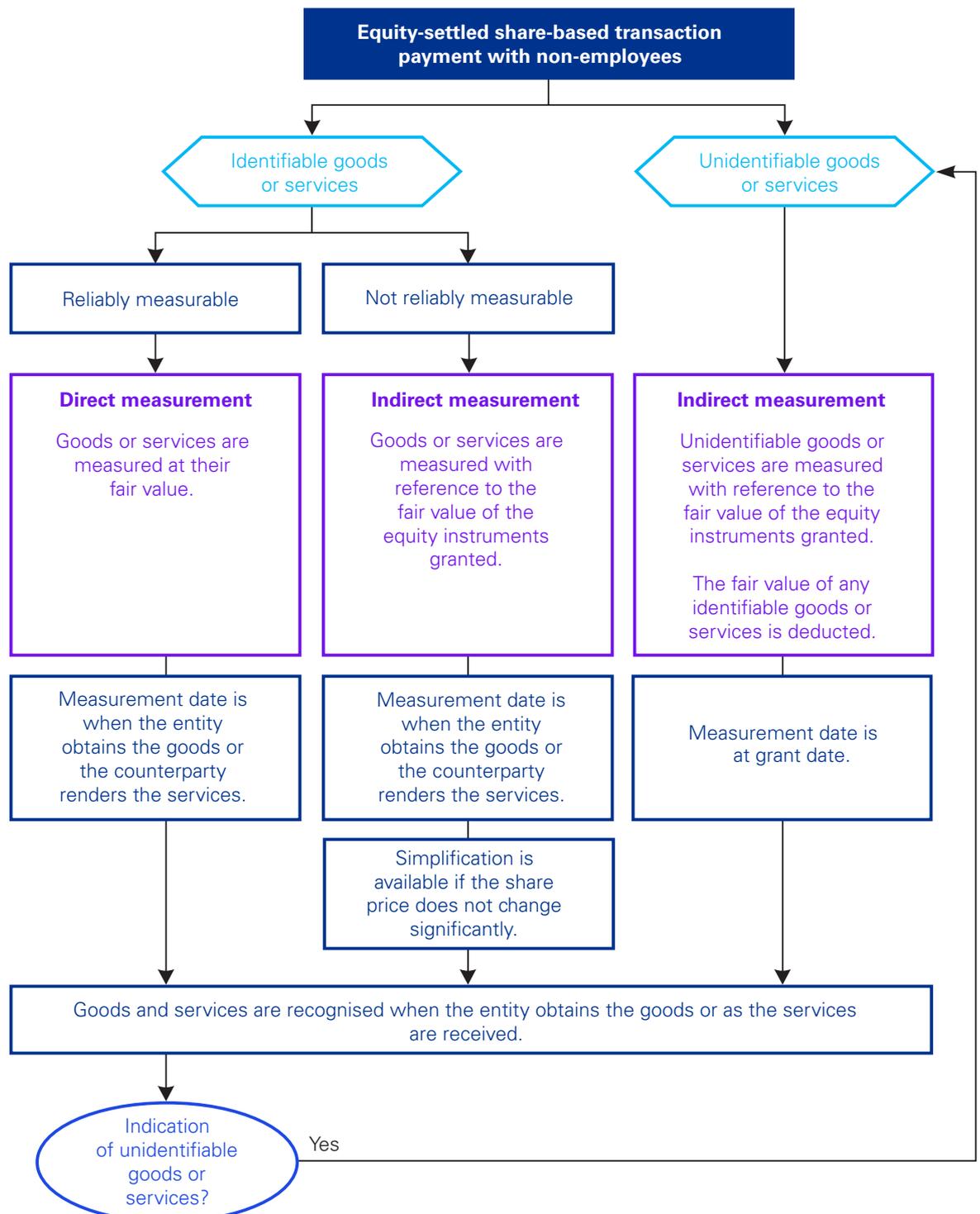
#### Example 11.1.2 – Counterparty classified as non-employee

In contrast to Example 11.1.1, Company C grants share options to Company Z, conditional on Z providing specified services to C. The services that Z is obliged to render are to design C’s new logo. Z is a small company with multiple owners and several individuals are expected to work on the project. In this example, the services are not required from a specified individual, the services are not similar to those rendered by employees, Z can determine when and how the services are performed, and the share options are granted to Z (i.e. not to a specified individual). Therefore, we believe that the counterparty should be classified as a non-employee.

## 11.2 Equity-settled share-based payment transactions with non-employees

### 11.2.10 Overview

The following flowchart summarises the requirements for equity-settled share-based payment transactions with non-employees.



## 11.2.20 Recognition principles

IFRS 2.7–8, 10, 14–15

In equity-settled share-based payment transactions with non-employees, goods are recognised when they are obtained and services are recognised when they are received. If the goods or services do not qualify for recognition as assets, then they are expensed. This is similar to equity-settled share-based payments with employees (see 6.2.10).

## 11.2.30 Measurement principles

IFRS 2.7, 13, A

In contrast to equity-settled share-based payment transactions with employees, which are measured at grant date, goods are measured when they are obtained and services are measured when they are rendered by the counterparty. Therefore, a single agreement with a non-employee can have multiple measurement dates, one for each delivery of goods or services. In this handbook, we refer to the ‘measurement date’ as the date on which the goods or services are received, which is consistent with the language used in IFRS 2.

IFRS 2.13

What is being measured depends on whether the goods or services can be measured reliably. There is a rebuttable presumption that the goods or services from non-employees can be measured reliably, in which case the goods or services are measured at their fair value (direct measurement), with the share-based payment exchanged for the goods or services measured at an equal amount. If in rare cases that presumption is rebutted, then the goods or services are measured indirectly – i.e. with reference to the fair value of the equity instruments granted (indirect measurement), as for equity-settled share-based payments with employees.

### Direct measurement

IFRS 2.13, 13A

If the goods or services can be measured reliably, then they are measured at their fair value, with a corresponding increase in equity. That is, the value of the equity instruments granted does not influence the measurement of such a transaction except as noted below.



#### Example 11.2.1 – Goods received from non-employees: Direct measurement

On 1 January Year 1, Company B, a chocolate producer, enters into a contract with Company E according to which E delivers one tonne of cocoa beans on 1 January Year 2, to be used by B in its production of chocolate. The forward price for one tonne of cocoa beans is 100,000 on 1 January Year 1. B agrees to pay E 20,000 shares, to be delivered on delivery of the cocoa beans. B’s shares have a market price of 5 on 1 January Year 1.

On delivery – i.e. 1 January Year 2 – the actual value of cocoa beans per tonne is 125,000. The actual market price of a share has increased to 5.50 for a total value of 110,000.

The ‘own-use’ exemption in paragraph 2.4 of IFRS 9 *Financial Instruments* applies and the transaction is therefore in the scope of IFRS 2 (see 3.4.40).

The goods acquired qualify for asset recognition as inventories.

B accounts for the transaction as follows.

	Debit	Credit
<b>Year 1</b>		
Inventories	-	
Equity		-
<i>Because goods are not obtained in Year 1, there is no journal entry in Year 1</i>		

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Inventories	125,000	
Equity		125,000
<i>To recognise goods received, measured at their fair value at date of receipt</i>		

This example illustrates that the share-based payment cost for reliably measurable goods is determined solely by the value of the goods on the delivery date.

🔍
**Example 11.2.2 – Services received from non-employees: Direct measurement**

On 1 January Year 1, Company D enters into an agreement with Legal firm L under which L provides 200 hours of legal services each year over a three-year period. As compensation, L receives 8,000 shares of D at the end of each year.

The fair value for the type of legal services provided by L is available: according to L's list of billing rates, generally applicable to all clients, the price for such a service is 400 per hour in Year 1 and Year 2. In Year 3, L increases its price to 450 per hour.

D accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	80,000	
Equity		80,000
<i>To recognise fair value of services received (200 hours x 400)</i>		
<b>Year 2</b>		
Expenses	80,000	
Equity		80,000
<i>To recognise fair value of services received (200 hours x 400)</i>		
<b>Year 3</b>		
Expenses	90,000	
Equity		90,000
<i>To recognise fair value of services received (200 hours x 450)</i>		

This example illustrates that the share-based payment expenses vary with the value of the services received. This is in contrast to equity-settled share-based payment transactions with employees, in which measurement is based on an amount determined at grant date (see 6.2.10).

IFRS 2.13A, BC126,  
 BC128B–BC128C

If in an equity-settled share-based payment with non-employees the consideration received appears to be less than the fair value of the equity instruments granted, then the entity may need to perform an indirect measurement test and to account for unidentifiable goods or services in addition to the identifiable goods or services. The circumstances in which this may be required are discussed in 11.2.40.

## Indirect measurement

*IFRS 2.13*

In rare cases, the presumption that the fair value of the goods or services received can be measured reliably can be rebutted. In these cases, the entity measures the fair value of the goods or services received indirectly, with reference to the fair value of the equity instruments granted (i.e. like an employee grant).

*IFRS 2.IG6*

However, as already discussed in 11.2.30, unlike an employee grant, the fair value of goods or services received is measured when they are received. As a result, a single agreement for payment may have multiple measurement dates for the equity instruments granted (i.e. one for each date on which goods or services are received), rather than being measured only once at the original grant date.

*IFRS 2.19–21A, BC120*

The treatment of vesting conditions and non-vesting conditions for indirectly measured transactions is similar to transactions with employees (see 6.2.10). This is because the placement of those requirements in the accounting standard indicates that they apply to all transactions measured with reference to the fair value of the equity instruments granted – i.e. not only to employee transactions.

## Approximation of the fair value of the equity instruments granted

*IFRS 2.IG5–IG7, BC89 footnote*

For equity-settled share-based payments with non-employees that are measured indirectly – i.e. with reference to the fair value of the equity instruments granted – determining the fair value at each measurement date can be burdensome, in particular when services are rendered over a period. This is because, in theory, the fair value of the equity instruments granted would need to be determined for each date within the period in which services are received.

*IFRS 2.IG7, BC89*

For practical reasons, the implementation guidance permits a simplification in certain circumstances. If, for example, the share price did not change significantly during a period, then the average share price can be used as an approximation. The approximation can be achieved by using the fair value at the end of each accounting period or by measuring the fair value at regular intervals during each accounting period.



### Example 11.2.3 – Services received from non-employees: Indirect measurement using approximation

On 1 January Year 1, Company E enters into an agreement with Company C under which C renders consulting services to E on a specific project. C will receive a payment of 100,000 shares of E if the project is completed by the end of Year 2. C provides the services throughout Year 1 and Year 2.

E considers that the fair value of this service cannot be measured reliably and therefore measures the services received indirectly.

Historically, the market price of E's shares has been relatively stable. At each reporting date, E analyses the share price movements and concludes that they have not changed significantly. E therefore applies the approximation technique to determine the average share price at regular intervals over the life of the project. A six-month interval is used in this case.

The average share price is as follows.

1st half Year 1	11
2nd half Year 1	13
1st half Year 2	11
2nd half Year 2	10

E expects the performance condition to be met, which it ultimately is.

E accounts for the share-based payment transaction as follows.

	Debit	Credit
<b>Year 1 (1st half)</b>		
Expenses	275,000	
Equity		275,000
<i>To recognise services received, measured with reference to average share price of equity instruments granted when services are rendered (100,000 shares x 11 x ¼)</i>		
<b>Year 1 (2nd half)</b>		
Expenses	325,000	
Equity		325,000
<i>To recognise services received, measured with reference to average share price (100,000 shares x 13 x ¼)</i>		
<b>Year 2 (1st half)</b>		
Expenses	275,000	
Equity		275,000
<i>To recognise services received, measured with reference to average share price (100,000 shares x 11 x ¼)</i>		
<b>Year 2 (2nd half)</b>		
Expenses	250,000	
Equity		250,000
<i>To recognise services received, measured with reference to average share price (100,000 shares x 10 x ¼)</i>		

## 11.2.40

IFRS 2.13A, IG5D.Ex1

### Unidentifiable goods or services

In some share-based payment transactions, it may not be possible to identify any goods or services received or to be received in consideration for the equity instruments granted. In these cases, the unidentifiable goods or services are measured indirectly – i.e. with reference to the fair value of the equity instruments granted.



#### Example 11.2.4 – Unidentifiable goods or services in a share-based payment under the South African BEE scheme

In response to the Black Economic Empowerment (BEE) government policy, Company S, a South African company, transfers 250,000 shares (25% of its outstanding equity instruments) to a company owned by historically disadvantaged individuals, Company B. The shares are issued for consideration of 8 when their fair value is 10, as a means of enhancing S's image as a good corporate citizen. As a result, economic benefits are expected to be derived – e.g. by enhancing B's ability to tender successfully for government contracts.

The share-based payment transaction is in the scope of IFRS 2 (see [Example 3.3.1](#)). In this equity-settled share-based payment with non-employees, there are no identifiable goods or services received in exchange for the discount on the share sale. Therefore, S measures the unidentified goods or services received at the fair value of the share-based payment granted. S immediately recognises an expense of 500,000 (250,000 shares x (10 - 8)), a receivable/cash of 2,000,000 and a corresponding increase in equity of 2,500,000.

IFRS 2.13A, BC126,  
BC128B–BC128C

In other cases, goods or services may be identifiable but the consideration received in the form of those identifiable goods or services *appears* to be less than the fair value of the equity instruments granted. In this case, the entity may be required to perform an ‘indirect measurement test’ to identify whether the entity has also received or will receive unidentifiable goods or services. However, IFRS 2 explicitly states that it is neither necessary nor appropriate to measure the fair value of goods or services as well as the fair value of the equity instruments granted for each and every transaction. The use of the term ‘appears to be less than fair value’ reflects the IASB’s decision to rebut the notion that a two-stage measurement is always required. An example of when the consideration appears to be less than the fair value of the equity instruments granted would be an obvious disparity in the values.

IFRS 2.BC128E–BC128F If the indirect measurement test demonstrates that the fair value of the equity instruments granted is greater than the fair value of the identifiable goods or services received, both measured at grant date, then the difference is attributed to the unidentifiable goods or services.

As noted, grant date is used for measuring the unidentifiable goods or services. Following the basic measurement requirements for reliably measurable items, the *identifiable* goods or services will be measured when they are received, which may be later than grant date. This means that the identifiable goods or services are measured twice on different dates; once for the purpose of valuing the unidentifiable goods or services and again when the identifiable goods are obtained or services rendered.

IFRS 2.8, 13A, 14,  
BC128H, IG5A–IG5D

The unidentifiable goods or services are recognised following the recognition principles for identifiable goods or services. Unless the facts and circumstances provide evidence to justify capitalisation as an asset or recognition over a period, the unidentifiable goods or services are expensed immediately. However, it seems unlikely that unidentifiable goods or services would satisfy the criteria for recognition as an asset (e.g. control and future benefits) if they cannot be identified.

## 11.3 Cash-settled share-based payment transactions with non-employees

### 11.3.10 Recognition principles

IFRS 2.7–8

In cash-settled share-based payment transactions with non-employees, goods or services are recognised when they are received. If the goods or services do not qualify for recognition as assets, then they are expensed. This is the same as for equity-settled share-based payments with all counterparties and cash-settled share-based payments with employees.

### 11.3.20 Measurement principles

IFRS 2.30

For cash-settled share-based payment transactions with non-employees, the liability is measured at its fair value. The liability is remeasured at each reporting date and ultimately at settlement date in the same way as with cash-settled transactions with employees.

In contrast to equity-settled share-based payments, the requirements for cash-settled share-based payments do not distinguish between those with employees and those with non-employees.

In transactions in which the goods or services cannot be measured reliably, the goods or services and the liability incurred are measured at the fair value of the liability with reference to the value of the equity instrument on which the payment is based.

In transactions in which the goods or services can be measured reliably, it is unclear whether the initial liability is also based on the fair value of the underlying instruments or if instead it should be based on the fair value of the goods or services received. In the latter case, it may be necessary to consider the requirements for unidentifiable goods or services (see 11.2.40). From the first date of remeasurement, the liability would be equal under both approaches. We expect this issue to be rare in practice.

# 12 Replacement awards in a business combination

## Overview

- In a business combination, consideration transferred in exchange for control of the acquiree could include replacement awards exchanged for awards held by the acquiree's employees (acquiree awards).
- Both the acquiree awards and the replacement awards are measured in accordance with IFRS 2 *Share-based Payment* at the date of acquisition. IFRS 3 *Business Combinations* uses the term 'market-based measure'.
- If the acquirer *voluntarily* issues awards to employees of the acquiree to replace awards that otherwise would have expired at the date of acquisition, then the market-based measure of the replacement awards is treated as post-combination remuneration cost of the combined entity.
- If the acquirer is *obliged* to issue replacement awards to employees of the acquiree in exchange for their existing unexpired awards, then the market-based measure of the replacement awards is allocated between consideration transferred and post-combination remuneration cost.
- Unreplaced awards of the acquiree are generally presented as part of non-controlling interests in the combined entity. If the acquiree awards are unvested, then their market-based measure is allocated between consideration transferred and post-combination remuneration.
- Subsequent accounting for the replacement awards, including the treatment of vesting and non-vesting conditions, follows the principles of IFRS 2.

## 12.1

IFRS 3.B61

## Scope of this section

Throughout this section, examples illustrate equity-settled replacement awards, unless noted otherwise. The same principles for determining the portions of a replacement award attributable to pre- and post-combination service apply to cash-settled share-based payments.

The majority of this section addresses the accounting in the consolidated financial statements of the acquirer. For a discussion of the accounting in the separate financial statements of the acquirer, see [Chapter 12.6](#). In addition, the remainder of this section refers to share-based payments to employees in exchange for service and describes the cost as 'remuneration cost', because this is the description used in the examples in IFRS 3.

This section does not address the accounting in the financial statements of the acquiree. However, for guidance on the accounting by the subsidiary when a parent modifies a share-based payment of that subsidiary, see [Chapter 10.5](#).

Except in [Examples 12.4.1](#) and [12.5.1](#), the journal entries presented in this section of the handbook represent an extract from the full journal entries that would be required on consolidation. The journal entries are prepared to illustrate the allocation of replaced share-based payment awards between pre- and post-combination service. Therefore, the debit entry in the example entries (except in [Examples 12.4.1](#) and [12.5.1](#)) to record pre-combination service is labelled ‘consideration transferred’ – i.e. an increase to consideration transferred – which increases goodwill/decreases a gain on bargain purchase.

*IFRS 3.30, B60*

Throughout this section, we use a term that is different from the language in IFRS 2 and therefore different from the other chapters in this handbook. This is because IFRS 3 uses the term ‘market-based measure’ when referring to the IFRS 2-compliant measurement of fair value of a share-based payment award. Following the measurement guidance in IFRS 2 is an exception to the general measurement principles of IFRS 3. We use the term ‘market-based measure’ as the amount before expected forfeitures.

## 12.2 Interaction between IFRS 2 and IFRS 3

*IFRS 2.5*

In a business combination, the consideration transferred might include certain elements of share-based payment awards exchanged for awards held by the acquiree’s employees. Typically, the grant of a share-based payment replacement award is an example of a transaction with an element that is part of the consideration transferred (pre-combination service) and an element that is accounted for outside the acquisition accounting (post-combination service).

IFRS 3 contains detailed attribution requirements that determine the amount of a share-based payment included in consideration transferred and the amount recognised outside the acquisition accounting as post-combination remuneration cost of the combined entity. Once attribution is completed, post-combination remuneration is accounted for in accordance with IFRS 2.

*IFRS 3.B56*

IFRS 3 provides guidance on attributing pre- and post-combination service when the awards held by the acquiree’s employees are voluntarily replaced, mandatorily replaced or unreplaced but remain unexpired. The accounting implications are summarised in the table below.

	<b>Voluntary replacements (see Chapter 12.3)</b>	<b>Mandatory replacements (see Chapter 12.4)</b>	<b>Unreplaced awards (see Chapter 12.5)</b>
<b>Description</b>	Acquirer voluntarily issues awards to employees of the acquiree to replace awards that otherwise would have expired at the date of acquisition.	Acquirer is obliged to issue replacement awards to employees of the acquiree in exchange for their existing unexpired awards.	Employees’ existing awards are not replaced.
<b>Valuation</b>	Market-based measure of the ‘new awards’ at the date of acquisition, adjusted for expected forfeitures.	Market-based measure of the ‘new awards’ at the date of acquisition, adjusted for expected forfeitures.	Market-based measure of the ‘unreplaced awards’ at the date of acquisition, adjusted for expected forfeitures.

	<b>Voluntary replacements (see Chapter 12.3)</b>	<b>Mandatory replacements (see Chapter 12.4)</b>	<b>Unreplaced awards (see Chapter 12.5)</b>
<b>Allocation</b>	<p>The market-based measure is allocated to post-combination service.</p> <p>The amount attributable to post-combination service is recognised in accordance with IFRS 2.</p>	<p>The market-based measure is allocated between pre- and post-combination service.</p> <p>The amount allocated to pre-combination service (which increases the consideration transferred in the acquisition) cannot exceed the market-based measure of the acquiree awards at the date of acquisition.</p> <p>The amount attributable to post-combination service is recognised in accordance with IFRS 2.</p>	<p>For vested awards, the market-based measure is allocated to non-controlling interests (which increases the consideration transferred in the acquisition).</p> <p>For unvested (i.e. partially vested) awards, the market-based measure is allocated between non-controlling interests and post-combination service.</p> <p>The amount attributable to post-combination service is recognised in accordance with IFRS 2.</p>

## 12.3 Voluntary replacement of expired acquiree awards

*IFRS 3.B56*

An award may expire when a business combination occurs – i.e. the employee is no longer entitled to the share-based payment and the award lapses. If such an award is replaced voluntarily, then all of the market-based measure of the replacement award is recognised as post-combination remuneration cost. None of the market-based measure of the replacement awards is attributed as consideration transferred in the business combination.

*IFRS 3.B56*

A replacement is considered voluntary unless the acquirer is obliged to issue replacement awards. An acquirer is 'obliged' to issue replacement awards if the acquiree or its employees are able to enforce replacement. Such obligations may arise from various sources, including:

- the terms of the acquisition agreement;
- the terms of the acquiree's awards; or
- applicable laws or regulations.

**Example 12.3.1 – Voluntary replacement of expired award**

On 1 January Year 1, Company B granted a share-based payment award to its employees, subject to a five-year service condition. The award contained a clause stating that the share-based payment expires on a change in control over B.

Company C acquires B on 1 January Year 4; consequently, all of B's acquiree awards expire. To motivate B's employees, C voluntarily grants a replacement award on 1 January Year 4 with a market-based measure of 200, subject to a one-year service condition.

No amount of the market-based measure of the replacement award is attributed to pre-combination service. In effect, the replacement award is recognised as if C had issued a new share-based payment award on 1 January Year 4. Even though C designated the replacement award as the replacement of an existing award (see [Chapter 9.4](#)), C accounts for the entire award as a new award because it was not obliged to replace those awards.

If all employees meet the service condition at 31 December Year 4, then the value of the replacement awards of 200 is attributed to post-combination service in accordance with IFRS 2. If some of the employees fail to meet the service condition, then the post-combination cost is adjusted to reflect the number of awards that vest in accordance with IFRS 2; see [Example 12.4.7](#).

In its consolidated financial statements, C records the following entry if all employees meet the service condition.

	<i>Debit</i>	<i>Credit</i>
<b>Year 4</b>		
Remuneration cost	200	
Equity		200
<i>To recognise amount of replacement awards attributed to post-combination service in accordance with IFRS 2 (200 x (1 year / 1 year))</i>		

## 12.4

## Mandatory replacement of acquiree awards

### 12.4.10

### Attribution principles of replacement awards

*IFRS 3.B56*

When the acquirer mandatorily issues replacement awards to employees of an acquiree in exchange for unexpired share-based payment awards issued previously by the acquiree, such exchanges are accounted for as modifications of share-based payment awards under IFRS 2. As a result, all or a portion of the market-based measure of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination.

*IFRS 3.B56*

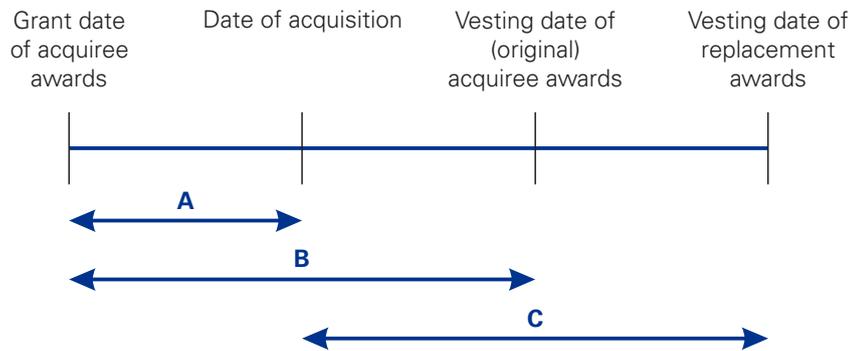
In some instances, a portion of the value of the replacement awards is allocated to post-combination service and accounted for separately from the business combination. This occurs when post-combination service is required to be rendered by the employees of the acquiree in connection with the acquirer issuing replacement awards or if the market-based measure of the replacement awards exceeds the market-based measure of the acquiree awards.

*IFRS 3.B56*

The amount of the market-based measure of the replacement awards treated as consideration transferred is determined in the following manner.

IFRS 3.B57

1. Determine at the date of acquisition, in accordance with IFRS 2:
  - the market-based measure of the acquiree’s awards (FVa); and
  - the market-based measure of the replacement awards (FVr).
2. Determine:
  - the period for which service has been provided by the employees before the date of acquisition (A in the diagram);
  - the original vesting period of the acquiree’s awards (B in the diagram);
  - the post-combination vesting period, if any, for the replacement awards (C in the diagram); and
  - the greater of the total vesting period (the sum of A plus C) and the original vesting period of the acquiree’s awards (B).



In our experience, the total vesting period of the original awards may be longer than the sum of the pre-combination period for which service has been provided plus the post-combination vesting period of the replacement awards. However, in other cases a change-in-control clause is included in the original terms of an acquiree award and the clause is triggered by an acquisition of the acquiree such that unvested awards immediately vest at the date of acquisition (see 12.4.50).

3. Calculate the portion of the replacement awards attributable to consideration transferred in the business combination as the product of:

- the market-based measure of the acquiree’s awards at the date of acquisition; and
- the ratio of the pre-combination vesting period to the greater of the total vesting period and the original vesting period of the acquiree’s awards.

$$\text{Amount included in consideration transferred} = FVa \times \frac{A}{\text{Greater of } (A + C) \text{ and } B}$$

IFRS 3.B58

IFRS 3.B59

Any remaining amount of the market-based measure of the replacement awards after deducting the amount attributed to consideration transferred is treated as post-combination remuneration cost.

IFRS 3.B61

These requirements for determining the portions of a replacement award attributable to pre- and post-combination service apply regardless of whether the replacement award is classified as cash-settled or as equity-settled in accordance with IFRS 2.

