



IFRS[®]
Accounting

Educational Module 26
Share-based Payment

IFRS for SMEs[®]

Accounting Standard
Third Edition



International Accounting Standards Board

IFRS[®] Foundation
Supporting Material for the
IFRS for SMEs[®] Accounting Standard

including the full text of
Section 26 *Share-based Payment* of the
IFRS for SMEs Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 26 *Share-based Payment* of the *IFRS for SMEs Accounting Standard* are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs Accounting Standard* contains the glossary (Glossary) and is part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 26.

This module has been prepared by International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs Accounting Standard* and have not been approved by the IASB.

INTRODUCTION

***IFRS for SMEs*[®] Accounting Standard**

The *IFRS for SMEs Accounting Standard* (Standard) is intended for use by entities that publish general purpose financial statements and that do not have public accountability (referred to as small and medium-sized entities—see Section 1 *Small and Medium-sized Entities*).

The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

This module

This educational module supports the requirements for the accounting for and the reporting of share-based payment transactions applying Section 26 *Share-based Payment* of the Standard.

The module:

- provides explanations and examples to improve understanding of the requirements in Section 26;
- identifies the significant judgements required to account for and report share-based payment transactions;
- includes questions to test your understanding of the requirements in Section 26; and
- includes case studies that provide a practical opportunity to apply the Section 26 requirements.

After completing the module, you should be able:

- to identify share-based payment transactions;
- to apply the recognition requirements for share-based payment transactions, including the requirements for vesting conditions;
- to account for equity-settled share-based payment transactions, including shares and share options;

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- to account for modifications, cancellations and settlements of equity-settled share-based payment transactions;
 - to account for cash-settled share-based payment transactions, including share-based payment transactions with cash alternatives;
 - to determine what information should be disclosed about share-based payment arrangements in financial statements; and
 - to demonstrate an understanding of the significant judgements required in accounting for share-based payment transactions.

Which version of the Standard does the module refer to?

Any reference in this module to ‘the *IFRS for SMEs Accounting Standard*’ is to the third edition of the Standard, issued February 2025.

Introduction to the requirements

Section 26 sets out the financial reporting requirements for share-based payment transactions.

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

In summary, Section 26 requires an entity:

- to recognise the goods or services received in an equity-settled share-based payment transaction in the entity’s financial statements either as assets or, if the goods or services do not qualify for recognition as assets, as expenses. The entity also recognises a corresponding increase in equity.¹
- to measure the goods or services received in an equity-settled share-based payment transaction by reference to the fair value of the equity instruments granted if the fair value of those goods or services cannot be estimated reliably, as for employee services. Section 26 provides specific guidance on how to account for vesting conditions, modifications, cancellations and settlements.
- to measure the goods or services received in a cash-settled share-based payment transaction at the fair value of the liability incurred. At each reporting date, the entity remeasures the fair value of the liability through profit or loss until it is settled.
- to account for share-based payment transactions that provide a choice of settlement in cash or equity as cash-settled share-based payment transactions unless specified conditions are met.

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

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

What has changed in the third edition of the Standard?

The IASB amended Section 26 in the third edition of the Standard by:

- aligning the scope of Section 26 with the scope of IFRS 2 *Share-based Payment* by excluding share-based payment transactions that occur in a business combination, in a combination of entities or businesses under common control, or on formation of a jointly controlled entity from the scope of Section 26 (see paragraph 26.1C);
- adding a definition of ‘fair value’ for the purpose of applying Section 26 (see paragraphs 26.1D–26.1E);
- clarifying that the requirements apply to share-based payment transactions with other parties, not only to employees and those providing similar services (see paragraphs 26.5–26.6, 26.9 and 26.16);
- clarifying the definitions of ‘vesting condition’ and ‘market vesting condition’, and adding definitions of ‘service condition’ and ‘performance condition’ (see the Glossary);
- adding requirements on the accounting treatment of vesting and non-vesting conditions in cash-settled share-based payment transactions (see paragraphs 26.14A–26.14B); and
- adding requirements on the classification of share-based payment transactions with a net settlement feature for withholding tax obligations (see paragraphs 26.15–26.15D).

Transition requirements are explained on pages 62–63 of this module.

REQUIREMENTS AND EXAMPLES

Scope of this section

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

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

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

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

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

26.1C This section does not apply to share-based payment transactions in which an entity acquires goods as part of the net assets acquired in:

- (a) a **business combination** as defined in Section 19 *Business Combinations and Goodwill*;
- (b) a combination of entities or **businesses** under common **control** as described in paragraph 19.2; or
- (c) the contribution of a business on the formation of a **jointly controlled entity** as defined in Section 15 *Joint Arrangements*.