## IFRS 3.B57–B59

The process described above demonstrates several points.

- The acquirer measures both the replacement awards given to employees by the acquirer and the acquiree awards at the date of acquisition. The measurement and attribution of replacement awards issued in a business combination are independent of the original grant-date value of the acquiree awards.
- IFRS 3 sets two limits on the amount of the replacement awards' value that is included in the consideration transferred:
  - the amount cannot exceed the market-based measure at the date of acquisition of the acquiree awards; and
  - the amount includes only the portion of the value attributed to pre-combination service.
- Any incremental value of the replacement awards over the value of the acquiree awards at the date of acquisition is attributed to post-combination service and is not part of the consideration transferred, even if all service has been rendered as at the date of acquisition. In this case, the excess value is recognised immediately as remuneration cost in the post-combination financial statements of the combined entity. If additional service is required, then the remuneration cost is recognised in the post-combination financial statements by applying the requirements of IFRS 2.
- Even if the acquiree awards are fully vested at the time of a business combination, a portion of the replacement awards is allocated to post-combination service if the acquiree's employees are required to render service in the post-combination period for the replacement awards to vest.



#### Example 12.4.1 – Attribution of market-based measure of replacement award: No forfeitures

On 1 January Year 1, Company E granted equity-settled share-based payment awards with a grant-date fair value of 100 to its employees, subject to a three-year service condition.

On 1 January Year 3, Company D buys 100% of E's shares for cash of 400. In addition, as part of the acquisition agreement, D is required to issue equity-settled replacement awards to E's employees. At the date of acquisition, the fair value of E's identifiable net assets is 450; the market-based measure of the original awards is 120; the market-based measure of the replacement awards is 140. The replacement awards have a one-year vesting condition.

Assuming that all employees are expected to meet the service condition, the following points are relevant to determining the amount attributed to the pre-combination service.

- The period for which service has been provided by E's employees before the date of acquisition is two years.
- The vesting period of the original (acquiree) awards is three years.
- The vesting period of the replacement awards is one year.
- The total vesting period and the original vesting period are both three years. The greater of those two periods is therefore also three years.

#### Amount attributed to pre-combination service

$$120^1 \times 67\% (2 \text{ years} / 3 \text{ years})^2 = 80$$

- <sup>1</sup> Market-based measure of the acquiree awards at the date of acquisition.
- <sup>2</sup> Ratio of service rendered as at 1 January Year 3 compared with the greater of the original vesting period (three years) and the sum of the pre-combination period for which service has been provided (two years) plus the post-combination vesting period (one year); both periods are three years.

**Amount attributed to post-combination service**

$$140^3 - 80^4 = 60$$

- <sup>3.</sup> Market-based measure of the replacement awards at the date of acquisition.  
<sup>4.</sup> Amount attributed to pre-combination service (see [above](#)).

For a discussion of the recognition of the amount of post-combination service, see [12.4.20](#).

In its consolidated financial statements, D records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Identifiable net assets of E	450	
Goodwill <sup>5</sup>	30	
Cash		400
Equity		80
<i>To recognise the acquisition of E</i>		
Remuneration cost	60	
Equity		60
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (60 x (1 year / 1 year))</i>		
<sup>5.</sup> Goodwill is calculated as follows:		
Cash		400
D's replacement awards		80
Total consideration		480
Fair value of E's identifiable net assets acquired		(450)
Goodwill		30

For a discussion of replacement awards with expected forfeitures, see [12.4.30](#).

**12.4.20****Recognition of pre- and post-combination service**

Neither IFRS 2 nor IFRS 3 provides explicit guidance on how to account for the amount allocated to post-combination service. In our view, an entity should choose an accounting policy, to be applied consistently, to account for the recognition of the remuneration cost in post-combination periods under either the new grant approach or the modification approach.

*IFRS 3.B59*

Because IFRS 3 provides guidance on how to allocate the market-based measure of the replacement awards between pre- and post-combination service, the cumulative amount recognised will be the same under either the new grant approach or the modification approach. This is because the allocation between pre- and post-combination service will always be undertaken in accordance with the method set out in [12.4.10](#).

In this handbook we have illustrated only the new grant approach. Under the new grant approach, in line with the basic attribution principle in IFRS 2, the amount attributed to post-combination service would be recognised over the vesting period of the replacement award.

If, instead, the modification approach is followed, then the attribution period may be different because the IFRS 2 requirements for recognising awards differ for new grants and modifications. For example, to apply modification accounting the acquirer would have to determine whether the terms of the replacement award, as compared with the terms of the acquiree award, are beneficial to the employee.

If the replacement is considered to be non-beneficial – e.g. replacement award with no incremental value and an extension of the vesting period – then the amount allocated to post-combination service would be recognised over a shorter period under the modification approach than under the new grant approach (see 9.2.20).

IFRS 3.IE61–IE71

Examples 12.4.2–5 are based on the illustrations provided in IFRS 3; it is assumed that at the date of acquisition, and subsequently, all replacement awards are expected to vest – i.e. estimated forfeitures are zero.



#### Example 12.4.2 – Acquiree awards for which no future service is required are replaced by awards that require no future service (new grant approach)

Company F acquires Company G on 31 December Year 3. At the date of acquisition, G's employees hold share options with a total market-based measure of 300. All of the acquiree awards were granted on 1 January Year 1 – i.e. three years before the date of acquisition – and had a vesting period of three years; therefore, these acquiree awards are fully vested at the date of acquisition.

F replaces the fully vested acquiree awards with fully vested awards with a market-based measure of 400 at the date of acquisition. Both the acquiree awards and the replacement awards are equity-settled.

##### Amount attributed to pre-combination service

$$300^1 \times 100\% (3 \text{ years} / 3 \text{ years})^2 = 300$$

1. Market-based measure of the acquiree awards at the date of acquisition.
2. Ratio of service rendered as at 31 December Year 3 compared with the greater of the original vesting period (three years) and the sum of the service provided in the pre-combination period (three years) plus the post-combination vesting period (zero years); both periods are three years.

##### Amount attributed to post-combination service

$$400^3 - 300^4 = 100$$

3. Market-based measure of the replacement awards.
4. Amount attributed to pre-combination service (see above).

Because no service is required after the date of the business combination, in accordance with IFRS 2, the amount attributed to post-combination service is recognised immediately as remuneration cost.

In its consolidated financial statements, F records the following entries.

	Debit	Credit
<b>Year 3</b>		
Consideration transferred	300	
Equity		300
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
Remuneration cost	100	
Equity		100
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2</i>		

**Example 12.4.3 – Acquiree awards for which no future service is required are replaced by awards that require future service (new grant approach)**

Assume the same facts as in [Example 12.4.2](#) except that under the terms of the replacement awards, G's employees are required to provide an additional year of service after the business combination to vest in the replacement awards.

**Amount attributed to pre-combination service**

$$300^1 \times 75\% (3 \text{ years} / 4 \text{ years})^2 = 225$$

1. Market-based measure of the acquiree awards at the date of acquisition.
2. Ratio of service rendered as at 31 December Year 3 compared with the greater of the original vesting period (three years) and the sum of the service provided in the pre-combination period (three years) plus the post-combination vesting period (one year).

**Amount attributed to post-combination service**

$$400^3 - 225^4 = 175$$

3. Market-based measure of the replacement awards.
4. Amount attributed to pre-combination service (see [above](#)).

The 175 attributed to post-combination service is recognised in accordance with IFRS 2.

In its consolidated financial statements, F records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Consideration transferred	225	
Equity		225
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
<b>Year 4</b>		
Remuneration cost	175	
Equity		175
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (175 x (1 year / 1 year))</i>		

**Example 12.4.4 – Acquiree awards for which future service is required are replaced by awards that require future service (new grant approach)**

Company F acquires Company G on 31 December Year 3. At the date of acquisition, G's employees hold share options with a total market-based measure of 300. All of the acquiree awards were granted on 1 January Year 1 – i.e. three years before the date of acquisition. G's share option plan does not contain a change-in-control clause that accelerates vesting (see 12.4.50).

The vesting period of the acquiree awards was four years. Accordingly, before the date of acquisition, the acquiree awards have a remaining vesting period of one year.

Based on a requirement in the acquisition agreement, F replaces the unvested acquiree awards with unvested awards with a total market-based measure of 300. Those awards require two years of service subsequent to the date of acquisition – i.e. they will vest a year later than the acquiree awards would have vested under their original terms.

**Amount attributed to pre-combination service**

$$300^1 \times 60\% (3 \text{ years} / 5 \text{ years})^2 = 180$$

1. Market-based measure of the acquiree awards at the date of acquisition.
2. Ratio of service rendered as at 31 December Year 3 compared with the greater of the original vesting period (four years) and the sum of the service provided in the pre-combination period (three years) plus the post-combination vesting period (two years).

**Amount attributed to post-combination service**

$$300^3 - 180^4 = 120$$

3. Market-based measure of the replacement awards.
4. Amount attributed to pre-combination service (see above).

The 120 attributed to post-combination service is recognised in accordance with IFRS 2.

In its consolidated financial statements, F records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Consideration transferred	180	
Equity		180
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
<b>Each of Years 4 and 5</b>		
Remuneration cost	60	
Equity		60
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (120 × (1 year / 2 years))</i>		

**Example 12.4.5 – Acquiree awards for which future service is required are replaced by awards that require no future service (new grant approach)**

Assume the same facts as in [Example 12.4.4](#) except that no post-combination service is required for Company G's employees to vest in the replacement awards; this means that the replacement awards vest a year earlier than the acquiree awards would have vested under their original terms.

**Amount attributed to pre-combination service**

$$300^1 \times 75\% (3 \text{ years} / 4 \text{ years})^2 = 225$$

1. Market-based measure of the acquiree awards at the date of acquisition.
2. Ratio of service rendered as at 31 December Year 3 compared with the greater of the original vesting period (four years) and the sum of the service provided in the pre-combination period (three years) plus the post-combination vesting period (zero years).

**Amount attributed to post-combination service**

$$300^3 - 225^4 = 75$$

3. Market-based measure of the replacement awards.
4. Amount attributed to pre-combination service (see [above](#)).

Because no service is required after the date of the business combination, the amount attributed to post-combination service is recognised immediately as remuneration cost in accordance with IFRS 2.

In its consolidated financial statements, F records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Consideration transferred	225	
Equity		225
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
Remuneration cost	75	
Equity		75
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2</i>		

**12.4.30****Replacement awards with expected forfeitures****Replacement awards without a change in estimated forfeitures**

IFRS 2.19–21, 30,  
3.B60

The recognition of remuneration cost in respect of share-based payment awards is based on the best available estimate at the date of acquisition of the total number of replacement awards expected to vest. Accordingly, the determination of the amount of replacement awards to be attributed to pre- and post-combination service takes into account the expected rate of forfeitures of the replacement awards due to expected failure to meet vesting conditions other than market conditions (see [6.2.10](#)).

**Example 12.4.6 – Replacement awards that are not all expected to vest (new grant approach)**

Company P acquires Company S in a business combination on 1 January Year 3. Under the terms of the acquisition agreement, P issues replacement awards in exchange for acquiree awards held by employees of S. The market-based measure of both the acquiree awards and the replacement awards is 200 at the date of acquisition. The acquiree awards were granted on 1 January Year 1, subject to a five-year service condition. The replacement awards require three years of service to be provided subsequent to the date of acquisition for the awards to vest – i.e. the vesting period is not changed as a result of the acquisition. At the date of acquisition, P estimates that 95% of the awards will vest.

**Amount attributed to pre-combination service**

$$200^1 \times 95\%^2 \times 40\% (2 \text{ years} / 5 \text{ years})^3 = 76$$

1. Market-based measure of the acquiree awards at the date of acquisition.
2. Estimate of portion of awards expected to vest.
3. Ratio of service rendered as at 1 January Year 3 compared with the greater of the original vesting period (five years) and the sum of the service provided in the pre-combination period (two years) plus the post-combination vesting period (three years); both periods are five years.

**Amount attributed to post-combination service**

$$200^4 \times 95\% - 76^5 = 114$$

4. Market-based measure of the replacement awards.
5. Amount attributed to pre-combination service (see [above](#)).

The 114 attributed to post-combination service is recognised in accordance with IFRS 2.

In its consolidated financial statements, P records the following entries.

	Debit	Credit
<b>Year 3</b>		
Consideration transferred	76	
Equity		76
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
<b>Each of Years 3, 4 and 5</b>		
Remuneration cost	38	
Equity		38
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (114 x (1 year / 3 years))</i>		

**Subsequent changes in estimated forfeitures**

IFRS 3.B60

Consistent with the guidance in IFRS 2, changes in estimated forfeitures are reflected as an adjustment to post-combination remuneration cost in the period in which the change in estimate occurs. Therefore, the acquirer does not adjust consideration transferred in periods subsequent to the date of acquisition if actual forfeitures differ from the forfeitures estimated at the date of acquisition.

**Example 12.4.7 – Subsequent change in estimated forfeitures (new grant approach)**

Assume the same facts as in [Example 12.4.6](#) except that, subsequent to the acquisition, employee turnover increases unexpectedly among Company S's employees. At 31 December Year 4, the end of the second year after the date of acquisition, the estimate of total forfeitures increases to 14% – i.e. only 86% of the awards are expected to vest. The effect of the change in the estimate of the number of awards expected to vest is reflected in the calculation of remuneration cost from the period in which that change in estimate is made.

The amount of the replacement awards attributable to post-combination service in respect of the year ending 31 December Year 3, estimated at 38 (see [Example 12.4.6](#)), is not restated, nor is the amount attributed to pre-combination service, estimated at 76.

**Revised amount attributed to post-combination service**

$$200^1 \times 86\%^2 - 76^3 = 96$$

1. Market-based measure of the replacement awards.
2. Revised estimate of awards expected to vest.
3. Amount attributable to pre-combination service (see [Example 12.4.6](#)).

In its consolidated financial statements, P records the following entry.

	<i>Debit</i>	<i>Credit</i>
<b>Year 4</b>		
Remuneration cost	26	
Equity		26
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (96 x (2 years / 3 years) - 38<sup>1</sup>)</i>		

**Note**

1. Remuneration cost recognised in Year 3.

In Year 5 (the third year after the business combination), the actual forfeitures equal the revised estimate.

In its consolidated financial statements, P records the following entry.

	<i>Debit</i>	<i>Credit</i>
<b>Year 5</b>		
Remuneration cost	32	
Equity		32
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (96 x (3 years / 3 years) - 38<sup>1</sup> - 26<sup>2</sup>)</i>		

**Notes**

1. Remuneration cost recognised in Year 3.
2. Remuneration cost recognised in Year 4.

Likewise, an acquirer does not adjust the amount of consideration transferred when other changes result in a change in the estimate of the number of awards expected to vest – e.g. those related to non-market performance conditions or modifications occurring after the date of acquisition. Accordingly, all relevant information is taken into account when determining the probability of meeting a non-market performance condition at the date of acquisition. For example, if at the date of acquisition it is not probable that a non-market performance condition for the replacement awards will be met, then no amount is attributed to pre-combination service and recognised as part of the consideration transferred. If the non-market condition of the replacement award is ultimately met, then the whole amount of the acquisition-date market-based measure of that award is recognised as post-combination remuneration cost.

## 12.4.40 Replacement awards with market or non-vesting conditions

### Replacement awards with market conditions

*IFRS 2.A*

A share-based payment may contain a market condition – i.e. a performance condition that determines whether a share-based payment vests that is related to the market price of the entity's equity instruments. For a discussion of the accounting for a market condition, see [6.2.10](#).

*IFRS 3.B56–B62*

The attribution of the acquisition-date market-based measure of the replacement awards to pre- and post-combination service follows the general requirements set out in IFRS 3. This applies regardless of the classification of the share-based payment as equity-settled or cash-settled.

However, the accounting for the replacement awards during the post-combination periods differs depending on the classification of the share-based payment – i.e. depending on whether the replacement awards with a market condition are classified as equity-settled or cash-settled.

- If the market condition of an equity-settled share-based payment is not met, then the accounting for the post-combination remuneration cost is not affected. For a discussion of equity-settled share-based payments, see [Section 6](#).
- If the market condition of a cash-settled share-based payment is not met, then the liability is reversed through profit or loss, even though the amount of the liability recognised for service attributed to pre-combination service remains in the consideration transferred. For a discussion of cash-settled share-based payments, see [Section 7](#).

There is no guidance on whether the remeasurement of the liability for a cash-settled share-based payment should be presented in profit or loss as a remuneration cost or as a finance income or cost (see [Chapter 7.3](#)).



#### Example 12.4.8 – Equity-settled replacement awards with a market condition that is ultimately not met (new grant approach)

On 1 January Year 1, Company L grants its CEO share options. The options vest if, at the vesting date, the CEO is still in service with L and if L's share price has increased by at least 20%. The vesting date of the acquiree award is 31 December Year 3 (a three-year service condition).

Company K acquires L on 1 January Year 2. At that date, the market-based measure of the acquiree's awards is 120. The acquisition agreement states that K is obliged to issue the CEO a replacement award. The replacement options (on shares of K) issued by K at the date of acquisition have a remaining vesting period of two years and vest if, at the vesting date, the CEO is still in service with the 'combined entity' and if K's share price has increased by at least 15%. It is expected that the CEO will remain employed by the group until the vesting date. The market-based measure of the replacement awards at the date of acquisition is 130.

Late in Year 2, it is still expected that the CEO will remain in service until the end of the vesting period.

**Amount attributed to pre-combination service**

$$120^1 \times 100\%^2 \times 33\% (1 \text{ year} / 3 \text{ years})^3 = 40$$

1. Market-based measure of the acquiree award at the date of acquisition.
2. The CEO is expected to remain employed by the group, so the estimated forfeiture rate is zero.
3. Ratio of service rendered as at 1 January Year 2 compared with the greater of the original vesting period (three years) and the sum of the service rendered in the pre-combination period (one year) plus the post-combination vesting period (two years); both periods are three years.

**Amount attributed to post-combination service**

$$130^4 \times 100\% - 40^5 = 90$$

4. Market-based measure of the replacement award.
5. Amount attributed to pre-combination service (see [above](#)).

The 90 attributed to post-combination service is recognised in accordance with IFRS 2.

In its consolidated financial statements, K records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Consideration transferred	40	
Equity		40
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
Remuneration cost	45	
Equity		45
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (90 x (1 year / 2 years))</i>		

Due to a downturn in the markets during the second half of Year 3, K's share price decreases significantly and the market condition is not met at 31 December Year 3. The CEO is still in service on that date. Despite the market condition ultimately not being met, K continues to recognise the post-combination remuneration cost estimated at the date of acquisition; it is not reversed.

In its consolidated financial statements, K records the following entry.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Remuneration cost	45	
Equity		45
<i>To recognise replacement awards attributed to post-combination service in accordance with IFRS 2 (90 x (2 years / 2 years) - 45)</i>		



### Example 12.4.9 – Cash-settled replacement award with market condition that is ultimately not met (new grant approach)

Assume the same facts as in [Example 12.4.8](#) except that the replacement and acquiree award granted to the CEO are cash-settled SARs. The market-based measures of the replacement awards is 150 at 31 December Year 2.

#### Amount attributed to pre-combination service

$$120^1 \times 100\%^2 \times 33\% (1 \text{ year} / 3 \text{ years})^3 = 40$$

1. Market-based measure of the acquiree award at the date of acquisition.
2. The CEO is expected to remain employed by the group, so the estimated forfeiture is zero.
3. Ratio of service rendered as at 1 January Year 2 compared with the greater of the original vesting period (three years) and the sum of the service rendered in the pre-combination period (one year) plus the post-combination vesting period (two years); both are three years.

#### Amount attributed to post-combination service

$$130^4 \times 100\% - 40^5 = 90$$

4. Market-based measure of the replacement award.
5. Amount attributed to pre-combination service (see [above](#)).

In its consolidated financial statements, K records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Consideration transferred	40	
Liability		40
<i>To recognise replacement award attributed to pre-combination service as part of consideration transferred</i>		
Remuneration cost	45	
Liability		45
<i>To recognise replacement award attributed to post-combination service in accordance with IFRS 2 (90 x (1 year / 2 years))</i>		
Remuneration cost	10	
Liability		10
<i>To recognise remeasurement of liability in accordance with IFRS 2 ((150 - 130) x (1 year / 2 years))</i>		

At the end of Year 3 (two years after the business combination), the market-based measure of the replacement awards is revised to zero, because the market condition is ultimately not met.

In its consolidated financial statements, K records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Remuneration cost	45	
Liability		45
<i>To recognise replacement award attributed to post-combination service in accordance with IFRS 2 (90 x (2 year / 2 years) - 45)</i>		
Liability	140	
Remuneration cost		140
<i>To recognise remeasurement of liability in accordance with IFRS 2 (40 + 45 + 10 + 45)</i>		

As illustrated in [Examples 12.4.8–9](#), the overall impact of not meeting a market condition can differ significantly depending on the classification of the share-based payment. In an equity-settled share-based payment (see [Example 12.4.8](#)), the accounting for the post-combination remuneration cost is not affected if a market condition is not met. In contrast, if such a condition is not met in a cash-settled share-based payment (see [Example 12.4.9](#)), then the liability is reversed through profit or loss, even though the amount of the liability recognised for services attributed to the pre-combination service remains in consideration transferred.

<b>Cumulative journal entry Example 12.4.8 (equity-settled)</b>			<b>Cumulative journal entry Example 12.4.9 (cash-settled)</b>		
	<i>Debit</i>	<i>Credit</i>		<i>Debit</i>	<i>Credit</i>
Consideration transferred	40		Consideration transferred	40	
Remuneration cost	90		Remuneration cost		40
Equity		130			

### Replacement awards with non-vesting conditions

IFRS 3.30

At the date of acquisition, non-vesting conditions, like market conditions, are reflected in the market-based measure of the share-based payment regardless of its classification as cash-settled or equity-settled (see [6.2.10](#) and [7.2.10](#)).

However, the accounting for replacement awards with a non-vesting condition during the post-combination period depends on the classification of the share-based payment (i.e. whether it is equity-settled or cash-settled). Accounting requirements for equity-settled share-based payments are addressed in [Section 6](#); cash-settled share-based payments are addressed in [Section 7](#).

If a replacement award contains a non-vesting condition, then the accounting consequences of not meeting the condition depend on whether it was the employer, the employee or neither who could choose to meet that non-vesting condition (see [Chapter 5.4](#) and [6.2.10](#)).

**Example 12.4.10 – Equity-settled replacement award with non-vesting condition that counterparty can choose to meet (new grant approach)**

On 1 January Year 1, Company N granted employee share options. The options vest on 31 December Year 3, if the employee is still in service with N (a three-year service condition). There is a non-vesting condition requiring the employee to pay a monthly deposit, which will be used to pay the exercise price of the options after three years, with accumulated interest paid to the employee. The options lapse if the employee stops contributing a deposit, in which case N will refund to the employee the contributed amount plus accumulated interest.

Company M acquires N on 1 January Year 2. At that date, the market-based measure of the employee's award is 72 and the employee has paid all required deposits. The acquisition agreement states that M is obliged to issue the employee a replacement award. The vesting date of the replacement award is 31 December Year 3. The service condition and non-vesting condition attached to the replacement award are the same as those attached to the original award. The market-based measure of the replacement award at the date of acquisition is 108 taking account of the non-vesting condition, and the employee is expected to remain in service until vesting date.

In December Year 2, M's share price has dropped and the employee does not expect the share price to increase to greater than the exercise price of the options. Therefore, the employee does not pay the required deposit and the options lapse in December Year 2.

**Amount attributed to pre-combination service**

$$72^1 \times 100\%^2 \times 33\% (1 \text{ year} / 3 \text{ years})^3 = 24$$

1. Market-based measure of the acquiree award at the date of acquisition.
2. The employee is expected to remain employed by the group, so the estimated forfeiture rate is zero.
3. Ratio of service rendered as at 1 January Year 2 compared with the greater of the original vesting period (three years) and the sum of the service rendered in the pre-combination period (one year) plus the post-combination vesting period (two years); both periods are three years.

**Amount attributed to post-combination service**

$$108^4 \times 100\% - 24^5 = 84$$

4. Market-based measure of the replacement award.
5. Amount attributed to pre-combination service (see [above](#)).

In its consolidated financial statements, M records the following entries.

	Debit	Credit
<b>Year 2</b>		
Consideration transferred	24	
Equity		24
<i>To recognise replacement award attributed to pre-combination service as part of consideration transferred</i>		

	<i>Debit</i>	<i>Credit</i>
Remuneration cost	84	
Equity		84
<i>To recognise replacement award attributed to post-combination service in accordance with IFRS 2<sup>1</sup></i>		
<b>Note</b>		
1. Because the employee has chosen not to meet the non-vesting condition, the failure to meet that condition (payment of the deposit) is treated as a cancellation (see 6.2.10). Under cancellation accounting, the full amount of the post-combination remuneration cost is recognised immediately (accelerated vesting) in profit or loss (see Chapter 9.3).		

## 12.4.50

### Replacement awards with various other features

#### Share-based payment award includes change-in-control clause

Share options or other share-based payment plans often include a clause that provides for the acceleration of vesting in the event of a change in control of the issuer (a change-in-control clause). In other instances, existing awards are sometimes modified to add a change-in-control clause in contemplation of a change in control of an acquiree. The effect of a change-in-control clause that accelerates vesting on the attribution of an acquirer's replacement awards between pre- and post-combination service depends on how the change-in-control clause arose. For a discussion of share-based payments that expire on change in control and are voluntarily replaced, see Chapter 12.3.

In some circumstances, a change-in-control clause is included in the original terms of an acquiree award and the clause is triggered by an acquisition of the acquiree such that unvested awards vest immediately at the date of acquisition. In these cases, the shortened vesting period resulting from the change in control was provided for by the terms of the acquiree award and is, in our view, regarded as the original vesting period for the purpose of determining the amount of a replacement award to be attributed to pre- and post-combination service.

For example, an acquiree award that includes a change-in-control clause providing for the acceleration of vesting is exchanged for a replacement award that does not require post-combination service to vest. In this case, we believe that the original vesting period and the sum of the pre-combination vesting period plus the post-combination vesting period is the same for the purpose of attributing the replacement award to pre- and post-combination service. Accordingly, if in such situations the market-based measure of the replacement award is not in excess of that of the acquiree award, then we believe that the total market-based measure of the replacement award should be attributed to the consideration transferred in the business combination; no amount should be attributed to post-combination remuneration cost. Any market-based measure of the replacement award in excess of that of the acquiree award is recognised as post-combination cost, following IFRS 2.

**Example 12.4.11 – Immediate vesting on change in control (new grant approach)**

On 1 January Year 1, Company R grants its employees a share-based payment award. Under the terms of the award, the entire award vests at the end of four years of service; however, the award vests immediately in the event of a change in control of R. Assume that forfeitures are estimated at zero.

Company Q acquires R on 1 January Year 3. Because of the change-in-control clause, R's share-based payment award vests immediately at the date of acquisition. At that date, the market-based measure of the fully vested R award is 200, and Q issues a fully vested replacement award to R's employees with a market-based measure of 200.

**Amount attributed to pre-combination service**

$$200^1 \times 100\% (2 \text{ years} / 2 \text{ years})^2 = 200$$

1. Market-based measure of acquiree award at the date of acquisition.
2. Ratio of service rendered as at 1 January Year 2 compared with the greater of the original vesting period (two years) and the sum of the service rendered in the pre-combination period (two years) plus the post-combination vesting period (zero years); both periods are two years.

**Amount attributed to post-combination service**

$$200^3 - 200^4 = 0$$

3. Market-based measure of replacement award.
4. Amount attributed to pre-combination service (see [above](#)).

In its consolidated financial statements, Q records the following entry.

	<i>Debit</i>	<i>Credit</i>
<b>Year 2</b>		
Consideration transferred	200	
Equity		200
<i>To recognise replacement award attributed to pre-combination service as part of consideration transferred</i>		

The replacement of a fully vested acquiree award by a fully vested replacement award of higher value is illustrated in [Example 12.4.2](#).

**Acquirer requests modification of acquiree award in contemplation of change in control***IFRS 3.B50*

If a change-in-control clause that provides for the acceleration of vesting is added to the terms of the acquiree's share-based payment award at the request of the acquirer, and is replaced by a fully vested acquirer award, then in our view the accounting should be the same as if the acquirer issued a fully vested replacement award in exchange for an unvested acquiree award. This is consistent with the guidance in IFRS 3 that a transaction entered into by the acquirer and the acquiree during negotiations of the terms of the business combination for the benefit of the combined entity is more likely to be separate from the business combination.

**Example 12.4.12 – Vesting on change in control linked to acquisition (new grant approach)**

On 1 January Year 1, Company S granted its CEO a share-based payment award. The terms of the award provided for the vesting of the entire award at the end of four years.

Company P acquires S on 1 January Year 2. Shortly before the date of acquisition, in contemplation of the acquisition, S modifies the award to add a change-in-control clause at the request of P. At the date of acquisition, the market-based measure of the acquiree award is 200. At the date of acquisition, P then issues a fully vested replacement award in exchange for S's award. The estimated forfeiture rate is zero.

In this example, the modification of the CEO's award is made at the request of P and is accounted for separately from the business combination.

Accordingly, we believe that the attribution of the market-based measure of the replacement award issued by P between pre- and post-combination service should be the same as it would have been had S's award remained outstanding under its original terms at the date of acquisition and been exchanged for an identical fully vested replacement award issued by P (see [Example 12.4.5](#)). This means that the amount attributed to post-combination service will be recognised immediately.

**Example 12.4.13 – Vesting on change in control linked to acquisition: Settled in cash**

On 1 January Year 1, Company S grants its employees awards, subject to a four-year service period. On 1 January Year 3, Company P acquires S. Shortly before the date of acquisition, in contemplation of the acquisition P asks S to modify the awards to accelerate vesting on a change in control, which entitles S's employees to a cash payment equal to the market-based measure of the acquiree award at the date of acquisition with no future service required. At the date of acquisition, the market-based measure of the acquiree award is 100.

When an acquirer settles in cash an acquiree's awards, at the acquirer's request, the cash payment is generally considered a transaction that is separate from the business combination. Like in [Example 12.4.12](#), the modification of the employees' awards is made at the request of P, and therefore is accounted for separately from the business combination.

To determine the amount attributed to pre-combination service, the following points are relevant.

- The period for which service has been provided by S's employees before the date of acquisition is two years.
- The vesting period of the original (acquiree) awards is four years.
- The vesting period of the replacement awards is zero.

The total vesting period is two years and the original vesting period is four years. The greater of those two periods is therefore four years.

**Amount attributed to pre-combination service**

$$100^1 \times 50\% (2 \text{ years} / 4 \text{ years})^2 = 50$$

**Notes**

1. Market-based measure of the acquiree awards at the date of acquisition.
2. Ratio of service rendered as at 1 January Year 3 compared with the greater of the original vesting period (four years) and the sum of the pre-combination period for which service has been provided (two years) plus the post-combination vesting period (zero years).

**Amount attributed to post-combination service**

$$100^3 - 50^4 = 50$$

**Notes**

3. Market-based measure of the replacement awards (the cash payment) at the date of acquisition.

4. Amount attributed to pre-combination service (see [above](#)).

For a discussion of the recognition of the amount of post-combination service, see [12.4.20](#).

**Awards with graded vesting**

IFRS 2.IG11

In some cases, share-based payment awards vest in instalments over the vesting period (graded-vesting awards). IFRS 2 requires each such instalment to be treated as a separate grant of share-based payment awards (see [6.4.20](#)). Accordingly, an entity determines the portion of replacement awards to be attributed to the pre- and post-combination service separately for each tranche of a graded-vesting award.

**Example 12.4.14 – Graded-vesting replacement awards (new grant approach)**

Company P acquires Company S on 1 January Year 1. Under the terms of the agreement, P issues replacement awards of 100 share options with a market-based measure of 700 (tranche 1: 100; tranche 2: 150; tranche 3: 200; and tranche 4: 250) to replace share options held by S's employees with the same value and vesting conditions on the date of acquisition.

The vesting for the acquiree awards is graded, with 25% vesting each year for four years, rather than all of the awards vesting at the end of a four-year period (a 'cliff-vesting' award). At the date of acquisition, S's employees have provided two years of service.

Assume that estimated and actual forfeitures are zero.

Assuming that none of the options are exercised by the date of acquisition, the amount of the awards attributed to the pre- and post-combination service is determined as follows.

**Amount attributed to pre-combination service**

Tranche 1: 100 x (1 year / 1 year)	100
Tranche 2: 150 x (2 years / 2 years)	150
Tranche 3: 200 x (2 years / 3 years)	133
Tranche 4: 250 x (2 years / 4 years)	125
Total	508

**Amount attributed to post-combination service**

Tranche 1: 100 - 100	-
Tranche 2: 150 - 150	-
Tranche 3: 200 - 133	67
Tranche 4: 250 - 125	125
Total	192

The 192 attributed to post-combination service is recognised in accordance with IFRS 2.

In its consolidated financial statements, Q records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Consideration transferred	508	
Equity		508
<i>To recognise replacement awards attributed to pre-combination service as part of consideration transferred</i>		
Remuneration cost	130	
Equity		130
<i>To recognise replacement award attributed to post-combination service in accordance with IFRS 2 ((67 x (1 year / 1 year)) + (125 x (1 year / 2 years)))</i>		
<b>Year 2</b>		
Remuneration cost	62	
Equity		62
<i>To recognise replacement award attributed to post-combination service in accordance with IFRS 2 (125 x (2 years / 2 years) - 63)</i>		

## 12.5 Unreplaced awards

### 12.5.10 Introduction

*IFRS 3.B62A, B62B*

IFRS 3 also contains guidance about equity-settled acquiree awards that are not replaced (unreplaced awards). This guidance does not apply to cash-settled acquiree awards.

*IFRS 3.B62A*

The accounting requirements for unreplaced acquiree awards distinguish between:

- acquiree awards that were vested at the date of acquisition; and
- acquiree awards that were not vested at the date of acquisition.

### 12.5.20 Vested acquiree awards are not replaced

*IFRS 3.19, B62A*

If equity-settled unreplaced acquiree options are vested but unexercised at the date of acquisition, then those acquiree awards form part of the non-controlling interests (NCI) in the acquiree and are measured at their market-based measure at the date of acquisition in accordance with IFRS 2. This assumes that the awards do not represent present ownership interests or entitle their holders to a proportionate share of the acquiree's net assets in the event of liquidation. The NCI are taken into account in the IFRS 3 acquisition accounting and affect the calculation of goodwill or a gain on bargain purchase.

**Example 12.5.1 – Vested equity-settled acquiree awards that are not replaced**

On 1 January Year 3, Company E acquires 100% of Company F's ordinary shares for cash of 300. The fair value of F's identifiable net assets at the date of acquisition is 320. In addition, F's employees hold share options at that date. All of the acquiree awards were granted on 1 January Year 1 – i.e. two years before the date of acquisition – are subject to a two-year service condition and can be exercised any time thereafter within three years. Therefore, these acquiree awards are fully vested at the date of acquisition.

E decides not to replace the acquiree awards. At the date of acquisition, the market-based measure of the acquiree awards is 48.

The acquiree options are part of the NCI in the acquiree (although such NCI are not present ownership interests that entitle their holders to a proportionate share of the entity's net assets in the event of liquidation) and are measured at their market-based measure at the date of acquisition.

E recognises the following entry.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Identifiable net assets of F	320	
Goodwill <sup>1</sup>	28	
Cash		300
Other NCI <sup>2</sup>		48
<i>To recognise the acquisition of F</i>		

Because the acquiree options are vested at the date of the business combination and are not replaced, no amount is attributed to post-combination service.

**Notes**

1. Goodwill is calculated as follows:

Cash consideration	300
Other NCI (unreplaced awards)	48
Total	348
Fair value of F's identifiable net assets acquired	(320)
Goodwill	28

2. Because these NCI are not present ownership interests that entitle their holders to a proportionate share of the entity's net assets in the event of liquidation, the acquiree options form part of the other NCI in the acquiree.

For further discussion of NCI accounting in business combinations, see Chapter 2.6 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#).

**12.5.30**

*IFRS 3.B62A*

**Unvested acquiree awards are not replaced**

If an equity-settled unreplaced acquiree award is not vested at the date of acquisition, then it is measured at its market-based measure as if the date of acquisition were the grant date under IFRS 2. In determining the portion of the market-based measure that is allocated to pre-combination service, all of the relevant data regarding the probability of meeting vesting conditions other than market conditions is taken into account. If the acquiree's awards have non-market performance conditions that are not probable of being met as at the date of acquisition, then no amount is allocated to pre-combination service and therefore no amount is allocated to NCI.

IFRS 3.B62B

If the non-market performance condition is probable of being met such that a portion of the market-based measure is allocated to pre-combination service, then the market-based measure of the unvested share-based payment transaction is allocated to pre-combination service, and therefore to NCI, based on the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the unreplaced awards. The balance is allocated to post-combination service. The attribution formula for unreplaced awards is the same as the formula for replaced awards (see 12.4.10).

The attribution requirements for replaced awards also apply to unreplaced awards in which the vesting period is modified. The portion of the market-based measure allocated to NCI is taken into account in the IFRS 3 acquisition accounting and affects the calculation of goodwill or a gain on bargain purchase. Example 12.5.2 illustrates how the acquirer accounts for an equity-settled unreplaced unvested award in a business combination.



**Example 12.5.2 – Unvested equity-settled acquiree awards that are not replaced: No change in vesting period**

Company G acquires Company H on 1 January Year 3. At the date of acquisition, H’s employees hold share options. All of the acquiree awards were granted on 1 January Year 1 – i.e. two years before the date of acquisition – and have a vesting period of five years; therefore, these acquiree awards are not yet vested at the date of acquisition. All of the vesting conditions are expected to be met.

G decides not to replace or modify the acquiree awards. At the date of acquisition, the market-based measure of the acquiree awards is 60.

**Amount attributed to pre-combination service**

$$60^1 \times 100\%^2 \times 40\% (2 \text{ years} / 5 \text{ years})^3 = 24$$

1. Market-based measure of the unreplaced award at the date of acquisition.
2. The employees are expected to remain employed by the group, so the estimated forfeiture rate is zero.
3. Ratio of service rendered as at 1 January Year 3 compared with the greater of the original vesting period (five years) and the sum of the service rendered in the pre-combination period (two years) plus the post-combination vesting period (three years); both periods are five years.

**Amount attributed to post-combination service**

$$60^4 \times 100\% - 24^5 = 36$$

4. Market-based measure of the unreplaced award at the date of acquisition.
5. Amount attributed to pre-combination service (see above).

In its consolidated financial statements, G records the following entries.

	Debit	Credit
<b>Year 3</b>		
Consideration transferred	24	
NCI		24
<i>To recognise NCI relating to unreplaced acquiree awards</i>		
<b>In each of Years 3, 4 and 5</b>		
Remuneration cost	12	
NCI		12
<i>To recognise unreplaced award attributed to post-combination service in accordance with IFRS 2 (36 x (1 year / 3 years))</i>		

**Example 12.5.3 – Unvested equity-settled acquiree awards that are not replaced: Change in vesting period**

Assume the same facts as in [Example 12.5.2](#) except that the original acquiree awards had a vesting period of three years and G decides to extend the vesting period by one year. In other words, the modified awards require two years of service to vest. At the date of acquisition, the market-based measure of the acquiree awards is 60.

**Amount attributed to pre-combination service**

$$60^1 \times 50\% (2 \text{ years} / 4 \text{ years})^2 = 30$$

1. Market-based measure of the unreplaced award at the date of acquisition.
2. Ratio of service rendered as at 1 January Year 3 compared with the greater of the original vesting period (three years) and the sum of the service rendered in the pre-combination period (two years) plus the post-combination vesting period (two years).

**Amount attributed to post-combination service**

$$60^3 - 30^4 = 30$$

3. Market-based measure of the unreplaced award at the date of acquisition.
4. Amount attributed to pre-combination service (see [above](#)).

In its consolidated financial statements, G records the following entries.

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Consideration transferred	30	
NCI		30
<i>To recognise NCI relating to unreplaced acquiree awards</i>		
<b>In each of Years 3 and 4</b>		
Remuneration cost	15	
NCI		15
<i>To recognise unreplaced award attributed to post-combination service in accordance with IFRS 2 (30 x (1 year / 2 years))</i>		

## 12.6 Replacement awards in the separate financial statements of the acquirer and the acquiree

The requirements in IFRS 3 for the attribution of the market-based measure of replacement awards were developed as part of the requirements for acquisition accounting in the consolidated financial statements of the acquirer (assuming that shares in the acquiree are acquired). It is not clear how replacement awards should be accounted for in the separate financial statements of the acquirer when shares in the acquiree are acquired.

*IAS 27.10*

If an entity accounts for its investments in subsidiaries at cost or under the equity method, then in our view one acceptable approach is to follow the attribution guidance in IFRS 3 by analogy. This is on the basis that, from the point of view of the separate financial statements, the issue of a replacement award may be considered to have been exchanged for two different items:

- as part of the cost of obtaining a controlling interest in the acquiree; and
- for post-acquisition services to be rendered by the acquiree's employees.

*IAS 27.10*

If an entity accounts for its investments in subsidiaries in accordance with IFRS 9 *Financial Instruments*, then it follows the measurement requirements of IFRS 9 and IFRS 13 *Fair Value Measurement* in determining the value of the investment at the date of acquisition.

From the perspective of the acquiree, in its separate financial statements the replacement awards are accounted for in accordance with the guidance on cancellations and replacements. For further discussion of the accounting for cancellations and replacements, see [Section 9](#).

# 13 Other application issues in practice

## Overview

- If a tax deduction in respect of a share-based payment is based on the value of the equity instrument at a future date, then the expected future tax deduction is estimated based on the information available at the reporting date, including the share price, exercise price and number of options expected to be exercised.
- If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative share-based payment cost, then the excess of the associated income tax is recognised directly in equity. Any subsequent reduction in the excess is also recognised in equity.
- In determining the amounts to be recognised in the financial statements in relation to the share-based payment transactions, an entity may need to consider events after the reporting period. Judgement is required to determine whether the event is an adjusting or a non-adjusting event.

## 13.1 Scope of this section

In our experience, the interaction between IFRS 2 *Share-based Payment* and other IFRS Accounting Standards can be difficult. The interaction with some of those standards is addressed in IFRS 2 – e.g. IFRS 3 *Business Combinations*. Some aspects of the interactions with IFRS 3 are covered in other parts of the handbook – e.g. [Section 12](#). However, there are some other accounting standards that are not addressed specifically in IFRS 2 but which raise questions on the interaction with IFRS 2. These include IAS 12 *Income Taxes*, IAS 33 *Earnings per Share* and IAS 10 *Events after the Reporting Period*. In this section, we address some common issues arising in practice. Further guidance on these accounting standards is available in the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#) – see Chapter 3.13 for income taxes, Chapter 5.3 for EPS and Chapter 2.9 for events after the reporting period. Additional guidance on the interaction with IAS 33 is also available in our publication [IFRS Handbook: Earnings per share](#).

## 13.2 Share-based payments and income taxes

### 13.2.10

[IAS 12.5](#)

### Introduction

IAS 12 requires the entity to account for current and deferred income taxes. Deferred taxes arise from temporary differences, which are determined by the difference between the carrying amount of an asset or liability and its tax base. There are two types of temporary differences:

- *taxable temporary differences*: e.g. when the carrying amount of an asset is greater than its tax base, which generally results in recognition of a deferred tax liability; and
- *deductible temporary differences*: e.g. when the carrying amount of an asset is lower than its tax base, which generally results in recognition of a deferred tax asset if the asset recognition criteria in IAS 12 are met.

[IAS 12.9](#)

Another example of a situation in which a deductible temporary difference may arise is when an item has a tax base but is not recognised as an asset or liability in the statement of financial position (e.g. an equity-settled share-based payment).

IAS 12.68A–68B,  
IE.Ex5

In some tax jurisdictions, an entity may receive a tax deduction that differs in amount or timing from the cumulative share-based payment expense recognised in profit or loss. This will generally result in deferred tax on the temporary differences. In our view, the deferred tax should be recognised for each share-based payment arrangement as the services are received over the vesting period.

## 13.2.20 Equity-settled share-based payments

### Tax deduction based on intrinsic value at exercise date

In some cases, the tax deduction may be based on the intrinsic value of the equity instrument at a future date. If this is the case, then the expected future tax deduction is estimated based on the information available at the reporting date. This includes, for example, share price, exercise price and number of options expected to be exercised. The information used to estimate the deductions available in future periods should be consistent with that applied in measuring the share-based payment expense. However, some information may result in an adjustment to the deferred tax but not to the share-based payment expense – e.g. failure to meet a market condition in the case of an equity-settled share-based payment arrangement.

IAS 12.68B, IE.Ex5

The wording of IAS 12 is not explicit about how the tax deduction is calculated during the vesting period. In our experience, the approach set out in the illustrative examples is generally followed, whereby the future tax deduction is based on the completed percentage of the vesting period multiplied by the intrinsic value of the equity instruments at the reporting date.



#### Example 13.2.1 – Tax deduction based on intrinsic value of options at exercise date

On 1 January Year 1, Company B grants 1,000 share options at an exercise price of 100 each to an employee, subject to a two-year service condition. The employee is expected to fulfil the service condition and ultimately does. B will receive a tax deduction in the amount of the intrinsic value of the options when they are exercised; the applicable tax rate is 40%. On 29 January Year 3, the employee exercises all 1,000 options.

The grant-date fair value of each option is 10. The intrinsic value of each option develops as follows.

	Intrinsic value (IV)
1 January Year 1 (grant date)	-
31 December Year 1	5.00
31 December Year 2 (vesting date)	9.00
29 January Year 3 (exercise date)	9.50

At the end of the vesting period, the share price target is not met.

	Share-based payment expense		Estimated future tax deduction	Deferred tax income	
				Cumulative	Current period
	Current period	Cumulative	Intrinsic value x options expected to vest x portion of vesting period	Estimated future tax deduction x tax rate	
Year 1	5,000	5,000	2,500	1,000	1,000
Year 2	5,000	10,000	9,000	3,600	2,600
Totals	10,000	10,000	9,000	3,600	3,600

B accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Share-based payment expenses	5,000	
Equity		5,000
<i>To recognise share-based payment expense in Year 1</i>		
Deferred tax asset	1,000	
Deferred tax income		1,000
<i>To recognise deferred tax income in Year 1 (5,000 × 1/2 × 40%)</i>		
<b>Year 2</b>		
Share-based payment expenses	5,000	
Equity		5,000
<i>To recognise share-based payment expense in Year 2</i>		
Deferred tax asset	2,600	
Deferred tax income		2,600
<i>To recognise deferred tax income in Year 2 ((9,000 × 40%) - 1,000)</i>		

In the year of exercise, B receives a current tax deduction based on the intrinsic value of the options at that date of 3,800 (1,000 × 9.50 × 40%).

	<i>Debit</i>	<i>Credit</i>
<b>Year 3</b>		
Deferred tax expense	3,600	
Deferred tax asset		3,600
<i>To recognise reversal of deferred tax asset</i>		
Receivable from tax authorities	3,800	
Current tax income		3,800
<i>To recognise current tax income</i>		
Cash	100,000	
Equity		100,000
<i>To recognise exercise of options</i>		
<b>Cumulative effects</b>		
Share-based payment expenses	10,000	
Receivable from tax authorities	3,800	
Cash	100,000	
Equity		110,000
Current tax income		3,800

IAS 12.68C

An issue arises if the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative share-based payment expense. This situation indicates that the tax deduction relates not only to remuneration expense, but also to an equity item. In this case, the excess of the associated income tax is recognised directly in equity. Any subsequent reduction in the excess is also recognised in equity. Such an excess benefit over the share-based payment expense may arise if the method of calculating the tax deduction differs from the method of calculating the IFRS 2 measure. An example is when the future tax deduction is measured based on the intrinsic value of share options rather than the grant-date fair value.

The excess is determined at each reporting date on a cumulative basis. The amount recognised in equity equals the excess multiplied by the tax rate. To achieve this, the movements in the excess also flow through equity. That is, if an excess recognised in equity is subsequently reversed, partially or in full, then the reversal is also recognised directly in equity (see [Example 13.2.2](#)).



**Example 13.2.2 – Tax deduction based on intrinsic value of options at exercise date:  
Excess tax deduction recognised in equity**

Assume the same fact pattern as in [Example 13.2.1](#), except that the vesting period is four years and the development of the intrinsic value of the share options is different.

The grant-date fair value of the options is 10. The intrinsic value of the options is as follows.

	Intrinsic value (IV)
1 January Year 1 (grant date)	-
31 December Year 1	5.00
31 December Year 2	10.00
31 December Year 3	13.00
31 December Year 4 (vesting date)	11.00
29 January Year 5 (exercise date)	11.50

	Share-based payment expense		Estimated future tax deduction	Excess of tax deduction	Deferred tax			
					Cumulative	Current period	Recognised in equity	Recognised in profit or loss
	Current period	Cumulative	Intrinsic value x options expected to vest x portion of vesting period	D - C, if >0				
	A	B	C	D	E	F	G	H
Year 1	2,500	2,500	1,250	-	500	500	-	500
Year 2	2,500	5,000	5,000	-	2,000	1,500	-	1,500
Year 3	2,500	7,500	9,750	2,250	3,900	1,900	900	1,000
Year 4	2,500	10,000	11,000	1,000	4,400	500	(500)	1,000
Totals	10,000	10,000	11,000	1,000	4,400	4,400	400	4,000

The example shows that when the actual final deduction exceeds the cumulative amount recognised as a share-based payment expense in profit or loss, the maximum amount of deferred tax income recognised in profit or loss (i.e. 4,000) equals the total share-based payment expense (i.e. 10,000) multiplied by the tax rate (40%). Any excess deferred tax income is recognised directly in equity 400 (4,400 - 4,000).

This example further shows that recognition in equity starts in the period in which the intrinsic value is higher than the grant-date fair value and that it is partially reversed when that difference decreases.

B accounts for the transaction as follows.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Share-based payment expenses	2,500	
Equity		2,500
<i>To recognise share-based payment expense</i>		
Deferred tax asset	500	
Deferred tax income		500
<i>To recognise deferred tax income</i>		
<b>Year 2</b>		
Share-based payment expenses	2,500	
Equity		2,500
<i>To recognise share-based payment expense</i>		
Deferred tax asset	1,500	
Deferred tax income		1,500
<i>To recognise deferred tax income</i>		
<b>Year 3</b>		
Share-based payment expenses	2,500	
Equity		2,500
<i>To recognise share-based payment expense</i>		
Deferred tax asset	1,900	
Deferred tax income		1,000
Equity		900
<i>To recognise deferred tax income with excess being recognised in equity ((9,750 - 7,500) x 40%)</i>		
<b>Year 4</b>		
Share-based payment expenses	2,500	
Equity		2,500
<i>To recognise share-based payment expense</i>		
Deferred tax asset	500	
Equity	500	
Deferred tax income		1,000
<i>To recognise deferred tax income with partial reversal of excess being recognised in equity ((11,000 - 10,000) x 40%) - 900)</i>		

In the year of exercise, B receives a current tax deduction based on the intrinsic value of the options at that date of 4,600 (1,000 x 11.50 x 40%).

The maximum amount of that current tax income to be recognised in profit or loss is 4,000 (10,000 x 40%). The remaining amount is credited directly to equity.

	<i>Debit</i>	<i>Credit</i>
<b>Year 5</b>		
Deferred tax expense	4,000	
Equity	400	
Deferred tax asset		4,400
<i>To recognise reversal of deferred tax asset</i>		
Receivable from tax authorities	4,600	
Current tax income		4,000
Equity		600
<i>To recognise current tax income</i>		
Cash	100,000	
Equity		100,000
<i>To recognise exercise of options</i>		
<b>Cumulative effects</b>		
Share-based payment expenses	10,000	
Receivable from tax authorities	4,600	
Cash	100,000	
Equity		110,600
Current tax income		4,000

### Other tax deductions

An entity may settle the share-based payment transaction by transferring treasury shares and receive a tax deduction based on the cost of the treasury shares. In this case, the entity estimates its expected future tax deduction based on the cost of the treasury shares.

In other cases, current tax deductions are available based on the intrinsic value of a share-based payment award at grant date. In these circumstances, in our view an entity should choose an accounting policy, to be applied consistently, based on one of the following approaches.

- Recognise deferred tax between points in time at which the share-based payment cost is recognised and the associated tax deduction is given. This results in a similar approach of recognising deferred tax irrespective of whether the tax deduction is received before or after the share-based payment expense is recognised.
- Recognise the current tax deduction entirely in equity at grant date and then reclassify it to profit or loss over the vesting period, such that no deferred tax is recognised.
- Recognise a deferred tax liability at the time when the tax deduction is received and build up a deferred tax asset as the share-based payment expense is recognised. The resulting asset and liability are then offset at the end of the vesting period.

### 13.2.30 Cash-settled share-based payments

IAS 12.IE.Ex5

For a cash-settled share-based payment, sometimes a tax deduction is received for an amount equal to the ultimate payment when it is made. In these cases, a question arises over whether the temporary difference should reflect the:

- carrying amount of the share-based payment liability, which is measured at fair value under IFRS 2 (see 7.2.10); or
- intrinsic value based on the price of the underlying share at the reporting date.