Therefore, equity instruments issued in a business combination in exchange for control of the **acquiree** are not within the scope of this section. However, equity instruments granted to employees of the acquiree in their capacity as employees (for example, in return for continued service) are within the scope of this section. Similarly, the cancellation, replacement or other modification of **share-based payment arrangements** because of a business combination or other equity restructuring shall be accounted for in accordance with this section.

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- 26.1D This section uses the term ‘fair value’ in a way that differs in some respects from the definition in the Glossary and in other sections of this Standard. When applying this section, an entity shall apply the definition of fair value in paragraph 26.1E and measure fair value in accordance with this section, not Section 12 *Fair Value Measurement*.
- 26.1E For the purpose of this section, fair value is the amount for which an asset could be exchanged, a **liability** settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm’s length transaction.
- 26.2 **Cash-settled share-based payment transactions** include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (instead of an equity instrument), based on the increase in the entity’s share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (for example, upon cessation of employment) or at the employee’s option.

Educational notes

The Glossary defines a share-based payment transaction as a transaction in which the entity:

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

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

There might be circumstances in which judgement is required because goods and services are received but cannot be specifically identified. An apparent discount might indicate that other consideration (such as employee services) has been or will be received (see paragraph 26.17).

An issue of shares for cash or other financial assets is not a share-based payment transaction if it does not involve the delivery of goods or services. Such transactions are covered by other sections of the Standard, for example, Section 22 *Liabilities and Equity*.

Some transactions meet the definition of a share-based payment transaction but are not in the scope of Section 26 (see paragraph 26.1C).

The definition of a share-based payment transaction refers to a share-based payment arrangement. The Glossary defines a share-based payment arrangement as 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:

- 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
- equity instruments (including shares or share options) of the entity or another group entity provided the specified vesting conditions, if any, are met.

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

Another common scenario is the use of share-based compensation to remunerate employees. Share-based compensation plans can motivate employees to higher levels of performance and build a sense of shared ownership in the entity. Such plans might help entities retain staff. These plans provide employees with the right to receive equity in the entity or a cash payment based on the entity's share price if the performance of the entity exceeds predetermined levels. Typical performance measures include increases in earnings per share, revenue targets and increases in market share.

Because the equity instruments of SMEs are not traded in a public market, employees of SMEs do not have a public market in which to sell their shares. An SME that is part of a group might grant its employees shares or share options in a listed company in the group. Alternatively, an SME might issue share appreciation rights that give employees the right to receive compensation linked to the share price's appreciation. An SME might pay the share appreciation in cash, in shares, or in a combination of both.

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

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

The Glossary defines an equity-settled share-based payment transaction as a share-based payment transaction in which the entity:

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

The Glossary defines a cash-settled share-based payment transaction as 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.

Section 26 includes a definition of 'fair value' for the purpose of measuring share-based payment transactions within the scope of Section 26, together with guidance on measuring fair value (see pages 33–38). Therefore, the definition of 'fair value' in the Glossary does not apply to Section 26.

Examples—Transactions within the scope of Section 26

Ex 1 As part of its ordinary activities, SME A contracts a consultant to advise on business development and strategy. The consultant agrees to accept ordinary shares of SME A as payment for the advisory services.

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

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

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

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

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

Ex 4 The management of SME B, similar to SME A in Example 3 above, has been concerned about the loss of experienced staff to a competitor and the cost of training new staff. On 1 May 20X0, it introduces a new bonus scheme. On 30 April 20X3, SME B will give, to each employee, shares in SME B with a total fair value on 1 May 20X0 equal to 5% of the employee's annual salary on 1 May 20X0, provided the employee is still employed by SME B on 30 April 20X3.

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

Ex 5 SME A is the parent of a group of companies that includes SME B. On 1 July 20X0, SME A establishes a group employee share plan. Under the terms of the plan, on 30 June 20X3 SME A will issue 10 ordinary shares in SME A to each employee of a subsidiary within the group (including employees of SME B) provided the employee is still employed by the subsidiary on 30 June 20X3.

SME A, SME B's parent, has granted ordinary shares in SME A to employees of SME B. SME A accounts for this transaction as an equity-settled share-based payment transaction in accordance with Section 26. In SME A's separate financial statements, it might recognise the debit as an increase to its investment in SME B. This increase in the investment acknowledges that the share-based payment increases the value of the parent's investment in the subsidiary. SME B, as the recipient of employee services in a share-based payment arrangement, also accounts for the grant of shares to its employees as an equity-settled share-based payment transaction within the scope of Section 26. (See pages 53–55 for further discussion of group share-based payment plans.)

Examples—Transactions outside the scope of Section 26

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

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

Therefore, the bonus payment is not a share-based payment and is outside the scope of Section 26.