Determining the temporary difference with reference to fair value would be consistent with general practice for calculating deferred tax on revalued items; for further guidance on this issue see Chapter 3.13 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#). Conversely, the guidance on deferred tax inserted into IAS 12 as a result of the issuance of IFRS 2 refers explicitly to *intrinsic* value in the case of equity-settled share-based payments. In our view, an entity should choose an accounting policy, to be applied consistently, in these circumstances.

### 13.2.40 Accounting for income tax effects of equity-settled replacement awards in business combination

IFRS 3.B62, IAS 12.IE.  
Ex6

An acquirer may issue an equity-settled replacement award that will result in a tax deduction at a later date. In this case, it recognises a deferred tax asset as part of the acquisition accounting for the deductible temporary difference that relates to the portion of the award attributed to pre-combination employee service. For portions of the award attributable to post-combination employee services, it recognises a deferred tax asset in the period in which the cost is recognised for financial reporting purposes. In this respect, it follows the principles discussed in 3.13.590.90 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#).

The deferred tax asset recognised as part of the acquisition accounting may subsequently be remeasured for changes in the amount expected to be received as a tax deduction – e.g. due to fluctuations in the market price of the related shares. IAS 12 does not stipulate how such changes in that deferred tax asset arising from the expected tax deduction are recognised. In our view, an entity should choose an accounting policy, to be applied consistently, to:

- recognise all such changes in profit or loss;
- recognise all such changes directly in equity; or
- recognise the effect of estimated future tax deductions in excess of a certain amount directly in equity and other such changes in profit or loss ('asymmetric' accounting policy).

An entity that adopts the 'asymmetric' accounting policy recognises changes in the expected tax deduction differently depending on whether the total estimated tax deduction attributed to the pre-combination service element of an award exceeds the amount of the acquisition-date market-based measure of that element of the award. To the extent that the expected tax deduction exceeds the market-based measure, the related tax effects are recognised in equity. All other such changes are recognised in profit or loss.

## 13.2.50

### Tax-deductible share-based payment replacement awards – Illustrative examples

The following two examples illustrate the accounting for income taxes related to share-based payment replacement awards.



#### Example 13.2.3 – Fully vested awards

Company B acquires Company C on 1 January Year 1. B issues replacement awards of 100 share options over B's shares with a total market-based measure of 100 and an exercise price of 2.00 each to replace share options with a market-based measure on the date of acquisition of 100 held by C's employees. The share option replacement awards are tax deductible, with the amount of the tax deduction based on the intrinsic value of the awards at exercise date. At the date of acquisition, the awards are fully vested and the replacement awards require no further services to vest. Accordingly, the entire market-based measure of the replacement awards is attributed to the pre-combination services. The options must be exercised by 31 December Year 1. B's share price on the date of acquisition is 2.75. The applicable tax rate is 40%. Assume that B expects sufficient future taxable income to enable it to recognise all of its deferred tax assets.

All of the holders of the replacement awards exercise their options on 31 December Year 1, when the share price is 3.25.

B accounts for the transactions as follows.

	Debit	Credit
<b>1 January Year 1</b>		
Deferred tax asset	30	
Goodwill		30
<i>To recognise deferred tax asset in acquisition accounting based on then-expected future tax deduction</i>		

The amount of 30 is calculated as 100 awards at an expected deduction of 0.75 (2.75 - 2.00) per award, based on the share price at the date of acquisition multiplied by the applicable tax rate of 40%.

	Debit	Credit
<b>31 December Year 1</b>		
Deferred tax asset	20	
Deferred tax income in profit or loss		20
<i>To recognise increase in deferred tax asset initially recognised based on increase in then-expected future tax deduction</i>		

The increase in the deferred tax asset of 20 is based on the tax rate of 40% multiplied by a 0.50 (3.25 - 2.75) increase in the expected tax deduction, based on the share price at the reporting date of 100 awards.

In the example, the deferred tax income is credited to profit or loss. We believe that, depending on B's accounting policy choice, the deferred tax income of 20 may be recognised directly in equity, or partly in profit or loss and equity (see 13.2.40). The estimated tax deduction at 31 December Year 1 is 125 ((3.25 - 2.00) x 100). This amount exceeds the acquisition-date market-based measure of the replacement awards (100) (the 'certain' amount). If the tax effect is recognised partly in equity and partly in profit or loss, then the tax effect on the excess, which amounts to 10 ((125 - 100) x 40%) is recognised in equity, and an amount of 10 ((100 x 40%) - 30) is recognised in profit or loss.

Based on B's accounting policy choice to recognise all deferred taxes in profit or loss, the subsequent journal entries are as follows.

	<i>Debit</i>	<i>Credit</i>
<b>31 December Year 1</b>		
Current taxes receivable	50	
Current tax income in profit or loss		50
<i>To recognise current tax effects of exercise of all share options</i>		
<b>31 December Year 1</b>		
Deferred tax expense	50	
Deferred tax asset		50
<i>To recognise reversal of deferred tax effects following exercise of all share options</i>		

The amount of 50 is calculated as the tax deduction of the intrinsic value (3.25 - 2.00) of 100 share options at the applicable tax rate of 40%. This equals the total deferred tax asset recognised at 31 December Year 1, being the sum of the deferred tax asset initially recognised in the acquisition accounting and the subsequent adjustments made in the year ended 31 December Year 1 to reflect changes in the expected amount of future tax deductions (30 + 20).

	<i>Debit</i>	<i>Credit</i>
<b>Cumulative effects</b>		
Current taxes receivable	50	
Goodwill		30
Income tax in profit or loss		20



### Example 13.2.4 – Awards that require further service subsequent to the business combination

Assume the same facts as in [Example 13.2.3](#) except that the acquisition-date market-based measure of the options of 100 is attributed 50 to the pre-combination services (recognised in the acquisition accounting) and 50 to the post-combination services (accounted for separately from the business combination). In addition, assume a post-combination service period of one year, after which all of the options are exercised.

The initial recognition of the deferred tax asset in respect of the replacement awards attributed to the pre-combination services is as follows.

	<i>Debit</i>	<i>Credit</i>
<b>31 December Year 1</b>		
Deferred tax asset	15	
Goodwill		15
<i>To recognise deferred tax asset in acquisition accounting based on then-expected future tax deduction</i>		

The amount of 15 is calculated as 100 awards at an expected deduction of 0.75 (2.75 - 2.00) per award, based on the share price at the date of acquisition multiplied by the applicable tax rate of 40% multiplied by the 50% attributed to the business combination.

The remeasurement of the deferred tax asset in respect of the replacement awards attributed to the pre-combination services is as follows.

	Debit	Credit
<b>31 December Year 1</b>		
Deferred tax asset	10	
Deferred tax income in profit or loss		10
<i>To recognise increase in deferred tax asset initially recognised in respect of replacement awards attributed to pre-combination service based on increase in then-expected future tax deduction</i>		

The increase in the deferred tax asset is based on the tax rate of 40% multiplied by a 0.50 (3.25 - 2.75) increase in the expected tax deduction, based on the share price at the reporting date of 100 awards, multiplied by the 50% attributed to the business combination.

Alternatively, depending on B's accounting policy choice (see 13.2.40), the deferred tax income of 10 may be recognised directly in equity, or partly in profit or loss and in equity. The estimated tax deduction relating to awards attributed to the pre-combination services at 31 December Year 1 is 62.5 ((3.25 - 2.00) x 50). This amount exceeds the market-based measure of the replacement awards recognised in the acquisition accounting of 50. If the tax effect is recognised partly in equity and partly in profit or loss, then the tax effect on the excess, which amounts to 5 ((62.5 - 50) x 40%) is recognised in equity, and an amount of 5 ((50 x 40%) - 15) is recognised in profit or loss.

The initial recognition of the deferred tax asset in respect of the replacement awards attributed to the post-combination services is as follows (see also 13.2.20 and Example 13.2.2).

	Debit	Credit
<b>31 December Year 1</b>		
Deferred tax asset	25	
Deferred tax income in profit or loss		20
Deferred tax income in equity		5
<i>To recognise tax effects of replacement awards attributed to post-combination services</i>		

The amount of 25 represents the deferred tax asset recognised on the portion of the market-based measure of the awards attributed to the post-combination services. The total tax deduction on the 100 options of 125 (100 x (3.25 - 2.00)) multiplied by the proportion of the total awards attributed to the post-combination services (50%) is 62.5. Therefore, the deferred tax asset is 25 (62.5 x 40%).

Because the amount of the tax deduction of 62.5 exceeds the amount recognised as the cumulative remuneration expense by the combined entity in profit or loss of 50 (100 x 50%), only the tax effect of the cumulative remuneration expense, being 20 (50 x 40%), is recognised in profit or loss. The excess of 5 ((62.5 x 40%) - 20) is recognised directly in equity.

The recognition of the tax effect on the exercise of all share options (i.e. in respect of the replacement awards attributed to the pre-combination and post-combination services) is as follows.

	Debit	Credit
<b>31 December Year 1</b>		
Current taxes receivable	50	
Current tax income in profit or loss		45
Current tax income in equity		5
<i>To recognise current tax effects of exercise of all share options</i>		

IAS 12.68C, IE.Ex5

	<i>Debit</i>	<i>Credit</i>
Deferred tax expense in profit or loss	45	
Deferred tax expense in equity	5	
Deferred tax asset		50
<i>To recognise reversal of deferred tax effects following exercise of all share options</i>		

The amount of 50 is calculated as the tax deduction of the intrinsic value (3.25 - 2.00) of 100 share options at the applicable tax rate of 40%. This equals the total deferred tax asset recognised at 31 December Year 1, being the sum of the deferred tax asset initially recognised in the acquisition accounting (15) and the subsequent adjustments made in the year ended 31 December Year 1 to reflect changes in the expected amount of future tax deductions (10 + 25).

	<i>Debit</i>	<i>Credit</i>
<b>Cumulative effects</b>		
Current taxes receivable	50	
Goodwill		15
Income tax in profit or loss		30
Income tax in equity		5

### 13.3 Share-based payments and EPS calculation

Share-based payments in the scope of IFRS 2 may impact EPS in a variety of ways and therefore it is important to understand how IFRS 2 interacts with IAS 33.

Share-based payments are not isolated as a separate type of instrument in IAS 33; instead they comprise different types of instruments – e.g. share options, unvested shares, contingently issuable shares and convertible bonds – each of which has its own specific EPS considerations. There are three main factors to be considered.

- Settlement alternatives that drive the classification as equity-settled or cash-settled share-based payment under IFRS 2: they determine whether and how EPS is affected (e.g. if a share-based payment is a potentially ordinary share).
- Vesting conditions: they impact how a share-based payment is dealt with in EPS (e.g. as an option or as a contingently issuable share).
- Form of the instrument: it determines which other considerations might be necessary to understand the EPS implications (e.g. dividend entitlements for non-vested shares or exercise prices for options).

In addition, it is worth noting that although the classification of share-based payments is considered in determining the impact of share-based payments on EPS, instances may arise in which the classification of share-based payments under IFRS 2 is different from the classification of share-based payments for the purposes of the calculation of EPS – e.g. when contracts may be settled in ordinary shares or cash.

For more information on the calculation of EPS and interactions of IAS 33 and IFRS 2, see our publication [IFRS Handbook: Earnings per share](#).

## 13.4 Share-based payments and hedging

An entity may buy treasury shares or derivative instruments as an economic hedge of the risk of share price fluctuations. Such arrangements raise the issue of whether hedge accounting can be applied.

In our view, it is not possible to apply hedge accounting for the obligation to issue shares or other equity instruments to settle equity-settled share-based payment transactions. This is because market fluctuations in share price do not affect profit or loss.

It may, in principle, be possible to apply cash flow hedge accounting for cash-settled share-based payment transactions. However, in our experience it may be difficult to meet the hedging requirements, and hedge accounting cannot be applied if the hedging instrument is itself equity.

For further guidance on hedge accounting, including in relation to share-based payments, see Chapter 7.9 of the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#).

## 13.5 Share-based payments and events after the reporting period

IAS 10.3, 8, 10

An entity adjusts the amounts recognised in its financial statements to reflect adjusting events occurring after the reporting period, but does not adjust the financial statements for non-adjusting events. 'Adjusting events' are those that provide evidence of conditions that existed at the reporting date. 'Non-adjusting events' are those that are indicative of conditions that arose after the reporting period.

A typical situation in which this is relevant for accounting for share-based payment transactions is when an entity estimates the probability of whether the counterparty – e.g. the employee – will meet the service conditions and/or any non-market performance condition in the future. Events after the reporting period may provide additional evidence of the estimated probabilities as at the end of the period.

Judgement is required to determine whether the event is an adjusting event or a non-adjusting event, taking account of the fact that the condition being estimated at the reporting date is a future outcome.



### Example 13.5.1 – Redundancy programme announced after reporting date

On 1 January Year 1, Company B grants share options to its employees, subject to a three-year service condition. Throughout Year 1, B estimates that 90% of the employees will meet the service condition.

On 25 January Year 2, before the issue of its Year 1 financial statements, B announces a major redundancy programme due to a factory fire in early January. Under the redundancy plan, at least 40% of the employees will be made redundant.

The necessary change in estimate of how many employees will stay in service until vesting date is a non-adjusting event. This is because the conditions for the change in estimate did not exist at the reporting date.

IAS 10.22(e)

**Example 13.5.2 – IPO process cancelled after reporting date**

On 1 January Year 1, Company C grants share options to an employee, subject to a three-year service condition and an IPO occurring within this period. Such an IPO condition is a non-market performance condition (see 5.5.30). On 31 December Year 2, C estimates that the employee will meet the service requirement and expects the IPO to occur before vesting date because preparations are far advanced and the launch date is expected shortly after the issue of the Year 2 financial statements.

On 25 January Year 3, before the issue of C's Year 2 financial statements, the IPO process is postponed unexpectedly for at least one year – i.e. until after vesting date.

To determine whether such a postponement is an adjusting or a non-adjusting event, the reasons for the postponement should be analysed.

In one example, the reason for postponement is that a review of C's Year 2 performance by the underwriters results in a decision that they will not support an IPO in Year 3. Because this decision is based on conditions that already existed at the end of the period, in our view that such a postponement should be treated as an adjusting event.

In another example, there may be an identifiable reason for the postponement that clearly arises after the reporting date. Examples of identifiable reasons include an unexpected downturn on the financial markets after the reporting date or the announcement by two of C's competitors on 20 January Year 3 of significant co-operation that will affect C's position in the market. Both of these should be treated as non-adjusting events.

# 14 Transition requirements and unrecognised share-based payments

## Overview

- If an unrecognised otherwise-exempt grant is modified after the effective date of the accounting standard, then in our view the original grant-date fair value remains unrecognised and only an incremental fair value, if there is any, needs to be accounted for.

## 14.1 Transition requirements

### 14.1.10 Introduction

*IFRS 2.60*

IFRS 2 *Share-based Payment* is required to be applied for annual periods beginning on or after 1 January 2005.

*IFRS 2.53–57*

The transition requirements in respect of the recognition and measurement of equity-settled share-based payment transactions are summarised below.

IFRS 2 applies to:		
Equity-settled transactions granted:	Original grant	Modifications after the effective date
On or before 7 November 2002	Optional <sup>1</sup>	Mandatory
After 7 November 2002 but vesting before the effective date of IFRS 2	Optional <sup>1</sup>	Mandatory
After 7 November 2002 and vesting after the effective date of IFRS 2	Mandatory	Mandatory
<b>Note</b>		
1. Entities are permitted to apply IFRS 2 only if the fair value of the equity instruments granted determined at the date of measurement in accordance with IFRS 2 has been disclosed publicly.		

*IFRS 2.44–45, 56*

However, certain of the disclosure requirements of IFRS 2 still apply to all equity-settled share-based payment transactions that are in the scope of IFRS 2, even if the recognition and measurement requirements of the accounting standard have not been applied. For grants of equity instruments to which the recognition and measurement requirements of IFRS 2 have not been applied, the disclosure

of information is required to provide an understanding of the nature and extent of the share-based payments. This disclosure includes both a general narrative description of the arrangements and quantitative information about the number and weighted-average exercise price of the awards.

### Modifications of unrecognised otherwise-exempt equity-settled share-based payments

IFRS 2.26–29, 57

If an unrecognised grant is modified *after* the effective date of the accounting standard – 1 January 2005 – then the entity accounts for the modification by applying paragraphs 26–29 of IFRS 2. In our view, this requirement should be interpreted such that the original grant-date fair value remains unrecognised and only the incremental fair value, if there is any, is accounted for. For a discussion of how to determine the incremental fair value, see 9.2.20. We do not believe that these requirements should be applied to the original share-based payment because paragraph 57 specifically refers to accounting for ‘the modification’.



#### Example 14.1.1 – Modification of an unrecognised otherwise-exempt equity-settled share-based payment

On 1 January 2002, Company B grants 100 share options to an employee, subject to a three-year service condition. The share options can be exercised at any date within the following 10 years – i.e. until 31 December 2014. All share options vested on 31 December 2004. B chooses not to apply the recognition and measurement principles of IFRS 2 to the original share option grant; no options have been exercised by the end of 2013.

After a decline in the share price in 2013, the options were out-of-the-money and on 1 January 2014 B modifies the share options granted. The exercise price is re-priced, resulting in an incremental fair value of the equity instruments granted of 3 per option, and a further two years of service from the modification date is required for the modified options to vest. B expects the employee to meet the additional service requirement.

We believe that the requirement to account for the incremental fair value does not affect the choice not to recognise the original grant-date fair value.

In its financial statements from 2005 to 2013, B chooses not to apply the recognition and measurement requirements of IFRS 2 to the original grant – i.e. no amounts are recognised in respect of that grant. However, B discloses a description of the arrangement and the required information about the number and weighted-average exercise prices of the share options.

B recognises the incremental fair value of 300 (100 options x 3) in its 2014 and 2015 financial statements – i.e. 150 in each year.

# 15 First-time adoption of IFRS Accounting Standards

## Overview

- A first-time adopter is required to apply IFRS 2 *Share-based Payment* to:
  - equity instruments that were granted after 7 November 2002 that will vest after the date of transition;
  - liabilities arising from cash-settled share-based payment transactions that will be settled after the date of transition; and
  - modifications of awards on or after the date of transition, even if the original grant of the award is not accounted for under IFRS 2.
- Certain of the disclosure requirements of IFRS 2 apply to all equity-settled share-based payment transactions, even if the recognition and measurement requirements of the accounting standard have not been applied.

## 15.1 Introduction

IFRS 1 *First-time Adoption of International Financial Reporting Standards* contains the transition requirements applicable to an entity on its first application of IFRS Accounting Standards. This section describes the transition requirements applicable to share-based payments when an entity is adopting IFRS Accounting Standards for the first time.

### IFRS 1.9

An entity adopting IFRS Accounting Standards does not apply the transition requirements of individual accounting standards unless it is specifically required or permitted to do so. The transition requirements in respect of share-based payments applicable to existing users of IFRS Accounting Standards are described in [Section 14](#).

The issues that arise in respect of share-based payment transactions on transition to IFRS Accounting Standards depend on the differences between previous GAAP and IFRS 2 in terms of scope (see [Sections 3](#) and [10](#)), as well as recognition and measurement (see [Sections 4–10](#)). For example, a share-based payment transaction in the scope of IFRS 2 may not have been subject to any recognition and measurement requirements under previous GAAP and therefore may not have been accounted for under previous GAAP before the date of transition to IFRS Accounting Standards.

### IFRS 1.7, D2–D3

The general principles of IFRS 1 require an entity to account for any unrecognised transaction retrospectively but that accounting standard also provides some relief and exemptions for share-based payment transactions.

## 15.2 Transition requirements and optional exemption

IFRS 1.D2–D3, IG65

The share-based payment requirements of IFRS 1 are based on the transition requirements that applied to existing users of IFRS Accounting Standards when IFRS 2 came into effect in 2005 (see [Chapter 14.1](#)). However, there is additional relief because IFRS 1 focuses on vesting before the date of transition to IFRS Accounting Standards, rather than the fixed effective date of financial years beginning on or after 1 January 2005. A first-time adopter is *required* to apply IFRS 2 to:

- equity instruments that were granted after 7 November 2002 that will vest *after* the date of transition;
- liabilities arising from cash-settled share-based payment transactions that will be settled *after* the date of transition; and
- modifications of awards *on or after* the date of transition, even if the original grant of the award is not accounted for under IFRS 2.

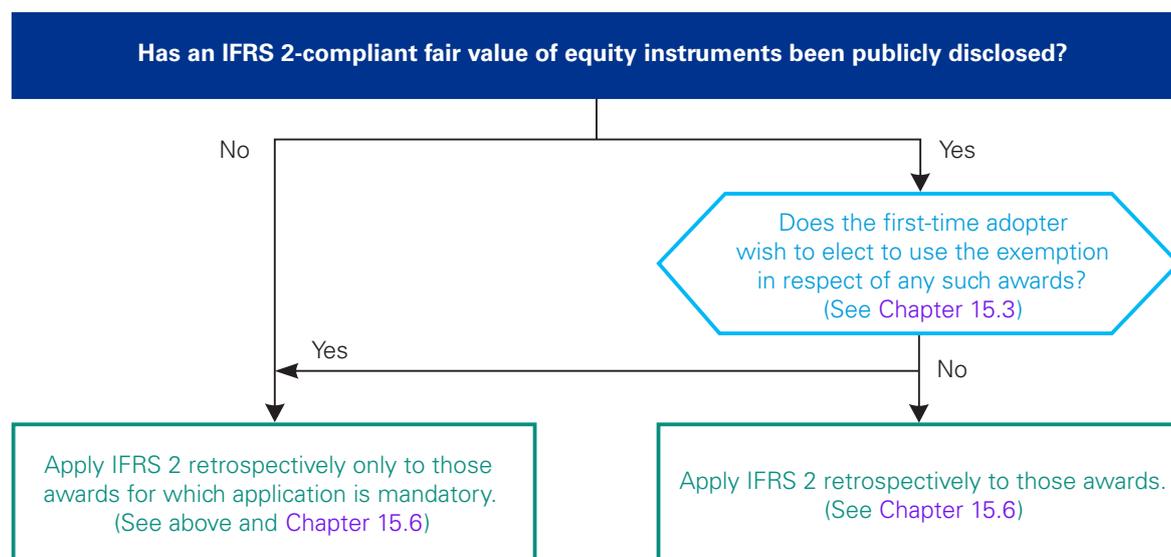
IFRS 1.D2–D3, IG64

Additionally, a first-time adopter is *encouraged*, but not required, to apply IFRS 2 retrospectively to the following:

- equity instruments that were granted on or before 7 November 2002, or equity instruments that were granted after 7 November 2002 that vested before the date of transition. However, such application is allowed only if the first-time adopter had disclosed publicly the fair value of such awards determined at the measurement date in accordance with IFRS 2 (see [Chapter 15.3](#)); and
- liabilities arising from cash-settled share-based payment transactions that were settled before the date of transition.

Awards for which retrospective application of IFRS 2 is encouraged but not required are referred to in this handbook as ‘otherwise-exempt’ awards. The optional exemption in IFRS 1 in respect of share-based payments permits a first-time adopter to elect not to apply IFRS 2 to otherwise-exempt awards.

The following decision tree illustrates the optional exemption available for otherwise-exempt equity-settled share-based payments. The decision tree assumes that all equity-settled awards granted before 7 November 2002 are vested at the date of transition.



The following table demonstrates how application of the optional exemption affects grants of equity-settled share-based payments made by entities with the end of their first IFRS reporting period on 31 December 2023 or 30 June 2024.

Reporting date	Date of transition	Grant date	Vesting date	Treatment <sup>1</sup>
31 December 2023	1 January 2022	On or before 7 November 2002	Before or after 1 January 2022	No share-based payment cost recognised
		After 7 November 2002	Before 1 January 2022	No share-based payment cost recognised
			On or after 1 January 2022	Recognise share-based payment cost for 31 December 2023 and 31 December 2022; and adjust 1 January 2022 retained earnings
30 June 2024	1 July 2022	On or before 7 November 2002	Before or after 1 July 2022	No share-based payment cost recognised
		After 7 November 2002	Before 1 July 2022	No share-based payment cost recognised
			On or after 1 July 2022	Recognise share-based payment cost for 30 June 2024 and 30 June 2023; and adjust 1 July 2022 retained earnings
<b>Notes</b> 1. This column illustrates only the debit side of the entries, if there is any; the offsetting credits are to equity. 2. Only a modification to the terms of the award on or after the date of transition would result in the recognition of share-based payment cost (see <a href="#">Chapter 15.5</a> ), unless the first-time adopter applies IFRS 2 retrospectively to an otherwise-exempt award (see <a href="#">Chapter 15.3</a> ).				

IFRS 1.D2, 2.44–45

The optional exemption applies only to the recognition and measurement requirements of IFRS 2. However, certain of the disclosure requirements of IFRS 2 still apply to all equity-settled share-based payment transactions that are in the scope of IFRS 2, even if the recognition and measurement requirements of the accounting standard have not been applied. For grants of equity instruments to which the recognition and measurement requirements of IFRS 2 have not been applied, the disclosure of information is required to provide an understanding of the nature and extent of the share-based payments. This disclosure includes both a general narrative description of the arrangements and quantitative information about the number and weighted-average exercise price of the awards.

## 15.3 Retrospective application to otherwise-exempt equity-settled awards

### *IFRS 1.D2*

A first-time adopter may apply the recognition and measurement requirements of IFRS 2 retrospectively to equity instruments for which it is otherwise not required to do so (see [Chapter 15.2](#)) *only* if:

- the first-time adopter had publicly disclosed the fair value of those equity instruments, measured in a manner consistent with IFRS 2; and
- the fair value was determined at the measurement date, as defined in IFRS 2.

In our view, retrospective application of the recognition and measurement requirements of IFRS 2 to otherwise-exempt awards may be applied on a grant-by-grant basis. We believe that a grant-by-grant election is possible because application of the accounting standard to otherwise-exempt awards is encouraged when possible and the availability of the required fair value data may vary for grants made at different dates.

### *IFRS 2.54*

In 2005, when IFRS 2 became effective, very few national GAAP required recognition or disclosure of the fair value of equity instruments. The IASB appeared to be concerned that applying the accounting standard retrospectively would result in the undue use of hindsight; therefore, the requirement to have publicly disclosed the fair value of equity instruments was included in IFRS 2 and was also carried forward into IFRS 1. The requirement effectively prohibits a first-time adopter from retrospectively determining the fair value of otherwise-exempt awards and therefore may preclude first-time adopters from retrospectively applying IFRS 2 to such awards.

### *IFRS 1.D2*

The publicly disclosed fair value should have been determined on the measurement date required by, and following the valuation methodology of, IFRS 2.

In our view, the fair value should have been disclosed before publication of the first IFRS financial statements; however, it does not have to have been publicly disclosed at the time when the award was granted.

If the first-time adopter has previously publicly disclosed fair value information at an aggregated level and that fair value is supported by sufficiently detailed calculations to permit estimates of the fair values of the separate share-based payment plans to be determined, then in our view the disclosure requirement for previous public disclosure has been met for the separate awards.

## 15.4 Awards to which recognition and measurement requirements of IFRS 2 have not been applied

IFRS Accounting Standards do not specifically address the treatment in the opening IFRS statement of financial position of share-based payment cost recognised under previous GAAP for awards to which the recognition and measurement requirements of IFRS 2 are not applied (see [Chapter 15.2](#)). For example, under its previous GAAP a first-time adopter may have accounted for equity-settled share-based payment awards by debiting share-based payment cost in profit or loss and crediting a separate category of equity – e.g. contributed surplus or additional paid-in capital (for a discussion of the presentation of the credit entry, see [Chapter 6.10](#)). As a result, for such equity-settled share-based payment awards that are effectively ‘grandfathered’, it is unclear what, if any, adjustments should be made at the date of transition.

In our view, a first-time adopter should choose one of the following approaches, to be applied consistently.

- *Approach 1:* The share-based payment cost recognised in equity under previous GAAP is reversed in the opening IFRS statement of financial position. This is because IFRS 1 generally requires the opening IFRS statement of financial position to be prepared under IFRS Accounting Standards, and the accounting standard is usually explicit when an optional exemption permits the grandfathering of previous GAAP. Because the optional exemption for share-based payments does not explicitly permit the grandfathering of the share-based payment cost recognised under previous GAAP, a first-time adopter may reverse the accounting under previous GAAP.
- *Approach 2:* The share-based payment cost recognised under previous GAAP is not reversed. This is because the circumstances in which IFRS 1 explicitly permits the grandfathering of previous GAAP generally relate to the accounting for assets and liabilities, and not to items of equity. This approach results in no adjustment at the date of transition, which may be seen as more in line with the objective of IFRS 2 – i.e. that a first-time adopter recognises in profit or loss, and thereby equity, the effects of share-based payment transactions.



### Example 15.4.1 – Share-based payment expense recognised in equity under previous GAAP

Company X will prepare its first IFRS financial statements for the year ending 31 December Year 6, with a date of transition of 1 January Year 5. In Year 1, X granted a total of 10,000 share options to its employees, subject to a three-year service condition. The aggregate fair value of the awards under previous GAAP was 200,000.

By 1 January Year 5, all of the awards have vested and the share-based payment expense of 200,000 was recognised in profit or loss under previous GAAP, with the corresponding credit being recognised as contributed surplus, which is a separate component of equity. Because the awards vested before X’s date of transition, X is not required to apply IFRS Accounting Standards to these awards.

Under Approach 1 (see above), X reverses the share-based payment expense recognised under previous GAAP and records the following entry on transition.

	<i>Debit</i>	<i>Credit</i>
Contributed surplus	200,000	
Retained earnings		200,000
<i>To reverse share-based payment expense at date of transition</i>		

Under Approach 2 (see above), X makes no accounting entry on 1 January Year 5 in respect of the share-based payment expense recognised under previous GAAP – i.e. the original entries made under previous GAAP are kept.

## 15.5 Modification of awards

An entity may modify the terms and conditions of a share-based payment arrangement – e.g. it may reduce the exercise price of the options granted, which would increase the fair value of those options.

Modifications to the terms or conditions of a grant of equity instruments will affect a first-time adopter as follows.

### IFRS 1.D2

- *Modifications occurring before the date of transition:* Modification accounting – i.e. the recognition and measurement requirements of IFRS 2 (see [Chapter 9.2](#)) – is not required to be applied if the original grant is not accounted for in accordance with IFRS 2 and the modifications are made before the date of transition to IFRS Accounting Standards.
- *Modifications occurring on or after the date of transition:* Modification accounting – i.e. the recognition and measurement requirements of IFRS 2 (see [Chapter 9.2](#)) – is applied, even if the original grant was not accounted for in accordance with IFRS 2. However, in our view this requires only an incremental fair value, if there is any, to be accounted for and does not require the original grant-date fair value to be recognised. For a discussion of how to determine the incremental fair value, see [9.2.20](#). We do not believe that the IASB intended to require accounting for the original share-based payment as well because paragraph 57 specifically refers to accounting for ‘the modification’.

If an entity applies IFRS 2 retrospectively to otherwise-exempt equity- or cash-settled awards (see [Chapter 15.2](#)), then in our view any modifications to those awards before the date of transition should also be accounted for in accordance with IFRS 2.

An equity-settled share-based payment granted after 7 November 2002 with a vesting date after the date of transition is required to be accounted for in accordance with IFRS 2 (see [Chapter 15.2](#)). However, if such a grant is modified before the date of transition so that the instruments vest fully before this date, then in our view the transaction is not required to be accounted for under IFRS 2.



### Example 15.5.1 – Modification of awards before date of transition

Company P will prepare its first IFRS financial statements for the year ending 31 December Year 3, with a date of transition of 1 January Year 2. In Year 1, P granted equity instruments to employees that do not vest until December Year 3. P would be required to account for the awards under IFRS 2 because they vest after the date of transition. However, in Year 1 P modified the grant so that the equity instruments vested fully in December Year 1 – i.e. before the date of transition.

Because the modification caused the awards to vest before the date of transition, we believe that P can elect not to restate the accounting retrospectively under IFRS 2 (see above).

However, if P applies IFRS 2 retrospectively to these otherwise-exempt awards, then the original grant and the subsequent modification would be accounted for in accordance with IFRS 2.



### Example 15.5.2 – Modification of unrecognised equity-settled share-based payment after date of transition

On 1 January Year 1, Company B, a first-time adopter with a date of transition of 1 January Year 9, granted 100 share options to an employee, subject to a three-year service condition – i.e. until 31 December Year 3. The share options could be exercised at any date within the following seven years – i.e. until 31 December Year 10. All of the share options vested on 31 December Year 3; no options have been exercised by the end of Year 9.

After a decline in the share price in Year 9, the options were out-of-the-money and on 1 January Year 10 B modifies the share options granted. The exercise price is re-priced, resulting in an incremental fair value of the equity instruments granted of 3 per option, and a further two years of service from the modification date is required for the modified options to vest. B expects the employee to meet the additional service requirement.

We believe that the requirement to account for the incremental fair value does not affect the choice not to recognise the original grant-date fair value.

*IFRS 1.D2*

In its first IFRS financial statements as at 31 December Year 10 with comparatives for Year 9, B chooses not to apply the recognition and measurement principles of IFRS 2 to the original grant. Therefore, no amounts are recognised in respect of that grant.

*IFRS 1.D2, 2.44–45*

However, B provides disclosures in accordance with IFRS 1 and IFRS 2 for the comparative period Year 9 – i.e. a description of the arrangement and the required information about the number and prices of the share options.

*IFRS 1.D2, 2.B43(a)*

In accordance with IFRS 1 and IFRS 2, B recognises the incremental fair value of 300 (100 options x 3) in its Year 10 and Year 11 financial statements – i.e. 150 in each year.

## 15.6 Adjustments on transition for awards to which recognition and measurement requirements of IFRS 2 are applied

IFRS 2.55

If the requirements of IFRS 2 apply (see [Chapter 15.2](#)), or the first-time adopter applies IFRS 2 to otherwise-exempt awards (see [Chapter 15.2](#)), then the recognition and measurement requirements of IFRS 2 are applied retrospectively. Any differences arising from this accounting at the date of transition are generally recognised in opening retained earnings.



### Example 15.6.1 – Adjustments on transition for forfeitures

Company Q will prepare its first IFRS financial statements for the year ending 31 December Year 3, with a date of transition of 1 January Year 2. On 1 January Year 1, Q granted 100,000 share options to employees, subject to a two-year service condition. The options have an aggregate fair value of 100,000 under both IFRS 2 and previous GAAP at the measurement date – i.e. each option has a grant-date fair value of 1. The share-based payment expense does not qualify for recognition as an asset under other IFRS Accounting Standards. At grant date and throughout the vesting period, Q estimates that 10,000 options will be forfeited.

The following options are forfeited during the vesting period:

- Year 1: zero
- Year 2: 10,000 (i.e. 10%).

IFRS and previous GAAP have the same requirement to recognise the share-based payment expense over the vesting period in profit or loss and equity.

Under previous GAAP, Q chose an accounting policy to recognise the share-based payment expense as if all instruments granted were expected to vest fully and to recognise the effect of actual forfeitures as they occur. Therefore, Q recorded the following entries under previous GAAP.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	50,000	
Equity		50,000
<i>To recognise share-based payment expense in Year 1 (100,000 x 1/2)</i>		
<b>Year 2</b>		
Expenses	40,000	
Equity		40,000
<i>To recognise share-based payment expense in Year 2 ((100,000 x 90%) - 50,000)</i>		

Under IFRS Accounting Standards, forfeitures due to service conditions are required to be estimated at the grant date and such estimates are revised for differences between the expected and actual number of instruments that vest (see 6.2.10). Therefore, Q would have recorded the following entries under IFRS Accounting Standards.

	<i>Debit</i>	<i>Credit</i>
<b>Year 1</b>		
Expenses	45,000	
Equity		45,000
<i>To recognise share-based payment expense in Year 1 (100,000 x 90% x 1/2)</i>		
<b>Year 2</b>		
Expenses	45,000	
Equity		45,000
<i>To recognise share-based payment expense in Year 2 ((100,000 x 90%) - 45,000)</i>		

At the date of transition of 1 January Year 2, Q has recognised share-based payment expense of 50,000 under previous GAAP, whereas IFRS Accounting Standards would have required recognition of 45,000; therefore, Q records the following entry on transition.

	<i>Debit</i>	<i>Credit</i>
Equity	5,000	
Retained earnings		5,000
<i>To reverse excess of share-based payment expense at date of transition</i>		

During Year 2, Q recognised a share-based payment expense of 40,000 under previous GAAP, whereas IFRS Accounting Standards require recognition of 45,000; therefore, Q will record the following entry in respect of the comparative period (Year 2) in its first IFRS financial statements.

	<i>Debit</i>	<i>Credit</i>
Expenses	5,000	
Equity		5,000
<i>To adjust share-based payment expense recognised in Year 2</i>		

## 15.7 Share-based payments and deferred taxes

### 15.7.10 Introduction

*IAS 12.9*

In some jurisdictions, entities receive a tax deduction based on the intrinsic value of equity-settled share-based payments when the employees exercise their options and receive the equity instruments (see [Chapter 13.2](#)).

### 15.7.20 Equity-settled share-based payments that are recognised

In respect of options issued after 7 November 2002, a temporary difference arises between the tax base (based on the future tax deductions) of the share option and its carrying amount in the opening IFRS statement of financial position (zero, because the IFRS 2 share-based payment cost is offset by a corresponding credit entry in equity).

A resulting deferred tax asset is recognised if the recognition criteria in IAS 12 *Income Taxes* are met.

The same applies to equity-settled share-based payments that are otherwise exempt but that are accounted for voluntarily in accordance with IFRS 2 (see [Chapter 15.2](#)).

### 15.7.30 Equity-settled share-based payments that are not recognised

*IAS 12.68C, IE.Ex5*

Neither IFRS 1 nor IAS 12 provides specific guidance on the treatment of taxes on share-based payments that are otherwise exempt and unrecognised – i.e. equity-settled share-based payments granted on or before 7 November 2002 or granted after 7 November 2002 but vested before the date of transition (see [Chapter 15.2](#)). Such share-based payments may not have been exercised by the date of transition, so that there is still a potential future tax deduction in the situation described in [15.7.20](#).

For a discussion of the same issue for existing users of IFRS Accounting Standards, see [Chapter 14.1](#).

# Appendix I

## Key terms

IFRS 2 uses numerous technical terms, most of which, but not exclusively, are defined in Appendix A of the accounting standard. The following list includes those technical terms but also includes other key terms that are used in this handbook. When it is necessary for an easy understanding of the meaning, we have adjusted and/or simplified the official technical definitions in this appendix. When taking decisions about how to apply IFRS Accounting Standards, please also refer to the official technical definitions, as set out in the table below.

Key term	Meaning	Reference to accounting standard	Reference in handbook
<b>Cash-settled share-based payment</b>	Share-based payment transactions that are settled by the transfer of cash or other assets. This includes share-based payments settled mandatorily or at the employee's option in redeemable or puttable equity instruments.	<i>IFRS 2.A</i>	<a href="#">Section 7</a>
<b>Equity instrument</b>	A contract that evidences a residual interest in the net assets of the entity. Classification as an equity instrument under IFRS 2 can be different from classification as an equity instrument under IAS 32.	<i>IFRS 2.A</i>	<a href="#">Section 3</a>
<b>Equity-settled share-based payment</b>	Share-based payment transactions that are settled by the transfer of equity instruments of the entity, or in which the entity does not have the obligation to settle.	<i>IFRS 2.A</i>	<a href="#">Sections 6 and 10</a>
<b>Grant date</b>	The date on which the parties agree a contract setting out details of the exchange of goods or services and the consideration for them. A contract is 'agreed' when the parties have a shared understanding of its terms and conditions. This is the date on which the fair value of equity instruments granted to employees is measured.	<i>IFRS 2.A</i>	<a href="#">Chapter 6.3</a>
<b>Grant-date fair value</b>	The fair value of an equity instrument at grant date, taking into account the impacts of any market and non-vesting conditions. In other words, the fair value of the equity instrument is adjusted downwards to reflect the market's view of the probability of meeting any market and non-vesting conditions. The probability of meeting any service and non-market performance conditions is not taken into account when measuring grant-date fair value. Instead, it is taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount.	<i>IFRS 2.16–22</i>	<a href="#">Chapters 6.6 and 7.2</a>

Key term	Meaning	Reference to accounting standard	Reference in handbook
<b>Group share-based payment transaction</b>	A group share-based payment transaction is one in which the receiving entity and the reference entity are in the same group from the perspective of the ultimate parent and which is settled either by an entity in that group or by an external shareholder of any entity in that group.	<i>IFRS 2.3A</i>	<a href="#">Section 10</a>
<b>Intrinsic value of a share option</b>	Intrinsic value is the greater of the share price minus the exercise price and zero. The total value of a share option is composed of the intrinsic value and the time value.	<i>IFRS 2.A, BC248</i>	<a href="#">Appendix II</a>
<b>Market condition</b>	A performance condition that requires the counterparty to meet a target that is related to the market price of the equity instruments of the entity (or the equity instruments of another entity in the same group).  A market condition requires the counterparty to complete a specified period of service – i.e. the service condition – that can be explicit or implicit.	<i>IFRS 2.A</i>	<a href="#">Chapter 5.3</a>
<b>Measurement date</b>	The date on which the fair value of equity instruments granted in a share-based payment is measured. Equity-settled share-based payment transactions with employees are measured at grant date. Cash-settled share-based payments with employees are measured at grant date and remeasured at each reporting date until settlement. Other share-based payment transactions – e.g. with non-employees – have different measurement dates.	<i>IFRS 2.A</i>	<a href="#">Chapters 6.3, 7.2 and 11.2</a>
<b>Modified grant-date method</b>	Equity-settled share-based payments with employees are accounted for under the modified grant-date method. The total cost to be initially recognised is based on the product of the grant-date fair value of an equity instrument granted multiplied by the number of equity instruments expected to satisfy any service and non-market performance conditions. Subsequently, this amount is adjusted only for true-up effects. It is not adjusted for changes in the fair value of the equity instrument or for changes in the estimate of how many instruments will meet any market or non-vesting conditions.	<i>IFRS 2.BC180</i>	<a href="#">Chapter 6.2</a>
<b>Non-market performance condition</b>	A condition that requires the counterparty to meet a performance target that is not a market condition – i.e. which is not related to the market price of the equity instruments of the entity.	<i>IFRS 2.A</i>	<a href="#">Chapter 5.3</a>

Key term	Meaning	Reference to accounting standard	Reference in handbook
<b>Non-vesting condition</b>	A condition that determines whether a counterparty is entitled to a share-based payment, but does not determine whether the entity receives the services that entitle the counterparty to the share-based payment.	<i>IFRS 2.BC171A</i>	<a href="#">Chapter 5.4</a>
<b>Performance condition</b>	A vesting condition that requires the counterparty to complete a specified period of service (i.e. a service condition) and a specified performance target to be met while the counterparty is rendering that service.  Performance conditions are subdivided into market conditions and non-market performance conditions.	<i>IFRS 2.A</i>	<a href="#">Chapter 5.3</a>
<b>Receiving entity</b>	The entity that receives the goods or services in a group share-based payment transaction.	<i>IFRS 2.3A</i>	<a href="#">Chapter 10.1</a>
<b>Reference entity</b>	The entity whose equity instruments are granted in a group share-based payment transaction or on whose equity instruments a cash payment is based in a group share-based payment transaction.	-	<a href="#">Chapter 10.1</a>
<b>Remeasurement</b>	A liability in a cash-settled share-based payment is remeasured at each reporting date, and ultimately at settlement date for changes in the fair value of the liability.	<i>IFRS 2.30</i>	<a href="#">Chapter 7.2</a>
<b>Service commencement date</b>	The date on which the counterparty starts to render the services under a share-based payment transaction. This may occur before grant date – e.g. if the share-based payment requires approval that can only be achieved at a later date.	<i>IFRS 2.IG4</i>	<a href="#">Chapter 6.4</a>
<b>Service condition</b>	A vesting condition that requires the counterparty to complete a specified period of service.	<i>IFRS 2.A</i>	<a href="#">Chapter 5.3</a>
<b>Settlement date</b>	The date at which the share-based payment is settled, either by transferring the equity instruments granted or by paying the counterparty in cash or with other assets.	<i>IFRS 2.39–40</i>	<a href="#">Chapter 7.2</a>
<b>Settling entity</b>	The entity that has the obligation to settle a group share-based payment transaction.	<i>IFRS 2.3A</i>	<a href="#">Chapter 10.1</a>
<b>Share appreciation right (SAR)</b>	A right that entitles its holder to receive a payment that equals the increase in value of a share from a specified level over a specified period of time – e.g. from grant date to settlement date. In this case, the counterparty participates directly in changes in the value of the underlying equity instrument and, accordingly, the cash payment is based on the price (or value) of the equity instrument.	-	<a href="#">Chapter 3.3</a>

Key term	Meaning	Reference to accounting standard	Reference in handbook
<b>Truing up</b>	In equity-settled share-based payment transactions, truing up is the effect of reflecting a change in the estimate of how many instruments granted are expected to satisfy a service condition and, if there is one, a non-market performance condition during the vesting period. Such a change in estimate changes the total expected expense to be recognised. In the period in which the change of estimate occurs, the pro rata expense recognised to date is adjusted to reflect cumulative expense as if the new estimate had always been in place. Subsequent periods also reflect the changed estimate. Prior periods are not adjusted.	<i>IFRS 2.BC184</i>	<a href="#">Chapter 6.2</a>
<b>Vesting condition</b>	A condition that determines whether the entity receives the services that entitle the counterparty to receive the share-based payment. Vesting conditions are subdivided into service conditions and performance conditions.	<i>IFRS 2.A</i>	<a href="#">Chapter 5.3</a>
<b>Vesting date</b>	The date on which a share-based payment vests – i.e. on which a service condition and, if there is one, performance condition (together: vesting conditions) are met. After this date, the employee can leave the entity without losing their entitlement to the share-based payment. However, to receive the share-based payment there may be other conditions, called non-vesting conditions, which also need to be met.	<i>IFRS 2.BC89</i>	<a href="#">Sections 6 and 7</a>
<b>Vesting period</b>	The period between the service commencement date and the vesting date. The total cost in a share-based payment transaction is spread over this period. A vesting period can be fixed or variable.	<i>IFRS 2.A</i>	<a href="#">Chapter 6.4</a>

# Appendix II

## Valuation aspects of accounting for share-based payments

### A2.10

#### Introduction

*IFRS 2.6A, 13.6, BC21*

IFRS 2 contains limited guidance on how to value share-based payments and there is no authoritative guidance issued by the valuation profession that is applicable to the valuation of share-based payments. In May 2011, the IASB issued IFRS 13 *Fair Value Measurement*. IFRS 13 applies to most fair value measurements or disclosures (including measurements based on fair value) that are required or permitted by other IFRS Accounting Standards. However, IFRS 13 specifically excludes share-based payment transactions under IFRS 2 from its measurement and disclosure requirements. A key reason for this exclusion is that the requirements of IFRS 2 for certain items – e.g. vesting conditions and reload features – differ from how those matters might be treated by market participants.

This appendix discusses valuation issues that arise in relation to share-based payments and some of the approaches applied to such issues. The objective of this appendix is not to provide a definitive guide or handbook on how share-based payments should be valued, but rather to help readers better understand the underlying valuation concepts and illustrate how some of the application issues are sometimes addressed in practice. This discussion is not intended to suggest that such approaches are required or are the only possible approaches to the application issues encountered.

### A2.20

#### Valuing unvested shares

Shares granted in a share-based payment are valued with reference to quoted share prices, if available. Quoted share prices are adjusted for terms and conditions that apply to the shares granted that do not apply to the publicly quoted shares, except when such terms and conditions (e.g. vesting conditions) are excluded from the fair value measurement under IFRS 2. Under IFRS 2, the per-instrument value of share-based payments is not adjusted for service and non-market performance conditions but is adjusted for market conditions and non-vesting conditions. Service and non-market performance conditions are considered in estimating the number of awards that are expected to vest (see 6.2.10).

*IFRS 2.B2*

If an entity's shares are not quoted publicly, then valuation techniques are used to estimate the fair value of the shares granted. Valuation techniques usually focus on valuing the entity as a whole as a starting point and are grouped into three general types of approaches: the income approach, the cost or net assets approach and the market approach. The techniques include market multiples such as enterprise value/EBITDA (EV/EBITDA) multiples and the DCF method. A detailed description of the techniques for valuing entities is beyond the scope of this appendix. For a discussion of enterprise value allocation techniques, which may be necessary to value shares in entities with a complex capital structure, see A2.100.

*IFRS 2.B3*

Examples of terms and conditions that may lead to adjustments to a current share price include awards in which a holder is not entitled to dividends declared on the shares during the vesting period, and awards in which a share is subject to post-vesting restrictions that limit the holder's ability to transfer the share after they have earned the award. For a discussion of discounts for post-vesting restrictions, see A2.50.

When an unvested share is granted to an employee, and the employee is not entitled to receive dividends on the share during the vesting period, the price of the share should be adjusted for the expected dividends forgone. The value of an unvested share that is not entitled to receive dividends during the vesting period can be estimated using a BSM model with a term equal to the vesting period, the expected dividend yield during the vesting period and a very small but greater than zero exercise price; a zero exercise price cannot be used because the BSM includes the exercise price in a denominator so the use of a zero exercise price value would cause the model to report an error.

Sometimes shares issued in share-based payment transactions do not have voting rights. When such instruments are valued with reference to the value of shares with similar economic rights (e.g. rights to dividends or rights in the case of a winding up) but which have voting rights, an adjustment may be required for the lack of voting rights of the instruments. There are not well-established rules or methods to value voting rights in these circumstances. One consideration may be whether the comparable shares used for valuation purposes reflect a controlling or non-controlling interest value. In the case of the latter, the voting rights may have a limited incremental value effect. This issue is also relevant for valuing shares without voting rights underlying share options.

For example, Company P, a publicly traded company, issues non-voting shares to employees with similar economic rights to publicly traded shares that have voting rights. The publicly traded share price reflects trades for small ownership interests in P. Although such shares may have voting rights, their ability to influence P is limited. As a result, the publicly traded price may not attribute significant value to the voting rights.

One approach to measuring the value effect of voting rights is to compare the share prices of dual classes of shares in public entities that have similar economic rights. For example, some entities have two classes of publicly traded shares, one of which has more votes per share than the other. The price differential between such classes may provide an indication of the value of voting rights, assuming economic rights are similar.

## A2.30 Valuing share options

Share options give the holder the right to buy the underlying shares at a set price, called the 'exercise price', over or at the end of an agreed period. If the share price exceeds the option's exercise price when the option is exercised, then the holder of the option profits by the amount of the excess of the share price over the exercise price. Benefit is derived from the right under the option to buy a share for less than its value. The holder's cost is the exercise price, whereas the value is the share price. It is not necessary for the holder to sell the share for this profit to exist. Sale only results in realisation of the profit. Because an option holder's profit increases as the underlying share price increases, share options are used to incentivise employees to contribute to an increase in the price of the underlying shares.

Employee options are typically call options, which give holders the right but not the obligation to buy shares. However, other types of options are also traded in markets. For example, put options give holders the right to sell the underlying shares at an agreed price for a set period. Given that holders of put options profit when share prices fall below the exercise price, such options are not viewed as aligning the interests of employees and shareholders. All references in this section to 'share options' are to employee call options.

### IFRS 2.B4

Share options granted by entities often cannot be valued by reference to market prices. Many entities, even those whose shares are quoted publicly, do not have options traded on their shares. Options that trade on recognised exchanges such as the Chicago Board Options Exchange are created by market participants and are not issued by entities directly. Even when there are exchange-traded options on an entity's shares for which prices are available, the terms and conditions of those options are generally different from the terms and conditions of options issued by entities in share-based payments and, as a result, the prices of such traded options cannot be used directly to value share options issued in a share-based payment. For example, the contractual lives of traded options are generally significantly shorter than the expected terms of share-based payments. In the absence of market prices, valuation techniques are used to value share options.

The value of a share option *at exercise* is relatively straightforward. If the exercise price is below the share price, then the value of the option is equal to the share price less the exercise price. However, if the exercise price is above the market price, then the option has no value. In these circumstances, an employee wishing to buy shares would be expected to buy shares in the open market rather than exercising the option. Exercising the option would cause a loss because the holder would be acquiring an item for more than its market price. The ability of an option holder to avoid a loss by not exercising the option (i.e. the option expires unexercised) highlights a feature of options – i.e. the option holder has the right but not the obligation to buy the shares. Therefore, the value of an option at exercise is the greater of zero or the share price less the exercise price.

The following table illustrates the value of an option at expiry under various share price scenarios.

Assume that an employee holds an option to buy shares in Company C at 10. At expiry, this right will have value if it allows the employee to buy shares at a price below that prevailing in the market.

	Scenario A	Scenario B	Scenario C
Share price	8	10	12
Exercise price	10	10	10
Intrinsic value	-	-	2

**Notes**

- Under Scenario A, the employee has a right to buy a share for 10 but the same share trades in the market at 8. Therefore, the employee would not exercise the option because they would lose money by buying something for more than the current market price. If the employee wants to buy a share, then they would buy it in the market rather than exercise the option. If the exercise price of an option is greater than the underlying share price, then the option is said to be 'out-of-the-money'. The intrinsic value in these circumstances is zero rather than negative because the holder is not required to exercise the option to buy the share.
- Under Scenario B, the employee has a right to buy a share for 10, whereas the same share trades in the market at 10. Therefore, the employee wishing to buy a share could either exercise the option or buy a share in the market at the same price. The option does not provide any advantage over market pricing and therefore has an intrinsic value of zero. If the exercise price of an option is equal to the underlying share price, then the option is said to be 'at-the-money'.
- Under Scenario C, the employee has a right to buy a share for 10 but the same share trades in the market at 12. Therefore, the employee has an advantage because they can buy the share at 10 and sell it at 12. This intrinsic value at exercise is sometimes referred to as the 'pay-off' of the option. When the exercise price of an option is less than the price of the underlying share, the option is said to be 'in-the-money'.