Ex 7 SME A issues 10,000 new shares in exchange for receiving 80% of the ordinary shares of SME B, a clothing manufacturer, resulting in SME A obtaining control of SME B. Also, to avoid a loss of experienced staff after the change in ownership, SME A grants to each of SME B's employees an option to acquire shares in SME A, provided the employee remains employed by SME B for the next three years.

SME A's acquisition of SME B is a business combination that is effected by the transfer of SME A's equity instruments to the previous owners of the shares in SME B.

Equity instruments issued by an acquirer (SME A) in a business combination in exchange for control of the acquiree (SME B) are specifically addressed in Section 19 *Business Combinations and Goodwill*. Therefore, this issue of shares is outside the scope of Section 26.

However, the grant of share options to employees of SME B is a transaction within the scope of Section 26 because the transaction involves the grant of equity instruments (share options) that were granted to the individuals in their capacity as employees. Accordingly, SME A accounts for the grant of share options to SME B's employees as an equity-settled share-based payment transaction in accordance with Section 26. In SME A's separate financial statements, it might recognise the debit as an increase to its investment in SME B.

SME B, as the recipient of employee services in a share-based payment arrangement, also accounts for the grant of share options as an equity-settled transaction in accordance with Section 26.

Recognition

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

Example—Recognition of goods received in exchange for equity

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

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

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

Educational notes

Typically, an expense arises from the consumption of goods or services. Services are typically consumed immediately, in which case the entity recognises an expense as the counterparty renders the services. Goods might be consumed over a period of time (for example, an item of equipment used over its useful life) or sold at a later date (for example, inventories). The entity recognises an expense when the goods are consumed or sold (for example, depreciation of equipment or the cost of goods sold for inventory).

However, sometimes it is necessary for the entity to recognise an expense before the goods or services are consumed or sold, because those goods or services do not qualify for recognition as assets.

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

Ex 9 SME A contracted a consultant to advise on a new marketing campaign. The consultant agreed to accept ordinary shares of SME A as payment for services.

Paragraphs 18.14 and 18.15 of Section 18 *Intangible Assets other than Goodwill* require an entity to recognise expenditure on advertising and promotional activities as an expense. Therefore, SME A recognises a marketing expense, in the same way as it would have done had it paid in cash. SME A also recognises a corresponding increase in equity.

Recognition when there are vesting conditions

- 26.5 If the share-based payments granted to an employee or another party (the counterparty) **vest** immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those share-based payments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the share-based payments have been received. In this case, on the **grant date** the entity shall recognise the services received in full, with a corresponding increase in equity or liabilities.
- 26.6 If the share-based payments do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those share-based payments will be received in the future, during the **vesting period**. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity or liabilities.

Educational notes

The Glossary definition of vest is:

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

Vesting conditions are conditions that need to be met for the employee or supplier to become entitled to the share-based payment. For example, employees might be awarded shares in an entity, but subject to the condition that the employees will be entitled to those shares only if the entity's profit before tax in a specified period exceeds a specified amount and the employees remain employed with the entity throughout that period. (See pages 20–24 for a fuller discussion about vesting conditions.)

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

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

Examples—Recognition when there are no vesting conditions

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

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

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

At 31 December 20X1, there are no further conditions to be met for employees to be entitled to the share options. The share options can be exercised after 31 December 20X2. If an employee were to leave SME A's employment before 31 December 20X2, the employee would still keep their share options and be entitled to exercise those options at any time during the three-year period after 31 December 20X2.

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

Example—Recognition when there are vesting conditions

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

This vesting condition is a service condition (see page 21 for the definition of a service condition). The services to be rendered by the employees as consideration for the share options will be received in 20X2 (the vesting period).

In the fact pattern, the share options are forfeited only if an employee leaves before 31 December 20X2. Therefore, even if the share options are exercised after 31 December 20X2, the vesting period does not extend to the exercise date, because the specified vesting condition is met on 31 December 20X2.

Consequently, SME A recognises the staff cost for the services received and a corresponding increase in equity in 20X2.