The 'pay-off' of an option is the value of the option for a given underlying share price. A 'pay-off function' describes the formula to calculate the pay-off. For example, on a plain vanilla – i.e. standard – call option, the pay-off formula is the greater of the share price less the exercise price or zero. More complex pay-off functions can be created. For example, when an entity wishes to place a cap on the maximum that an employee could earn from an award, the pay-off formula would be the greater of the share price less the exercise price, up to a maximum amount of the cap, or zero.

The pay-off or value of an option at exercise is relatively straightforward because the share price is known. However, *before exercise* the future share price at the exercise date is not known, which makes the valuation of an option more complex. Option valuation models use mathematical techniques to identify a range of possible future share prices at the exercise date. From these possible future share prices, the option's pay-off can be calculated. The fair value of an option at its grant date is estimated by calculating the present value of the possible future intrinsic values, which are estimated under a probability-weighted outcome technique (hereafter referred to as 'probability-weighted values').

An option has two primary components of value: intrinsic value and time value. Time value is the difference between the total value of an option and its intrinsic value and can be viewed as having two components: minimum value and volatility value. As stated previously, intrinsic value can be calculated easily on any given date, but option pricing models are needed to estimate the overall value of an option, including its time value. These terms are described further as follows.

- *Intrinsic value:* Intrinsic value is the greater of (a) the share price minus the exercise price and (b) zero. Intrinsic value is the pay-off that would be realised by the option holder, assuming that they exercised the option on the measurement date, even though, in practice, the option may not be exercisable – e.g. because it has not vested.
- *Minimum value:* Minimum value is equal to the value of the underlying share, less the value of any dividends to which the option holder is not entitled, less the present value of the exercise price; it represents the value to the option holder of delaying payment of the exercise price until the exercise date. Under standard present value techniques, future cash flows – in this case, cash outflows related to payment of the exercise price – have a present value below the nominal future amount.
- *Volatility value:* Volatility value relates to the upside potential associated with an option.

Option pricing models, which are discussed in more detail in [A2.100](#), use six key assumptions, as discussed below.

## A2.40

IFRS 2.B6

### Assumptions

There are a number of assumptions or inputs that are used in option pricing models. These assumptions and their relationship to an option's value are as follows and are discussed over the next few pages.

The higher the...	The... is the value of the option
Share price	Higher
Exercise price	Lower
Expected volatility	Higher
Expected dividends not receivable	Lower
Risk-free rate	Higher
Expected term	Generally higher

The expected term of an option is the length of the period over which the option is expected to be unexercised. Expected term is the contractual life of an option adjusted to reflect early exercise of the option by employees – i.e. employees exercising an option before the end of its contractual term. In general, the longer an option's expected term, the higher is the value of the option because of the greater potential for the share price to increase even further as well as the benefits of delaying payment of the exercise price. However, there are circumstances in which it will be optimal for an option holder to exercise an option earlier – e.g. because there are large dividends being paid on the underlying shares, so that a shorter term is better. Expected term is discussed in detail below.

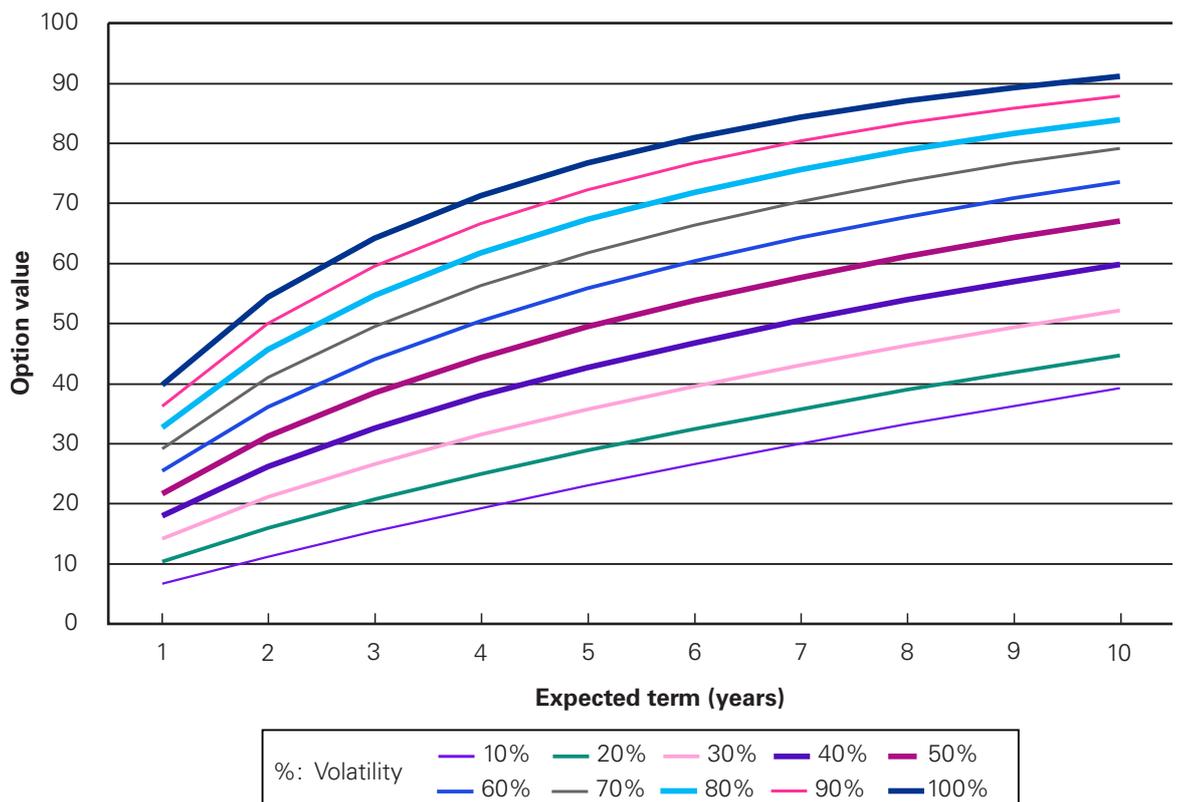
Each of these assumptions is discussed in detail below. In our experience, expected volatility and expected term are often the assumptions with the greatest potential subjectivity. The table below shows the different option values that result from changing an option's expected term and expected volatility assumptions, assuming a share price and exercise price of 100, a risk-free rate of 5 percent and a dividend yield of 0 percent.

Expected volatility	Expected term (years)				
	2	4	6	8	10
10%	11.3	19.3	26.6	33.2	39.3
20%	16.0	25.0	32.4	38.9	44.7
30%	21.1	31.4	39.6	46.4	52.2
40%	26.2	38.0	46.8	53.9	59.9
50%	31.2	44.4	53.8	61.2	67.1
60%	36.2	50.5	60.4	67.8	73.6
70%	41.0	56.3	66.4	73.8	79.3
80%	45.6	61.7	71.9	79.0	84.0
90%	50.1	66.7	76.8	83.4	88.0
100%	54.4	71.3	81.0	87.1	91.2

IFRS 2.B20

A graph of this table shows that option values are not a linear function of expected term. This means that the value of an option with a two-year term is not twice the value of an option with a one-year term. As a result, calculating an option's value based on the average date at which all employees are expected to exercise their options may be less accurate than stratifying employees into different groups based on similarity of early exercise behaviour and separately valuing the options received by each such group. This is discussed further below.

**Effect on option value of varying the expected term for a specified volatility**



## A2.50

IFRS 2.B11–B14

### Selecting inputs to option pricing models

The valuation of an option should use the expectations for inputs that would be reflected in a market price on the measurement date. In estimating such inputs, a range of factors including the historical values of the individual parameters would be considered. When there is a range of reasonable expectations, an expected value may be calculated by weighting each specific expectation with its associated probability. In some circumstances, specific factors may indicate that the historical outcome may be a poor predictor of future experience. For example, in estimating the expected dividend input to an option pricing model, historical dividend levels would not be used without considering possible changes to dividend policy, future capital and forecasts from market analysts.

#### Share price

For an entity with publicly traded shares, the share price used to value an option at grant date is generally the closing share price on grant date. Daily prices can be sourced from data services and stock exchange pricing data. For an entity whose shares are not traded publicly, valuation techniques are used to estimate the fair value of shares (see [A2.20](#)).

The higher the share price, assuming that all other inputs remain the same, the greater is the value of an option. For a given exercise (or cost) price, a rational holder would prefer a higher underlying share price to a lower underlying share price.

An option with a zero *intrinsic* value has a *total* value that is greater than zero before expiry of the option because the share price might move in-the-money before expiry. Clearly, the share price input also affects the value of an out-of-the-money option. For example, for an option with an exercise price of 20, the value of the option is higher when the underlying share is trading at 15 than when the underlying share price is 10. This is because, although in either case the option has zero intrinsic value, the likelihood of the option expiring in-the-money is higher in the former case.

#### Exercise price

The exercise price of an option, which is also referred to as the option's 'strike price', is the price at which the option holder is entitled to acquire the underlying share.

Frequently, an option plan states that options should not be issued with an exercise price below the share price on grant date. This may lead a valuer to use an exercise price equal to the share price in the option valuation model, which may not always be appropriate. In particular, the exercise price is a matter of contract and will be set out in the agreement with the recipient and may differ from the share price on grant date. For example, the exercise price may be set before grant date – i.e. before the share price input is measured, because of delays in communicating details of the option grant to employees (see [Chapter 6.3](#)).

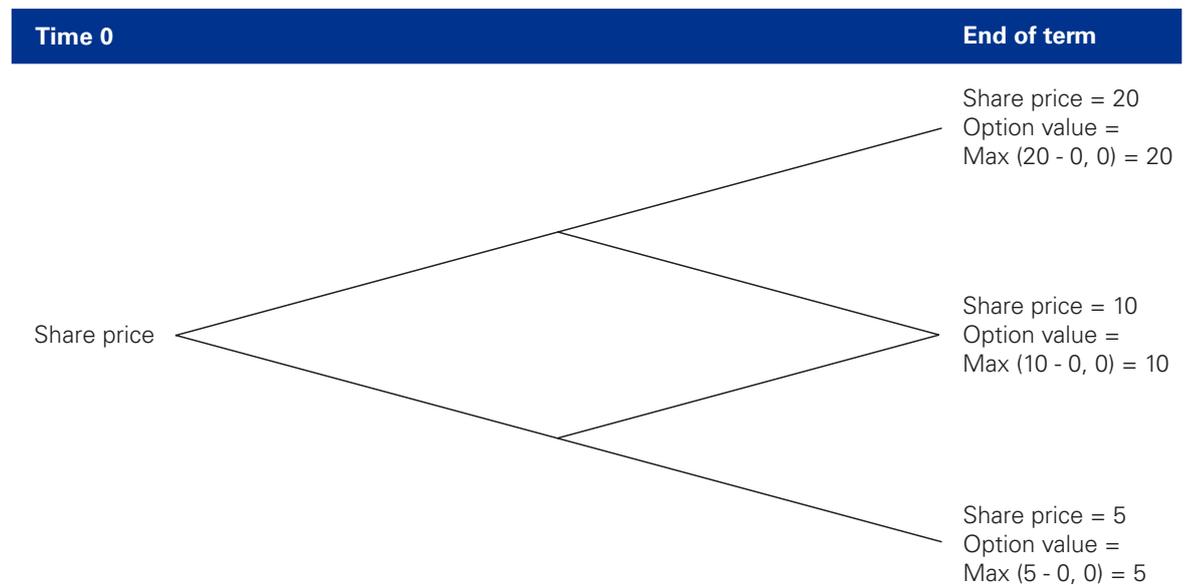
Because the exercise price represents the cost of the share to the holder, they will prefer a lower exercise price, assuming that all other inputs remain the same. Similarly, an option holder is worse off if an award's exercise price is higher.

Some entities issue options with a zero exercise price. This is equivalent to issuing unvested shares when the holder does not have a right to a dividend during the vesting period. Such an award can be modelled in an option pricing model, though a very small but greater than zero exercise price input is used<sup>2</sup>. If an option holder is entitled to dividends during the vesting period, then an option with a zero strike price will have a value indistinguishable from the share price, assuming that all other inputs remain the same.

The reason why an option with a zero (or nominal) exercise price is considered equivalent to an unvested share can be understood by considering the option's intrinsic value. Consider first an option on a non-dividend-paying share. The value of the share is the present value of the probability-weighted possible future share prices. The value of an option is the present value of the probability-weighted

2. In the BSM model, the formula includes the exercise price in a denominator. Attempting to divide by zero would cause the model to report an error.

possible future intrinsic values. If an option has a zero strike price, then the possible future share prices and intrinsic values are equal so the value of the option must equal the value of the share, as illustrated below.



The diagram shows a share price lattice, which includes different possible future share prices, over time, moving from left to right (from the valuation date). This illustrates that the possible future share prices are equal to the future intrinsic values. A small number of possible future share prices is shown for simplicity but the principle is unchanged if the number of share prices is increased.

For a share that entitles the holder to dividends, an option with a zero strike price is not equal to the full current value of a share. In essence, the current value of a share is based on its expected future cash flows – i.e. dividends – to shareholders. The value expected to be realised by an individual shareholder will comprise expected dividends and expected future proceeds from sale of the shares. However, future sale proceeds should be based on the future dividends thereafter. In this way, the value of a share over its life is ultimately related to expected dividends. Because option holders are not generally entitled to dividends paid during the vesting period, the value received by the option holder is worth less than the value of shares on which dividends are expected during the vesting period. Such an instrument can be valued using an option pricing model with a very small, but greater than zero, exercise price.

### Expected volatility

The expected volatility of returns on the underlying share is a key assumption when valuing an option. Volatility is a measure of the range of possible future returns on a given investment. Zero volatility means that the actual return on an investment is always equal to its expected return and only applies to risk-free investments. Volatility other than zero reflects the fact that for investments with some risk of variability, actual returns will often differ from expected returns. Higher volatility means that the range of possible share price returns is wider and that differences between actual and expected returns are likely to be greater than when there is lower volatility.

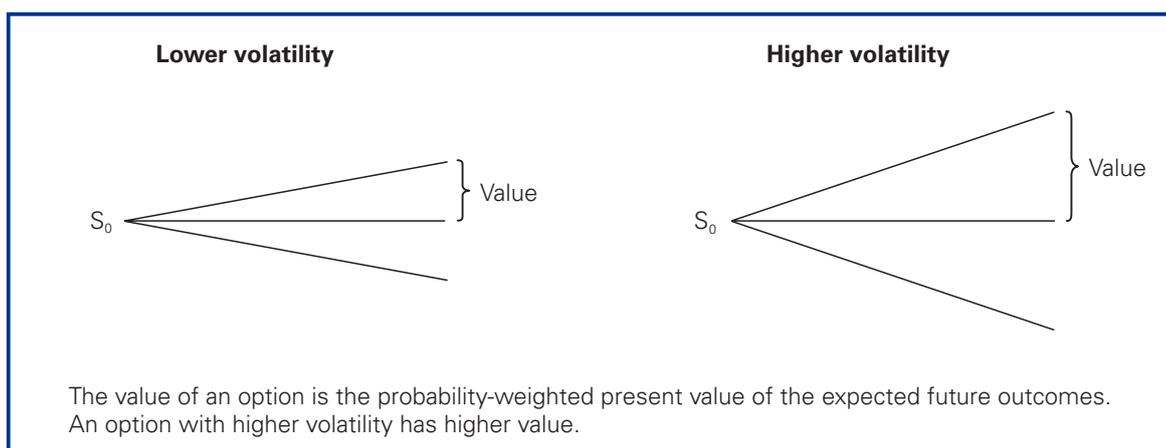
IFRS 2.B22–B23

Option pricing models use the annualised standard deviation of the continuously compounded rates of return on a share over time as the measure of volatility. The rate of return on a share comprises both share price movements – i.e. capital gains or losses, whether realised or unrealised over a period – and dividends, if applicable. Volatility of 30 percent, for example, as an expression, means one standard deviation of returns is the range of  $e^{\text{return} \pm 0.30}$ , in which (e) is the base of natural logarithms and is used due to the greater ease of working with natural logarithms in complex formulas. Option pricing models use the risk-free rate as the return assumption.

## IFRS 2.B24

The expected volatility of a share provides a range within which the actual return is expected to fall two-thirds of the time. For example, if a share has an expected return of 10 percent and expected volatility is 40 percent, then annual share returns are expected to fall within a range of -30 percent to +50 percent two-thirds of the time (10 percent - 40 percent and 10 percent + 40 percent, respectively). If the share traded currently at 20, then the share price in a year would be expected to be in the range of 14.82 ( $20 \times e^{-0.30}$ ) to 32.97 ( $20 \times e^{0.50}$ ), two-thirds of the time.

One might expect that the greater the possible dispersion of returns – i.e. the wider the range of possible returns – and the higher the uncertainty about the ultimate outcome, the lower the value of an investment would be. However, this is not the case in the context of option valuation. For shares, greater possible upside is balanced by greater possible downside and greater risk will often result in a lower value for a share. However, for options, the downside is a zero value and the amount by which the share price is below an option's exercise price is irrelevant. For example, whether an option is out-of-the-money by 1 or 100 at expiration, the intrinsic value is zero. Therefore, in the case of a risky share, there may be a greater likelihood that the share price will end up significantly below the exercise price compared with a less risky share. However, the pay-off to the option holder in either scenario is the same – i.e. zero. The greater upside benefits available for a high-volatility share with similar downside risk means that higher volatility leads to a higher value for an option on that share.



Unlike the share price and exercise price assumptions, expected volatility cannot generally be taken from a single objective source and there is subjectivity in estimating this model input.

## IFRS 2.B25

Some factors to be considered in estimating expected volatility include the following.

- The implied volatility (see below) of traded share options on the entity's shares or traded instruments that have option features such as convertible debt.
- The historical volatility (see below) over the most recent period commensurate with the expected term of the instrument. For example, in estimating the expected volatility of an option with a five-year expected term, significant weight would generally be placed on the historical volatility of the shares over a five-year period ending on grant date.
- The length of time that the entity's shares have been traded publicly (public company). For example, an option may have an expected term of seven years but the entity's shares may have been traded publicly for only six months. As such, the entity has limited experience with the historical volatility of its own shares on which to base longer-term volatility estimates.
- The tendency of volatility to return to longer-term average levels, which is sometimes referred to as 'reverting to its long-term mean' or to be 'mean-reverting'. For example, a period of very high volatility may relate to an event that is not expected to recur. In such circumstances, it could be appropriate to exclude the volatility from such a period. However, the basis for the exclusion of specific historical periods should be carefully supported, as discussed below. For example, an entity that disposed of

its core business (e.g. high-risk development of a new pharmaceutical) and used the funds to enter a different, less volatile business (e.g. a product with an existing stable revenue stream) may be able to support the exclusion of a historical period.

IFRS 2.B25

- Appropriate and regular intervals for price observations.

IFRS 2.B29

Unlisted entities do not have quoted share prices and look to the historical and implied volatilities of comparable listed entities.

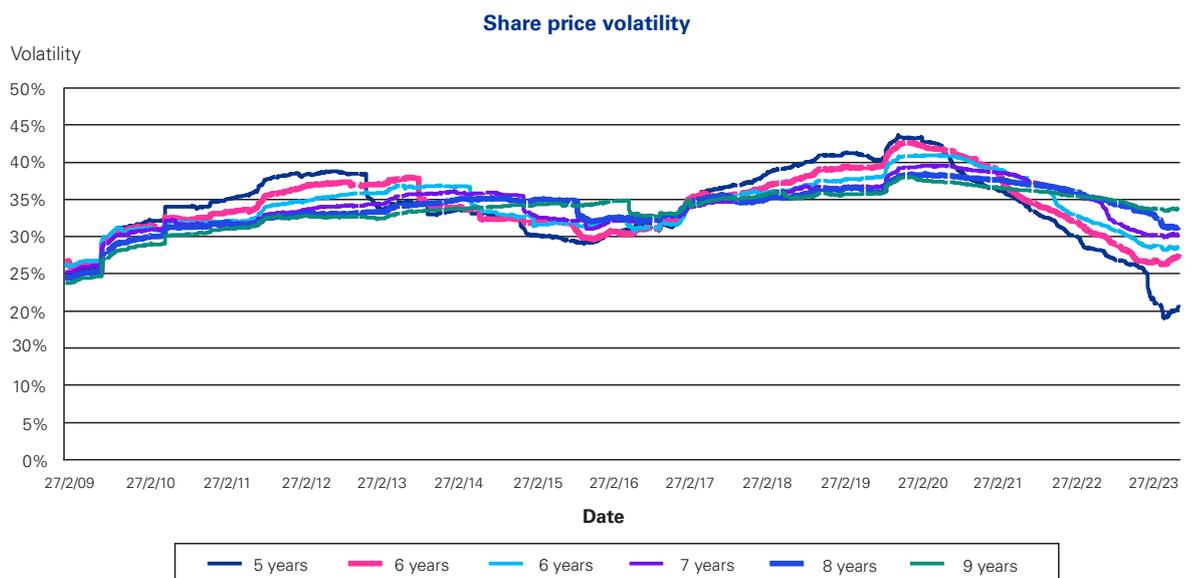
There are a number of issues that arise in practice when estimating expected volatility, including the following.

- The period over which share price volatility is estimated.
- Possible adjustments to remove especially volatile periods from the historical period over which volatility is calculated.
- Sourcing volatility information, especially implied volatility data.
- The trading volume required to place (exclusive) reliance on implied volatility.
- The weightings applied to implied and historical volatility estimates.

Two measures of volatility are historical volatility and implied volatility.

### Historical volatility

Historical volatility is a measure of the volatility of share returns over a given interval (e.g. daily, weekly, monthly), over a specified term (e.g. one year, two years, three years), which can be measured over time. For example, for an award with a five-year expected term, one might focus in particular on the volatility of daily share returns over the five-year period preceding the valuation date. This might be calculated only for the most recent five-year period on the valuation date. Alternatively, one might measure a series of rolling five-year daily (or other period) volatilities, starting on grant date and moving back over time, one day at a time, to have more information on movements in historical volatility over time to understand trends and outliers. This is shown in a graph below.



Historical volatility estimates may be provided by information sources or may be calculated from a sample of share prices. Whether they are sourced externally or calculated directly, a consistent method is applied to calculate historical volatility.

To illustrate this, the steps involved in calculating historical volatility from a sample of share prices are as follows.

- Source share prices for the interval selected – e.g. daily share prices over the past 10 years. The share prices of dividend-paying shares should be adjusted to remove the effect of the payment of dividends, which cause a reduction in the price of a share unrelated to generalised volatility. Such adjustments are often made by the data provider but may also be made directly.
- Calculate the share price returns on a natural logarithm basis. This is done by dividing each share price by the preceding price and then obtaining the natural logarithm. This can be done using a spreadsheet function. Option pricing models use continuous compounding for which natural logarithm returns are required. It is beyond the scope of this discussion to explain the specific detailed basis for why logarithms are used to perform these calculations.
- Calculate the standard deviation of the returns. Most spreadsheet programs include a function to perform this calculation.
- Convert the resulting standard deviation into an annualised standard deviation. This is done by multiplying the standard deviation by the square root of the number of the intervals selected in a year. For example, if daily share price volatility was calculated, then annualised share price volatility is calculated by multiplying the daily estimate by the square root of 260 (there are approximately 260 trading days in a year). If weekly share price volatility was calculated, then annualised share price volatility is calculated by multiplying the weekly estimate by the square root of 52.

The steps are illustrated as follows, when day zero may be either grant date or the previous day.

Day	Share price	$S_n/S_{n-1}$	$\text{Ln}(S_n/S_{n-1})$
0	109	0.9909	-0.913%
-1	110	0.9910	-0.905%
-2	111	1.0091	0.905%
-3	110	1.0092	0.913%
-4	109	1.0093	0.922%
-5	108	1.0093	0.930%
-6	107	1.0288	2.844%
-7	104	0.9630	-3.774%
-8	108	1.0693	6.701%
-9	101	0.9902	-0.985%
-10 <sup>1</sup>	102		
Standard deviation (daily)			2.765%
Standard deviation (annualised) <sup>2</sup>			44.589%
<b>Notes</b>			
1. Eleven days is too short a period from which to sample share returns but is used for simplicity above.			
2. To convert from a daily volatility estimate to an annual volatility estimate, use the square root of time – i.e. multiply the daily standard deviation by a factor of $260^{0.5}$ (there are approximately 260 trading days in a year).			
S: Share price.			

The following are some of the factors that are considered in using historical volatility.

*IFRS 2.B25(d)*

- Older historical periods may be less relevant than more recent periods. For example, a company may have changed its operations, disposed of a core business or significantly changed its capital structure<sup>3</sup>.
- A specific historical period may be excluded from the volatility measurement period if during that period the share price was extraordinarily volatile and such extraordinary volatility is not expected to recur. In many cases, events or other factors that caused spikes in volatility may be reasonably expected to recur, in which case specific historical periods would not be excluded. It is important to remember that, because the expected term of many options is relatively long, a relatively short period of volatility will be a relatively small part of the overall measurement period.

*IFRS 2.B26*

- A newly publicly traded entity may not be able to calculate historical volatility over a period that is commensurate with the expected term of its options. Such an entity should calculate its own historical volatility for the longest period available. It should also consider the historical volatility of comparable entities over a period that is commensurate with the expected term. If the volatility of comparable entities is used to estimate the volatility of an entity – e.g. for privately held or newly publicly traded entities – then differences in capital structure and operations should be considered. Adjusting for any such differences in operations is a matter of judgement rather than being subject to a formulaic adjustment mechanism. Adjustments for differences in leverage across entities are often performed by unlevering the comparable companies' reported equity volatilities based on their financial leverage to calculate asset volatilities and then relevering the selected asset volatility based on the company's capital structure.

### Implied volatility

Implied volatility is a measure of the volatility assumption implicit in a traded instrument. For example, for an option that is traded on an options exchange, the price of the option as well as variables such as the underlying share price, the exercise price, the contractual term and the risk-free rate over the term are known. With these variables being known, it is possible to calculate the expected volatility implicit in the traded option price. This is because the implied volatility variable, used together with the other model inputs in a standard option valuation model such as BSM, results in a model value that is equal to the option's price. This implied volatility is often regarded as the market's estimate of volatility over the term of the quoted instrument.

Given that implied volatility is often regarded as the market's estimate of expected volatility over the term of an instrument, it might be expected that it would always be used in share option valuation. Implied volatility already reflects historical volatility to the extent to which the market believes that historical volatility is relevant over the expected term of an instrument. However, it is frequently not possible to apply implied volatility for a number of reasons, including the following.

- The entity does not have traded options or other derivative securities on its shares. Paragraph B25(a) of IFRS 2 states that an entity may be able to calculate the implied volatility of traded instruments with option features such as convertible debt. This may be difficult to apply in practice because such instruments often have a number of features that complicate the estimation of implied volatility. For example, convertible debt may have callable or puttable features that complicate the derivation of implied volatility estimates related to its conversion features.
- Traded options generally have significantly shorter maturities than the expected term of options granted to employees. For example, many traded options have lives of three, six or nine months, whereas the contractual terms of an employee option can be 10 years.

3. Capital structure influences the volatility of an entity's shares. When an entity is leveraged, one effect of the debt is to amplify the volatility of the share price. Share price volatility primarily arises from changes in the value of an entity's operations. Debt in the capital structure will have volatility below the volatility of the value of the operations, and equity will have volatility above the volatility of the value of operations. The greater the proportion of debt in the capital structure, the greater is this effect.

- Quoted options may not be traded sufficiently actively to be a reliable basis for estimating expected future volatility. Market data is frequently used, if it is available, on the basis that the interaction of multiple buyers and sellers in a market brings a balanced perspective from sources highly incentivised to make correct estimates. However, when a market is not active such ‘wisdom of crowds’ is not present and the resulting values are less reliable. It is worth noting that there may be a number of options traded on the entity’s shares with different terms – e.g. puts vs calls, different maturity dates and different exercise prices. The large number of options available means that trading volumes may be split. Traded option information is useful in such circumstances, but lower volumes may reduce the level of reliance that can be placed on the data.
- The traded instrument from which the implied volatility estimate is derived may have an exercise price that is either heavily in or out-of-the-money. Implied volatility derived from such instruments is regarded as less reliable when valuing an at-the-money option.

A study of implied and historical volatility data provides information to help estimate expected volatility. However, in the absence of implied volatility from an actively traded instrument with a remaining life equal to the expected term of a share option, an entity will have to weigh the merits of different historical and implied volatility data points in estimating expected volatility. An entity may conclude that it is appropriate to weight both implied and historical volatility. The weights attached to the implied and historical volatility estimates are a matter of judgement. No strict formula or rules of thumb exist to calculate such weights.

### Expected dividends

#### *IFRS 2.B31–B32*

The treatment of expected dividends in a valuation of unvested shares or options depends on whether the holder is entitled to dividends or dividend equivalents during the vesting period. An example of a dividend equivalent is a reduction of an option’s exercise price by the amount of a dividend. This section will first discuss the valuation of unvested shares and options when the holder is not entitled to dividends or dividend equivalents, before discussing circumstances in which holders are entitled to dividends or dividend equivalents.

Dividends paid by an entity reduce the value of an option on the entity’s shares, if all other inputs remain the same. Payment of a dividend does not change a shareholder’s wealth. Instead, payment of a dividend monetises a portion of a share’s value so that after payment of a dividend, a shareholder holds cash plus a share whose value is equal to the pre-dividend value of the share less the amount of the dividend. For example, assume that a share is trading at 10 and then pays a dividend of 1. The price of the share will decrease by the amount of the dividend to 9. Before payment of the dividend, the shareholder held a share worth 10; after payment of the dividend, they hold a share worth 9 and cash worth 1, with no change in their aggregate wealth.

However, an option holder is worse off by payment of a dividend. Until they exercise their options and hold the underlying shares, they are not generally entitled to dividends. Therefore, option holders receive all of their return from share price appreciation and anything that reduces the underlying share price, such as a dividend payment, will reduce the value of their options.

Continuing the example, suppose that an option holder held an option on the underlying share that had an exercise price of 9.5. Before payment of the dividend, the option was in-the-money and had an intrinsic value of 0.5. However, after payment of the dividend and the resulting decline in the share price, the option moves out-of-the-money. This illustrates that the higher the dividend is on an underlying share, the lower is an option’s value.

#### *IFRS 2.B35*

Dividends can be incorporated into an option pricing model using the estimated dividend amounts, though it is more common to use an estimated dividend yield. Dividend amounts, if they are used, should be discounted at the risk-free rate from the expected dividend payment date to the measurement date. If dividend payments are modelled as specific amounts, then increases in the dividend over the expected term should be considered.

Option models frequently incorporate the effect of dividends by reducing the current price of the share from which a future distribution of share prices is calculated. This is usually accomplished in the model through the entry of the dividend assumption.

In estimating expected dividends over the expected term, one should consider the following.

- Historical dividends or dividend yield. However, the reported historical dividend yield may be unreliable as an estimate of the expected future dividend yield. For example, if a dividend is perceived to be unsustainable, then investors will mark down the price of a share (the denominator in the dividend yield calculation) before the decline shows up in the actual dividends paid (the numerator in the calculation). This can be apparent when the dividend yield appears very large relative to an entity's historical practices and/or its cost of capital. For example, for many banks during the financial crisis, the reported dividend yields were very large because the market anticipated a decline in dividends before the dividend was cut.
- Planned changes to the dividend over the expected term. An entity may not have paid dividends historically but is expected to pay dividends within the expected term of a share-based payment award. In these circumstances, the expected dividends should be considered in the option valuation. An entity that does not pay dividends and has no plans to do so would use a dividend yield assumption of zero.
- Guidance on dividends provided by management to the market.
- Forecast dividends: e.g. from investment analysts and analyst reports.
- Sustainability of dividends given current and projected profitability and current and projected investment requirements.
- Changes in the nature of the business, including its cash generation and cash requirements.

*IFRS 2.B32–B34*

A valuation should consider whether the terms of an option include any dividend protection features so that the holder is entitled to dividends or dividend equivalents during the vesting period. Such terms protect an option holder from a decline in the value of the option that would otherwise occur from the payment of a dividend. Such a feature can take the form of a reduction in the exercise price by the amount of any dividends paid. When an option includes a dividend protection feature, the dividend assumption in the model is generally set at zero because the dividend protection feature prevents any decline in the value of the option caused by the payment of a dividend.

### **Risk-free rate**

*IFRS 2.B37*

The risk-free rate used in an option pricing model is generally derived from zero coupon government bond yields in the currency in which the option's exercise price is denominated with a maturity equal to the expected term of the award.

It is possible to incorporate the term structure of interest rates into certain option pricing models. However, this is not possible for closed-form models and dramatically increases the complexity of lattice models (for more details about such models, see [A2.100](#)). A term structure is rarely used in practice.

*IFRS 2.B37*

Issues arise when there are no appropriate government bond rates or when government bond rates do not represent risk-free rates, particularly when the credit risk of certain governments has increased. One indication of whether and the extent to which credit risk is included in a government bond rate may be pricing in derivative markets – e.g. credit default swaps on debt issued by the government concerned. In these circumstances, appropriate substitutes for the risk-free rate should be found. This could include the use of government bond rates from a more creditworthy country that uses the same currency – e.g. for countries using the euro, the rate used would be from the country with the highest credit rating in the euro zone. Other approaches might include adjusting available government bond rates from countries that are believed to be risk-free for expected inflation differentials between that country and the country in whose currency the exercise price is stated.

The higher the risk-free rate, the greater the value of an option. The risk-free rate is sometimes referred to as the 'assumed drift of the share price' – i.e. the share price is assumed to increase on average at the risk-free rate (less the dividend yield) and therefore the higher the risk-free rate, the greater the average assumed increase in price. Use of the risk-free rate is consistent with risk-neutral pricing, an assumption of option pricing models.

Use of the risk-free rate is not intended to suggest that options or the underlying shares are risk-free. However, the riskiness of the share is already reflected in the share price input assumption into the option valuation model. Moreover, option pricing models assume that an investor could create a portfolio that hedges the risk from an option.

Government bond rates can be sourced from a number of data sources.

### Expected term

Options may be exercisable at the end of their contractual life, at any point up to the end of their contractual life or at certain periods over the contractual life. An option that is exercisable only at the end of its contractual life is referred to as a 'European option'. An option that is exercisable at any point over its life is referred to as an 'American option'. An option that is exercisable at specified periods over its life is referred to as a 'Bermudan option' (on the basis that Bermuda lies between America and Europe). An employee option is generally a Bermudan option, because it is usually exercisable at any point until the end of its life once the vesting period has passed, subject to potential 'blackout periods' when employees are restricted from trading in their employers' shares.

In general, it is sub-optimal to exercise an option before the end of its contractual life. This is because when an option is exercised, its intrinsic value is secured but the time value of the option is lost. As a result, in most cases, models suggest that options should be held through to the end of their contractual life. An exception to this general principle arises for options on dividend-paying shares. Payment of a dividend will tend to accelerate option exercise so that the option holder can benefit from payment of the dividend.

#### IFRS 2.B16

However, it is observed that employees exercise their options early. This may, in part, be because employee options are not tradable, and therefore any employee wanting liquidity cannot sell their options and has to exercise the options and sell the underlying shares. Similarly, holders who cease employment with the entity are generally required to exercise their options within a short period. The inability to transfer an option is reflected through an adjustment to the expected term to reflect early exercise rather than through the application of a separate discount for lack of marketability.<sup>4</sup> As a result, IFRS 2 provides that options are valued based on their expected term rather than their contractual life. Expected term reflects option holders' early exercise decisions.

Traditionally, expected term has primarily been incorporated into the value of an employee option by using a term assumption in the option pricing model that is shorter than the contractual life.

If an entity does not have experience of employees exercising options, then there is no entity-specific information on which early exercise assumptions can be based. For example, employees in a private entity will often not exercise their options because if they were to do so they would be left holding risky, illiquid shares. As a result, decisions made by employees when an entity was private may not be relevant after such an entity has gone public.

In general, an entity should base its estimate of the expected term on its own specific history. Industry data may become available over time but may not be appropriate for a specific entity's facts and circumstances – e.g. because of differences in size, share price volatility, employee wealth, rank or age, underlying share price performance.

If entity-specific information does not exist, then an entity forms an estimate. The earliest date at which an option could be exercised is the end of the vesting period, whereas the last date is the end of the

4. A discount for lack of marketability may be appropriate for the share price input if there are post-vesting restrictions on the transferability of the underlying shares that are obtained when an option is exercised.

contractual life. In the absence of entity-specific information, some entities have used the average of these two periods, which is calculated as (vesting period + total contractual life) / 2. For example, if an option had a 10-year contractual life and four-year cliff vesting (see A2.70), then the expected term under this approach would be seven years ((4 + 10) / 2). When this approach is used because an entity has limited employee exercise history, the entity collects and analyses employee exercise behaviour in order to use entity-specific information when sufficient exercise history is available.

A share-based payment award with a longer vesting period will generally have a longer expected term than a share-based payment award with a shorter vesting period, even if they both have the same contractual life. Share-based payment awards with a longer vesting period may have a higher calculated value through a longer expected term. This is somewhat counterintuitive because it might be expected that an option with a shorter vesting period would be more valuable than an option with a longer vesting period because the holder in the former case has greater discretion, flexibility and control over when they decide to exercise the option. However, because options should not generally be exercised early, features that tend to extend the life of an option, including a longer vesting period, will result in a higher value in an option valuation model compared with features that shorten the life of the option.

*IFRS 2.B18–B19*

Other factors to consider in estimating expected term include the following.

- Whether one should apply different expected term assumptions for different groups of employees. For example, senior executives may be expected to hold options for longer periods than other employees, partly because senior executives may be expected to hold shares to demonstrate confidence to shareholders and also because senior executives frequently have other sources of wealth beyond options that can be used to fund cash requirements. Because options are not a linear function of expected term (e.g. the value of an option with a two-year term is not twice the value of an option with a one-year term), averaging expected term assumptions across groups of employees with very different expected term expectations may result in a less accurate result than an analysis that considers groups of employees with similar exercise behaviour (see A2.40).
- The reliability of early exercise parameters. Although lattice models allow for greater flexibility in modelling and valuing an award, the resulting values will be more reliable than more simplistic models such as the BSM model only if the input assumptions are reliable. The IASB identified certain possible early exercise parameters – e.g. when a particular share price was reached or the volatility of the underlying shares. However, options may have been exercised in the past because of a range of complex factors that are not modelled easily. For example, an employee may exercise options to fund the purchase of a holiday home, children’s higher-level education or divorce. Use of historical experience to predict future behaviour using these factors may be unreliable.
- A holder’s decision not to exercise an option may not have been voluntary. For example, an option that was deeply out-of-the-money for long periods of its contractual life will not have been exercised because it was out-of-the-money. In such circumstances, a long historical holding period is not necessarily indicative that holders will hold future awards that are in-the-money for a similar length of time before exercising them. This may be a very important factor to consider when evaluating the exercise behaviour in respect of awards from entities whose share price suffered significant declines in value.
- Changes to the terms of an award. It may not be appropriate to apply exercise behaviour from an award with a specific set of contractual terms to an award whose terms differ – e.g. with respect to a market condition or contractual life.
- The volatility of the underlying shares. Options on shares with higher volatility may have earlier exercise than options on shares with lower volatility.
- The average length of time during which similar share options have remained outstanding in the past.

*IFRS 2.B18*

## Vesting and non-vesting conditions

As stated in A2.20, service and non-market performance conditions are not considered in estimating the value of an individual share or share option but are considered in estimating the number of instruments expected to vest (see 6.2.10).

Market conditions and non-vesting conditions are considered in estimating the fair value of an individual share or share option. Market conditions can be modelled using lattice models or Monte Carlo simulations, as discussed below, but not using the BSM model.

Non-vesting conditions that are based on prices available in a market – e.g. commodity prices – can be valued by simulating the underlying share price and the reference price. A complication is that these simulations are not independent and a simulation of the reference instrument – e.g. the commodity – should take account of the share price simulation, or vice versa. Complicated techniques – e.g. Cholesky's decomposition – can be employed in such simulations.<sup>5</sup>

Non-vesting conditions that are not price-based – e.g. a requirement to hold underlying shares to retain a separate share option award – are not readily modelled and should be based on entity-specific or industry estimates.

## Restrictions on transferability

*IFRS 2.B8,  
BC153–BC169*

A share-based payment arrangement may include restrictions on transferability that restrict the recipient from selling an award. Such restrictions may be categorised as either pre-vesting or post-vesting restrictions – i.e. restrictions that restrict a holder from disposing of an award before it vests or post-vesting restrictions that apply even once an award has vested. Pre-vesting restrictions are not considered in valuing an award but post-vesting restrictions are.

A discount that is applied to reflect the effect on the value of a share because the share cannot be traded readily either because the shares are not traded publicly or because they are subject to a transfer restriction is referred to as a 'discount for lack of marketability'. Discounts for lack of marketability are often applied for factors other than restrictions in a share-based payment arrangement – e.g. restrictions on transferability are often imposed on shareholders in private entities.

A share that has a limitation or restriction on transferability is less valuable than a share that is freely traded. However, quantifying the level of such a discount is difficult. Moreover, if a non-quoted share is subject to a post-vesting restriction, then care should be taken to avoid a double count of a lack of marketability discount – i.e. a discount for lack of marketability may have been applied already to reflect the fact that the share is not publicly quoted and is therefore less marketable than a quoted share. In such circumstances, an incremental discount may apply for the post-vesting restriction but the level of such a discount should reflect the fact that a discount has already been applied in arriving at the value of a share.

*IU 11-06*

In November 2006, the Interpretations Committee considered adding an issue to its agenda related to the fair value measurement of post-vesting transfer restrictions. The specific issue was whether an approach to estimate the value of shares issued only to employees and subject to post-vesting restrictions could look solely or primarily to actual or synthetic markets that consisted of transactions between an entity and its employees in which, for example, prices reflected an employee's personal borrowing rate. Although it did not add the issue to its agenda, the Interpretations Committee noted several requirements of IFRS 2 that highlighted that value from an employee's perspective was not the measurement objective, and that consideration should be given to actual or hypothetical transactions with actual or potential market participants. It also noted that when the shares are traded actively in a

5. A similar approach is typically followed where a market condition ties the proportion of an award that a recipient earns to the company's total return or share price performance relative to the performance of a group of comparable companies – e.g. 50% of the award vests if the TSR of the company over the measurement period exceeds the median TSR performance of a specified group of companies that operate in the same industry as the company and 100% of the award vests if the company's TSR is above the third quartile performance of the group. The simulation approach used to measure such an award needs to consider the correlations between the companies.

deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.

There are several methods used to estimate the level of a discount for lack of marketability, as discussed below. The estimation of a marketability discount should consider the specific characteristics of the entity and of the restriction, including the volatility of the value of the entity and length of the restriction.

- *Option pricing or derivative models:* Some have sought to use options or other derivatives to quantify discounts for lack of marketability. This appears intuitively attractive because some of the inputs into option pricing models are also factors that would be considered by an investor in estimating a discount for lack of marketability – e.g. the length of the restriction or the volatility of the underlying shares. It has been suggested that an at-the-money put option can be used to quantify a marketability adjustment. This assumes that the value of the put option is equal to the value of the restriction and, implicitly that the value of a restricted share with a put option is equal to the value of an unrestricted share. However, the restricted share plus the put option is more valuable on a cash flow basis than an unrestricted share because the put option essentially eliminates the downside on the share while the unrestricted share would still have risk – i.e. the expected cash flows of the restricted share and the put option are greater than the cash flows on the unrestricted share. It is increasingly common for non-plain vanilla put options such as the Finnerty or Asian put models to be used to quantify a discount for lack of marketability.
- *IPO studies:* These studies compare the prices at which shares were issued by an entity before an IPO with the entity's subsequent IPO price. They quantify the discount for lack of marketability as the difference between the pre- and post-IPO prices. Potential weaknesses in this approach include that some of the pre-IPO transactions included in the studies may have been with related parties and that changes in an entity's circumstances and prospects and/or investment markets may have contributed to any changes in value. It is not appropriate to apply average discounts from IPO studies without considering the specific facts and circumstances of an entity.
- *Restricted share studies:* Restricted share studies compare the prices at which registered shares in entities trade with the prices at which unregistered shares trade. In US equity markets, a public entity may have registered and unregistered shares. The latter are less marketable than the former because they can be sold only to qualified investment buyers. Differences in prices between registered and unregistered securities are attributed to the latter's reduced marketability and such differences are used as a basis for estimating the level of a marketability discount. The level of discounts reported in these studies has varied both over time and within studies, depending on the characteristics of the entities involved. Their application to estimating post-vesting restrictions should be carefully considered and supported. It is not appropriate to apply average discounts from restricted share studies without considering the specific facts and circumstances of an entity.

In estimating or evaluating a marketability discount, it is useful to note that there is no difference between the underlying cash flows on a restricted share and those on an unrestricted share. A large marketability discount implies that a holder of a restricted share has a significantly higher required return than a holder of an unrestricted share. For example, a holder of an unrestricted share in Company B requires an annual rate of return of 10 percent. Assuming that Company B does not pay a dividend, this return is expected to result from a capital gain from an increase in the share price – e.g. an increase to 110 after one year ( $100 \times (1 + 10 \text{ percent})$ ). If a restriction of 40 percent was applied to value a restricted share in Company B, then the current price of a restricted share would be 60 – i.e.  $100 \times (1 - 40 \text{ percent})$ . If the restriction expires in one year, at which stage the share is equal to other unrestricted shares, then the implied current required annual return on a restricted share would be 83 percent per annum ( $110 / 60 - 1$ ). This indicates that the discount is too large.

## A2.60 Dilution

In most cases, dilution does not need to be taken into account in valuing an employee share option provided that one is using a share price after announcement of the share grant or if it is reasonable to assume that the market would anticipate the option grants. In these circumstances, the share price already reflects the effects of dilution and no additional factor is applied. However, entities planning major unanticipated share or share option grants should consider the application of dilution factors if it is unreasonable to assume that the share price already reflects the market's assessment of the effect of the grant on the value of the shares. In our experience, dilution adjustments are rarely applied because there is a high hurdle to demonstrate that the share-based payment has not been anticipated by the market.

## A2.70 Graded vesting

*IFRS 2.IG11*

Awards are generally subject to either cliff or graded vesting. An award with cliff vesting vests in full at the end of the vesting period. An award with graded vesting vests over the vesting period. The expected term of each of the separately vesting tranches of a graded-vesting award may be different because they have different vesting periods. Because they can be anticipated to have different expected terms, IFRS 2 indicates that the fair value of each tranche will differ.

## A2.80 Put options

A share-based payment may provide the share or option holder with a put option that entitles the holder to sell shares back to the entity. The primary purpose of such an option is to provide liquidity to the holder; this occurs most often when the shares received by a holder are non-quoted. As a result, a marketability discount would not generally be appropriate or would be reduced in valuing a share with a put option.

If a put option's exercise price is the market value of the share at the date of exercise, then the model-derived value of the put option is zero. The reason for this is that under such an option, a holder exchanges a share for an equivalent amount of cash. Exchanges of items of equivalent value have zero intrinsic value and therefore such an option would have a model-derived value of zero – i.e. the value of the underlying share and the exercise price are always equal. If the price in a put option is fixed, then there may be model-derived value associated with the put. However, such put options are uncommon because the holder of a put option benefits from declines in an entity's share price, which is contrary to the general corporate objective of increasing the value of the entity's shares. If a share-based payment includes a put option, then the award will be classified as cash-settled.

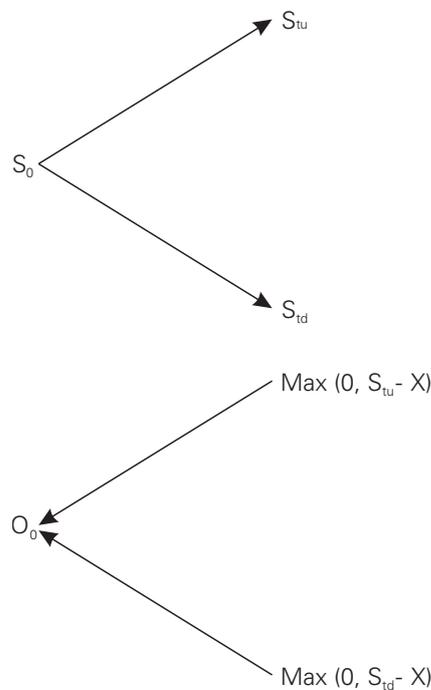
## A2.90 Credit risk

Credit risk is potentially relevant when valuing an award with a cash settlement feature. However, in our experience such adjustments are encountered very rarely because payments under such awards are due only when the value of the entity has increased, and in these circumstances the credit risk is likely to have improved. Credit risk is not relevant for equity-settled awards because these are settled through the issuance of shares rather than through the transfer of cash or other assets.

## A2.100 Option valuation models

Option valuation models use mathematical techniques to identify a range of possible future share prices at the exercise date. From these possible future share prices, the pay-off of an option can be calculated. These intrinsic values at exercise are then probability-weighted and discounted to their present value to estimate the fair value of the option at the grant date.

The approach followed in a lattice model illustrates this principle in a simplified manner below.



### Share price distribution

1. Calculate a distribution of possible future share prices from grant date to the exercise date.

The share price distribution depends on:

- the opening share price
- the risk-free rate
- volatility
- time
- dividends.

### Option value

2. Calculate the option pay-off at the exercise date (t) for each share price node – i.e.  $\text{Max}(0, S - X)$ .

The pay-off depends on the share price at the equivalent node in the share price tree and the exercise price – i.e. the intrinsic value. When the share price is below the exercise price, the intrinsic value at the exercise date is zero.

3. Present value, probability weight the future intrinsic values.

There are clearly many other possible future share price paths beyond the two-stage up (u), down (d) shown above. Other paths have been excluded for simplicity. The formulas for u and d are provided in [A2.100](#). Each different price point in a lattice model is referred to as a node.

Lattice models can also consider early exercise of an option at intermediate nodes so that the value of the option is not necessarily just the discounted, probability-weighted terminal intrinsic values. Such early exercise might be assumed based on the ratio of the share price at a node to the exercise price (S/X), post-vesting termination rates or payment of dividends.

Share price modelling does not depend on estimates of future share prices from management and/or valuation advisers. The future share prices and associated probabilities are derived from the model's assumptions – i.e. the current share price, the risk-free rate, volatility, time and dividends.

## Model selection

There are three main models used to value options:

- closed-form models: e.g. the BSM model;
- lattice models; and
- simulation models: e.g. Monte Carlo models.

These models generally result in very similar values if the same assumptions are used. However, certain models may be more restrictive than others – e.g. in terms of the different pay-offs that can be considered or assumptions that can be incorporated. For example, a BSM model incorporates early exercise behaviour by using an expected term assumption that is shorter than the contractual life, whereas a lattice model or Monte Carlo model can incorporate more complex early exercise behaviour.

Model selection will depend, in part, on the complexity of an award (e.g. an award with a market condition cannot be valued using BSM) and the ability to estimate more reliable predictors of early exercise behaviour than time. Therefore, although a lattice or Monte Carlo model is able to incorporate more complex early exercise behaviour, an entity will be able to take full advantage of such features only if reliable early exercise parameters are available.

### Black-Scholes-Merton

The BSM model is a closed-form equation that values plain vanilla options – i.e. options with the standard pay-off formula of the greater of zero and the share price at the end of an option's term less the option's exercise price.

The key advantage of the BSM model is its simplicity: it is readily available over the internet and relatively straightforward to implement, even by those with limited understanding of the underlying mathematics, once a reliable model is obtained. However, it cannot be employed to value options with complex pay-offs – e.g. an award with a market condition. Moreover, because the BSM model is based on expected share prices at the end of an option's term and it cannot consider early exercise, it may not be appropriate for options when early exercise is likely – e.g. for shares that are dividend-paying.

The formula for the BSM is as follows:

$$C = Se^{-qT}N(d_1) - Xe^{-rT}N(d_2)$$

in which

$$d_1 = \frac{\ln(S/X) + (r - q + \sigma^2 / 2)T}{\sigma\sqrt{T}}$$

$$d_2 = d_1 - \sigma\sqrt{T}$$

In the formula above:

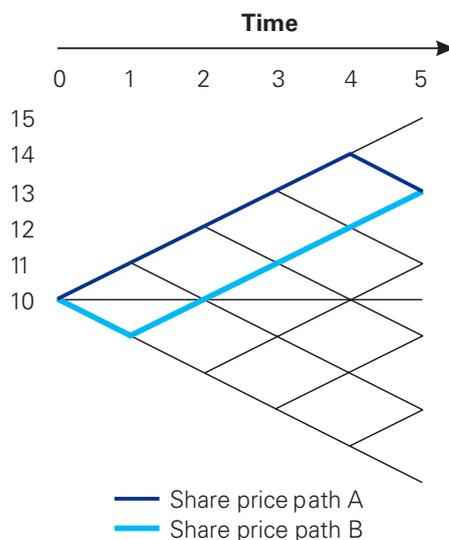
- S is the share price;
- N() is the cumulative distribution function of the standard normal distribution;
- X is the exercise price;
- T is the expected term;
- q is the continuously compounded dividend yield;
- r is the continuously compounded risk-free rate; and
- $\sigma$  is the volatility in the log-returns of the underlying share.

### Lattice

A lattice model builds a lattice of future share prices from which option values can be calculated. Examples of lattice models include binomial and trinomial models. In a binomial model, shares can move to one of two possible outcomes from any given point, whereas in a trinomial model, share prices can move to one of three possible outcomes from any given point (hereafter also referred to as 'nodes').

Advantages of a lattice model include the following.

- Because it shows share price movements over an option's term, early exercise parameters can be built into the model. For example, if there is evidence that option holders exercise their options when an entity's share price is twice the amount of an option's exercise price, then a lattice model can be built that monitors points or nodes in a share price lattice at which the share price is twice the amount of the exercise price and assumes exercise at that point.
- More complex pay-offs can be measured. For example, if an option has a capped return, then this could be incorporated into a pay-off formula. The standard pay-off formula for a plain vanilla option at exercise is its intrinsic value, which can never be negative. In the case of a capped option, the pay-off formula would be the lower of the intrinsic value or the cap.
- A lattice model may be used to measure an award with a market condition when the market condition is measured on the exercise date. For an award with a market condition that is measured on the exercise date, the pay-off formula at the terminal nodes would check if the share price was greater than that required under the market condition, in which case intrinsic value would be assumed; otherwise the pay-off would be zero. However, if a market condition is measured at a date other than the exercise date, which is normally the case, then a Monte Carlo model may be more appropriate. The reason for this is that there are a number of routes through a lattice by which a market condition may be met and by which a terminal node is reached and it is difficult to monitor which route may have been followed. This is illustrated below.



The pay-off under a share option with no market condition would be the same for different share price paths that end at the same terminal node.

If an award has a market condition that is measured before the end of the expected term, then both the share price path taken and the terminal node reached will be important.

For example, assume an option award with a market condition that the share price must exceed 12 after three years. Without a market condition, the intrinsic value at exercise would be the same for paths A and B. However, only path A meets the market condition so even though path B ends in-the-money, the pay-off to the recipient under B would be 0 because the market condition is not met.

The difficulty of mapping share price paths through a lattice model generally makes Monte Carlo models easier to use for market conditions.

### Implementing a lattice model

A lattice model can be built in a spreadsheet, once certain core formulas are known. The ability to build a lattice model allows a valuer the flexibility of modelling awards with complex pay-offs not modelled easily using closed-form models such as the BSM.

The steps in valuing an option using a lattice model are as follows.

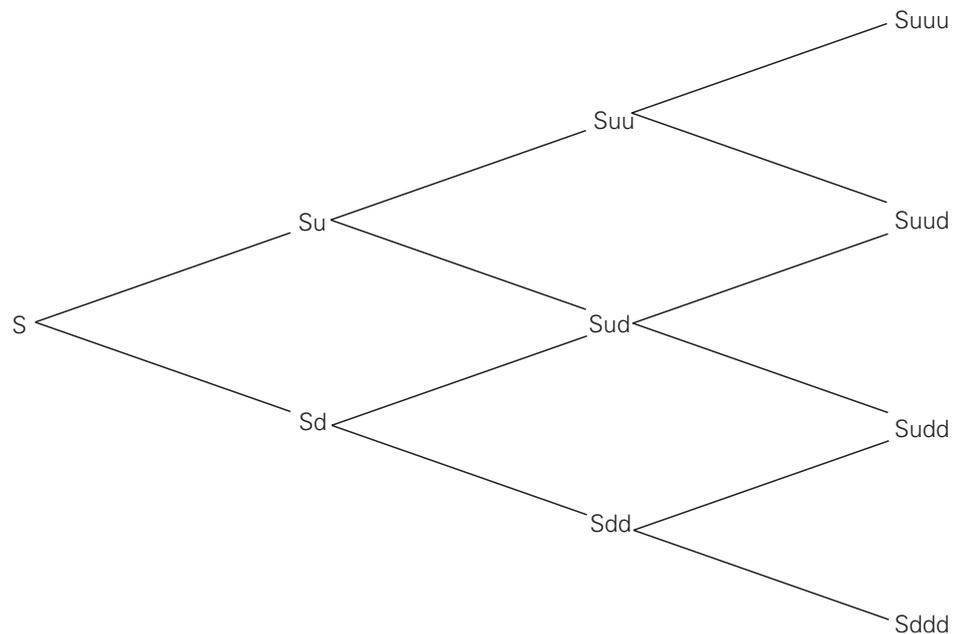
1. Calculate the distribution of possible future share prices from grant date to the end of the option term (moving left to right). The share price distribution depends on the opening share price (S), the risk-free rate, volatility, time and dividends.

2. Calculate the option pay-off at the end of the option term (t) for each share price node. The pay-off depends on the share price at the equivalent node in the share price tree and the exercise price (X) – i.e. the intrinsic value. If the share price is below the exercise price, then the intrinsic value at the exercise date is zero.
3. Calculate the discounted, probability-weighted intrinsic values at the terminal nodes, working backwards in the lattice (moving right to left).
4. Consider early exercise of the option at intermediate nodes. Such early exercise might be assumed based on the ratio of the share price to the exercise price [S/X], post-vesting termination rates or dividends.

### Calculating the share price distribution

From the opening share price (S), the share price is assumed to be able to increase to a value (Su) or decrease to a value (Sd; 'u' is referred to as the 'up factor' and 'd' is referred to as the 'down factor'). From each of these nodes, the share price can then increase by a factor (u) or decrease by a factor (d). The probability of an increase is (p) and the probability of a decrease is (1-p); these probabilities are not necessarily equal.

This can be seen as follows.



The formulas for (u), (d) and (p) are as follows<sup>6</sup>.

$$u = e^{\sigma\sqrt{\Delta t}}$$

$$d = 1/u$$

$$p = \frac{e^{r\Delta t} - d}{u - d}$$

6. These parameters are constant over the contractual life of the option in most lattice models.

Because there are only two possible moves, the probability of either an increase or a decrease must be equal to one. This can be seen as follows: the probability of an up and down move is  $p + (1 - p) = 1$  (the ps cancel out).

This can be implemented as follows.

<b>Assumptions</b>					
Volatility (years)	40%	Up factor (u)	1.32690		
Total time (years)	2	Down factor (d)	0.75364		
Number of periods	4	Up factor probability (p)	45.57%		
Time per period (years)	0.50	Down factor probability (1-p)	54.43%		
Time sq root	0.71	Sum of probability	100.00%		
Dividend yield (continuously compounded)	0.0%			Binomial value	2.33
Return annual	3.00%			BSM value	2.46
Return (continuously compounded)	2.96%			Difference	(0.13)
Exercise price	10			Difference	-5.6%
Opening price	10				
<b>Time</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
<b>Share price</b>					
				31.00	
			23.36		
		17.61 <sup>3</sup>		17.61	
	13.27 <sup>1</sup>		13.27		
10.00		10.00 <sup>4</sup>		10.00	
	7.54 <sup>2</sup>		7.54		
		5.68		5.68	
			4.28		
				3.23	
<b>Notes</b>					
1. $S_u = 10 \times 1.3269$ .					
2. $S_d = 10 \times 0.75364$ .					
3. $S_{uu} = 10 \times 1.3269 \times 1.3269$ .					
4. $S_{ud} = 10 \times 1.3269 \times 0.75364$ or $S_{du} = 10 \times 0.75364 \times 1.3269$ .					

### Node probabilities

				4.31%
			9%	
		21% <sup>1</sup>		20.61%
	46%		34%	
100%		50% <sup>2</sup>		36.91%
	54%		41%	
		30% <sup>3</sup>		29.39%
			16%	
				8.78%
	100%	100%	100%	100%

### Intrinsic value at terminal nodes

Node	S	X	S - X	Max (S - X, 0)
(4,4)	31.00	10.00	21.00	21.00
(4,3)	17.61	10.00	7.61	7.61
(4,2)	10.00	10.00	-	-
(4,1)	5.68	10.00	(4.32)	-
(4,0)	3.23	10.00	(6.77)	-

### Option value

	0	1	2	3	4
					21.00
				13.51 <sup>4</sup>	
			7.90		7.61
		4.37		3.42	
2.33			1.53		-
		0.69		-	
			-		-
				-	
					-

#### Notes

- $p \times p$  – i.e.  $0.4557 \times 0.4557$ .
- $p \times (1 - p) + (1 - p) \times p$  – i.e.  $0.4557 \times (1 - 0.4557) + (1 - 0.4557) \times 0.4557$ .
- $(1 - p) \times (1 - p)$  – i.e.  $(1 - 0.4557) \times (1 - 0.4557)$ .
- The option value at this node is equal to the probability-weighted present value of the succeeding nodes – i.e.  $((21 \times 45.47\%) + (7.61 \times (1 - 45.47\%))) \times \exp(-0.05 \times 2.96\%)$ .

The following points are relevant in relation to the diagram in [A2.100](#).

- A very small number of nodes has been used to simplify presentation of the analysis – i.e. only four time periods. Based on an assumed time period of two years, share prices are calculated only every six months. Significantly more calculated share prices would be used in an actual valuation (e.g. 100 sub-periods).
- Even with only four time periods, the resulting lattice-derived value is within 5.6 percent of the value reached under the BSM model. Increasing the number of nodes would cause the lattice value to converge to the BSM value, if the same assumptions are used.
- More complex lattice models could consider early exercise in the periods before the end of the contractual life. Therefore, the lattice model can be amended to include more complex assumptions than BSM.

## Monte Carlo

A Monte Carlo model simulates future share prices. The share prices can be simulated at the end of the expected term or, if the share price path is needed from the grant date through to the end of the expected term, more frequent estimation of share prices is possible.

Once the share price at the end of the option's term has been simulated, the pay-off to the option can be calculated based on the option's pay-off function. As with a lattice model, because of the transparency of the simulated share prices, it is possible to model complex pay-offs using Monte Carlo simulation. The average pay-off is then discounted to the present value using the risk-free rate.

More complex modelling may be required when it is necessary for the Monte Carlo model to consider early exercise of the option. In these circumstances, techniques such as a regression-based least squared method may be required. Detailed discussion of such techniques is beyond the scope of this appendix.

Monte Carlo simulation is computationally intensive because a high number of simulations have to be run to ensure a sufficiently large sample. Generally, tens of thousands of simulations of share prices are run. If it is necessary to model share prices over the expected term, then this will increase the computational intensity. However, it is not generally necessary to run share price simulations over each trading day before the end of the expected term. For example, if there is a fixed date on which achievement of the market condition is measured and the end of the expected term is later, then two simulations can be performed for every share price path: one to the measurement date of the market condition, and the second to the end of the expected term. More frequent simulations may be required when early exercise parameters are applied over an award's contractual life.

The results of a Monte Carlo simulation can be tested by assessing whether the average simulated future share price is broadly equal to the current share price 'increased' at the risk-free rate less the dividend yield over the expected term.

The formula in a Monte Carlo simulation for each simulated share price is as follows.

$$S_T = S_{t_0} e^{(rf - q - \sigma^2/2)\Delta t + \sigma\sqrt{\Delta t}z}$$

In this formula:

- $rf$  is the risk-free rate (continuously compounded);
- $q$  is the dividend yield (continuously compounded);
- $\sigma$  is volatility;
- $t$  is the start of the time period;
- $\Delta t$  is the length of the time period over which the share price is simulated, expressed in years; and
- $z$  is a random number.

It can be seen from the above that the formula contains two elements: (1) the share's drift, based on the risk-free rate less the dividend yield, which is the same in all simulations; and (2) a variable element based on the application of a random number to the share's volatility that changes in each simulation as a new random number is generated.

### Comparing option valuation models

Normally, the BSM model is applicable only for European-style options and the lattice model can be applied to both European and American options. Although the Monte Carlo is normally used to value European options, it can be modified to estimate the value of American options. However, the use of an expected term assumption, under which an option is assumed to be exercised at the end of the expected term, which is shorter than the contractual life, essentially converts an American or Bermudian option into a European option from a financial modelling perspective because early exercise is reflected in the input assumption into the option pricing model rather than in the model itself.

A comparison of different option valuation models is set out below.

Characteristics	Black-Scholes-Merton	Lattice	Monte Carlo
<b>Incorporation of early exercise</b>	Indirectly, through use of an expected term input rather than a contractual term input	Early exercise can be incorporated directly based on assumptions such as post-vesting termination, the price of the underlying shares (or expected term could be used)	
<b>Ability to incorporate market conditions</b>	Cannot incorporate valuation effect of market conditions	Can incorporate valuation effect of market conditions if market conditions are measured on the exercise date	Can incorporate valuation of more complex market conditions
<b>Ability to model complex pay-offs</b>	Can only value plain vanilla awards	More complex pay-offs such as capped awards can be valued	
<b>Calculation speed</b>	Results available relatively instantaneously (once assumptions agreed)		May be computationally intensive and time consuming
<b>Third party assistance</b>	Model readily available (companies may require assistance with assumptions)	Third party assistance generally required (for both model and assumptions)	

### Complex capital structures

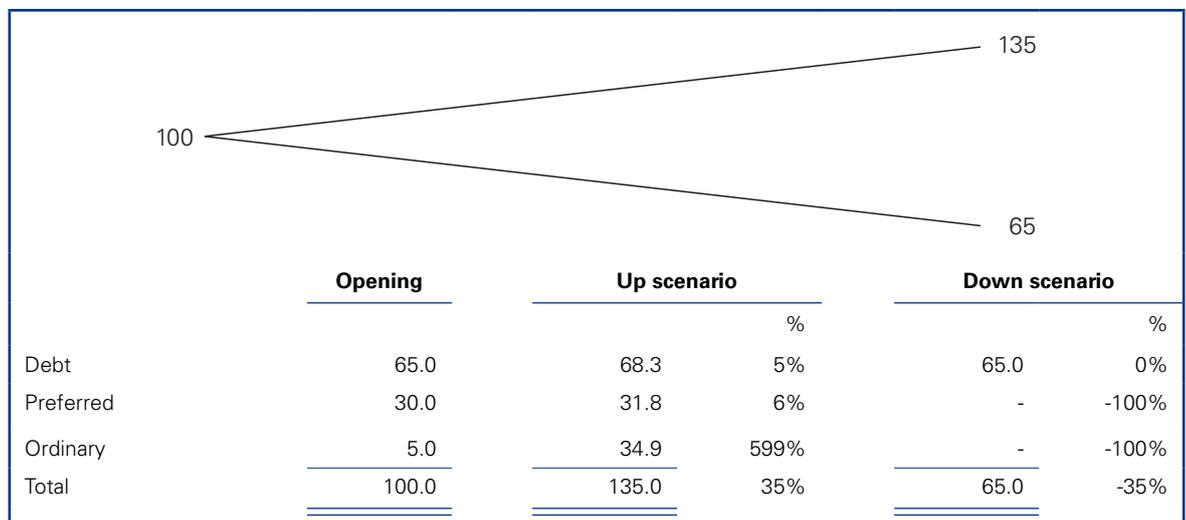
Complexity arises in valuing shares or share options when the entity has a complex capital structure – i.e. when the entity that grants shares or share options in a share-based payment award has different forms of capital (e.g. ordinary and preferred shares, and/or convertible instruments). In these circumstances, the valuation of individual elements of the capital structure in order to value shares or share options granted is difficult because of the interacting rights of different securities. Any valuation of individual elements of the capital structure should consider their specific contractual terms.

The issues that arise in these circumstances can be illustrated using a simplified example. Company P is acquired by a private equity fund for 100. The transaction is funded using 65 of third party debt at 5 percent and 35 from the private equity fund. Thirty of the 35 is attributed, without doing a formal valuation, to preferred shares with a coupon of 6 percent, recognised at par. The residual amount of 5 is attributed to ordinary equity. P then issues ordinary shares or options on ordinary shares to management based on the residual amount attributed to the ordinary shares in the transaction.

Considered from a commercial perspective, the preferred shares have limited upside potential (6 percent per annum), whereas they carry significant downside risk because there is only a very limited

equity 'cushion' in the capital structure. In reality, the preferred coupon is probably below market rates for instruments with similar risk profiles and as such the value of the preferred shares is economically below their par value.

If, in the example above, the value of P increases by 35 percent at the end of one year, then the third party debt will have earned interest of 3.25, the preferred shares will have earned a coupon of 1.8 and the balance of the increase in value of 29.95 will have been to the benefit of the ordinary shareholders, a rate of return of almost 600 percent. However, if the value of the entity decreased by 35 percent at the end of one year, then the ordinary shareholders and the preferred shareholders will have been wiped out. In this example, although the ordinary shareholder bears significant risk, they are compensated for this risk through very large upside. The preferred shareholders also bear significant risk without the benefit of significant upside to compensate. This is illustrated below.



Although this example highlights that the preferred shares may not be worth their par value when they are issued, the private equity fund is likely to focus on the value of its aggregate position and may not differentiate between the value of its ordinary shareholding and its preferred shareholding in P. From this viewpoint, when the investment is made, undervaluation of the ordinary shares would compensate for the extent to which the preferred shares are overvalued.

Although the private equity fund in these circumstances focuses on its aggregate position and may be unconcerned about undervaluation of the ordinary shares, such undervaluation would lead to understatement of the value of the ordinary shares or options granted to management and the related share-based payment cost.

There are several techniques that may be used to value complex capital structures. One of the most comprehensive descriptions of possible approaches in this area is the practice aid produced by the American Institute of Certified Public Accountants, *Valuation Of Privately Held Company Equity Securities Issued As Compensation*, which, although it is not authoritative and not developed for application to IFRS 2, provides a useful discussion of methods that may be used to value share-based payments in these circumstances. In particular, it sets out approaches that can be followed to value complex capital structures, once the value of the aggregate entity has been estimated using standard valuation techniques such as market multiples or DCF. These enterprise value allocation techniques include the following.

- *The current value method:* This method assumes that the business is sold at the valuation date for the enterprise value, which is distributed among the elements of the capital structure, based on their contractual rights. The weakness of this method is that it ignores the potential upside inherent in the instruments. Therefore, the current value method would value the ordinary shares at 5 in the example above.

- *Probability-weighted expected return (PWER) approach:* The PWER approach looks at different scenarios under which the investment would be expected to be realised – e.g. IPO or trade sale. This approach estimates the probability of each such scenario and calculates the pay-off to different elements of the capital structure under each scenario. The present value of the probability-weighted pay-offs of each instrument under all scenarios represents the value of the elements of the capital structure. The difficulty in applying the PWER method is the estimation of the different possible outcomes and the probabilities associated with such outcomes. The PWER approach may be especially useful close to an expected exit event – e.g. during the preparation for an upcoming IPO.
- *The option pricing method:* This method uses option mathematics to value different elements of the capital structure. Under this approach, various levels of security holders in the entity are seen as holding a series of options.

Under the option pricing method, using the same example, the debt holders are seen as owning P but having written an option to the preferred shareholders to buy P for an exercise price equal to the third party debt including accumulated interest. The preferred shareholders' holding is seen as equal to the value of the option written by the debt holders (which has an exercise price equal to the debtor holders' claims on the business, both principal and interest) net of the option that the preferred shareholders have written to the ordinary shareholders (which has an exercise price equal to the par value of the preferred shares plus the preferred dividends plus the amount payable to the debt holders). In essence, P can be seen as a cascading chain in which it is owned in the first instance by the entity that has the most senior security – i.e. the debt holders – but in which the upside can be secured by those further down in security in the capital structure by paying off those elements of the capital structure higher up in security. The amount to be paid off is treated as the exercise price of the option. This can be illustrated using the BSM as follows.

Instrument	Option 1	Option 2	Option 3
Option value	\$100.00	\$35.00	\$17.24

	Debt	Preferred	Ordinary
<b>Exercise price</b>			
Opening par value	65.0	30.0	5.0
Interest rate/coupon	5%	6%	
Years	2.0	2.0	
Interest/accrued coupon	6.7	1.8	
Closing amount	71.7	31.8	
'Exercise price' in option	-	71.7	103.5

	Debt	Preferred	Ordinary	Total
<b>Assumptions</b>				
Volatility (years)	30%	30%	30%	
Total time (years)	2.0	2.0	2.0	
Dividend yield (annual)	0.0%	0.0%	0.0%	
Return (annual)	2.25%	2.25%	2.25%	
Exercise price	0.0	71.7	103.5	
Opening price	100.0	100.0	100.0	

<b>Value of option with above assumptions</b>	100.0	35.0	17.2	
<b>Valuation of elements of capital structure</b>				
Value of option held	100.0	35.0	17.2	
Written option	(35.0)	(17.2)		
Net value of instruments	<u>65.0</u>	<u>17.8</u>	<u>17.2</u>	
Par value of instrument	65.0	30.0	5.0	100.0
Fair value of instrument	<u>65.0</u>	<u>17.8</u>	<u>17.2</u>	<u>100.0</u>
<b>Over/(under) valuation</b>	<u>-</u>	<u>12.2</u>	<u>(12.2)</u>	<u>-</u>

This table can be interpreted as follows.

- The debt holders have the first claim on the value of P – i.e. they have the right to be repaid before other providers of capital. Once they have been repaid, any residual value is available to the other sources of finance. The first right to enterprise value can be modelled as a call option with an exercise price of zero. This option is referred to as Option 1 in the table and has a value of 100, equal to the entity's current enterprise value.
- Once they have been repaid, the debt holders do not have any further right to the remaining enterprise value of P. This can be shown to be equivalent to the debt holders writing (or giving) the next highest ranking source of capital, in this case the preferred shareholders, a call option on the enterprise value with an exercise price equal to the future amount due on the debt (71.7). Essentially, the preferred shareholders have a choice to repay the debt to secure the residual future enterprise value. If the amount due on the debt is greater than the enterprise value, then the option will not be 'exercised' and the debt holders secure all of the enterprise value at that point in time. However, if the enterprise value at that point in time is greater than the outstanding debt, then holders of the preferred securities will 'exercise the option' by paying off the debt and securing the remaining enterprise value. This is referred to as Option 2 in the table and has a value of 35.
- The preferred holders' claim on the business is also fixed. Therefore, if they are paid off in full, then any residual value is available to the ordinary shareholders. The ordinary shareholders have a residual claim on the business – i.e. they have the right to receive the upside on the business once the debt holders and preferred shareholders are paid off. This can be viewed as a call option written by the preferred shareholders giving the ordinary shareholders the right to acquire the enterprise value with an exercise price equal to the required pay-off to the debt and preferred shareholders. In certain scenarios, the enterprise value will be below the debt and preferred shareholders' claims and the ordinary shares would have no value. This is equivalent to an option being out-of-the-money. In other scenarios, the enterprise value may exceed the debt and preferred shareholders' claims and the ordinary shares would have value. This is equivalent to the option being in-the-money. This is shown as Option 3 in the table and has a value of 17.24.
- The value of each security is equal to the value of the implicit options that they hold, net of the implicit options that they have written. The table above shows that the values of debt, preferred and ordinary shares are 65, 17.8 and 17.2, respectively. The difference between the fair values identified above and the values attributed on a par value basis reflects the option characteristics of the securities. The par value of the securities was based on their rights assuming an immediate wind-up, which is equivalent to the current value method. This approach is equivalent to the intrinsic value of the securities. The option pricing method reflects both intrinsic and time value.

- The amount of the share-based payment is the difference between the value of the ordinary shares and the amount paid by management. For example, if the option pricing method was used to value ordinary shares granted to or acquired by management, with a price paid per share of 5, and the value per share under this approach is 17.2, then the price paid of 5 would result in a share-based payment of 12.2. This differs from the result under the current value method, under which the value of the shares and the amount paid are both 5, resulting in a share-based payment of zero.
- The valuation depends on similar assumptions to any option valuation, including time, volatility and the risk-free rate. The time assumption, in particular, is a matter of judgement because there may be no contractual restriction on the life of an individual security. Factors to be considered include the expected holding period of investors – e.g. private equity or venture capital investors may target an exit event in three to seven years – the ability of investors to delay a liquidity event if circumstances are unfavourable and the willingness of debt holders to continue to finance the entity, which is especially important when the approach is applied to heavily indebted entities.

The table uses the BSM model to value the embedded options. These could also be valued using a lattice model, which is useful particularly for securities with more complex rights.

# Appendix III

## Table of concordance between IFRS 2 and this handbook

Paragraph of IFRS 2	Handbook reference
<b>Objective</b>	
1	3.5.40
<b>Scope</b>	
2	3.1 3.3.20 10.1.10 10.1.40
3A	3.1 3.4.50 10.1.10 10.1.20 10.1.40
4	3.3.20 3.4.10 3.4.20 3.5.10
5	3.3.20 3.4.10 3.4.20 3.4.30 Example 3.4.4 12.2
6	3.4.10 3.4.20 3.4.40
6A	A2.10
<b>Recognition</b>	
7	6.2.10 11.2.20 11.2.30 11.3.10

Paragraph of IFRS 2	Handbook reference
8	6.2.10 7.2.10 11.2.20 11.2.40 11.3.10
9	6.2.10 7.2.20
<b>Equity-settled share-based payment transactions</b>	
10	6.2.10 11.2.20
11	6.1 6.2.10 6.3.10 6.6.10
12	6.2.10
13	11.2.30
13A	3.3.20 10.1.40 10.3.10 11.2.30 11.2.40
14	3.3.20 6.2.10 11.2.20 11.2.40

Paragraph of IFRS 2	Handbook reference
15	3.3.20 6.2.10 6.4.30 6.4.40 6.4.50 6.8.30 6.9.20 11.2.20
16	6.6.10
17	6.6.10
18	6.6.10
19	6.2.10 6.6.10 6.9.10 11.2.30 12.4.30
20	6.2.10 6.4.50 6.6.10 11.2.30 12.4.30
21	6.2.10 6.6.10 6.8.30 6.9.20 11.2.30 12.4.30
21A	6.2.10 6.6.10 11.2.30
22	6.2.10
23	6.2.10
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# About this publication

## Content

Our IFRS handbooks are prepared to address practical application issues that an entity may encounter when applying a specific accounting standard or interpretation. They include discussion of the key requirements, guidance and examples to elaborate or clarify the practical application of the requirements. This edition provides an analysis of IFRS 2 *Share-based Payment* and addresses practical application issues that KPMG member firms have encountered.

This fourth edition of the handbook reflects IFRS Accounting Standards in issue at 30 October 2023, which are effective for annual periods beginning on or after 1 January 2024 unless noted otherwise.

This handbook focuses on the requirements of IFRS 2 as well as the interaction with other IFRS Accounting Standards, though it does not provide a comprehensive analysis of the requirements of these other accounting standards and interpretations to which it refers. Further discussion and analysis of these accounting standards and interpretations is included in the 20<sup>th</sup> Edition 2023/24 of our publication [Insights into IFRS](#). However, IFRS Accounting Standards and their interpretation change over time. Accordingly, neither this handbook nor any of our other publications should be used as a substitute for referring to the accounting standards and interpretations themselves.

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