Measurement of equity-settled share-based payment transactions

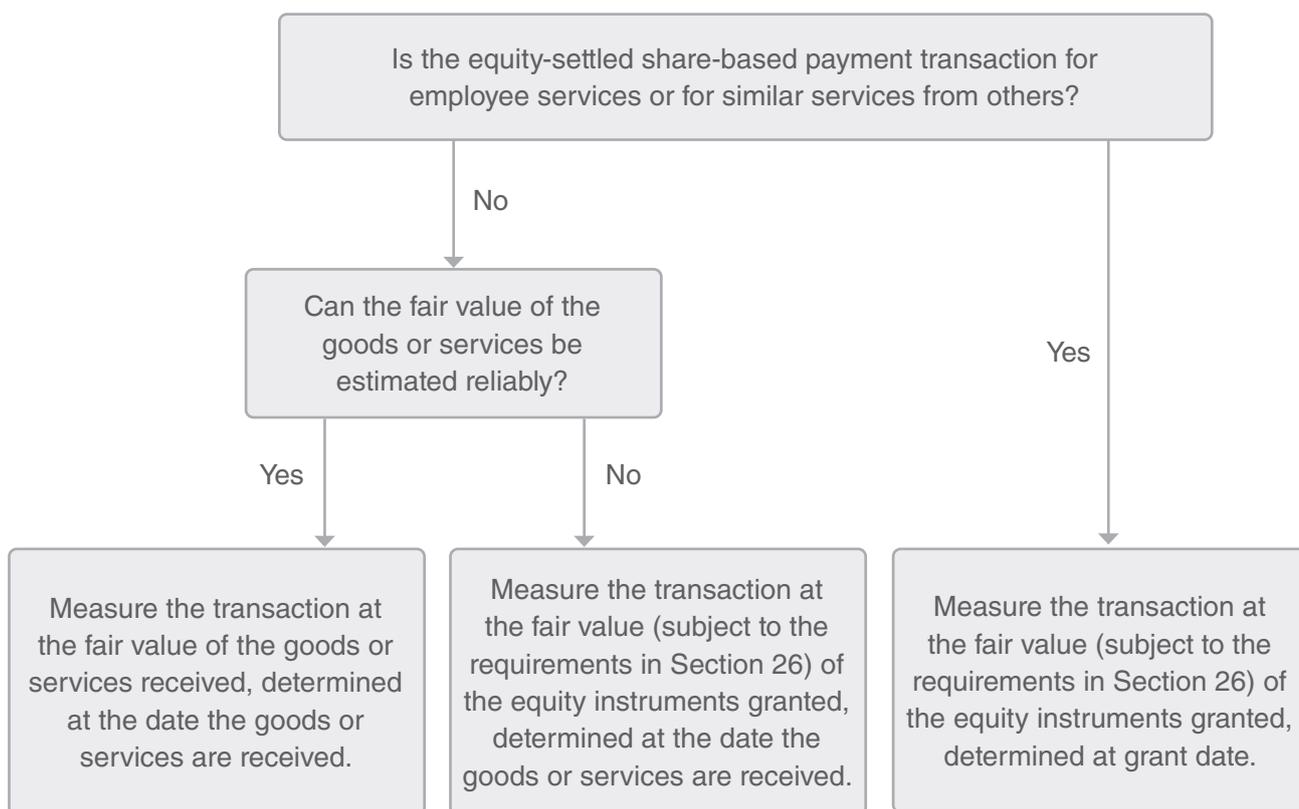
Measurement principle

- 26.7 For equity-settled share-based payment transactions, an entity shall measure the goods or services received, and the corresponding increase in equity, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received.
- 26.8 For transactions with employees and others providing similar services,⁶ the fair value of the equity instruments shall be measured at the grant date. For transactions with parties other than employees, the measurement date is the date when the entity obtains the goods or the counterparty renders service.

⁶ In the remainder of this section, all references to employees also include others providing similar services.

Educational notes

The requirements in paragraphs 26.7–26.8 are summarised in the following decision tree.



Fair value measurement of equity-settled share-based payment transactions under Section 26

For the purpose of applying Section 26, fair value is defined as the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction (see paragraph 26.1E). The definition of fair value in Section 26 differs in some respects from the definition of fair value in the Glossary. Therefore, the requirements of Section 12 *Fair Value Measurement* do not apply to transactions within the scope of Section 26 (see paragraph 26.1D).

Section 26 also contains requirements on measuring the fair value of equity instruments granted in a share-based payment transaction (see paragraphs 26.9–26.11). As a result of these requirements, the measurement of the fair value of equity instruments granted in a share-based payment transaction might differ from fair value measurements made applying the requirements in Section 12.

An equity-settled share-based payment transaction with employees, or others providing similar services, is measured by reference to the fair value of the equity instruments granted. That fair value is measured at the date the equity instruments were granted. In a transaction with other parties, fair value is measured at the date on which the goods or services were received, including transactions in which the fair value of the goods or services received is measured by reference to the fair value of the equity instruments granted.

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

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

For the purposes of illustrating the requirements in Section 26, Examples 13–16 recognise the credit to equity as ordinary share capital (for the par value of the shares) and in a share premium account (for the fair value in excess of the par value of the share). The examples therefore reflect legal requirements in jurisdictions in which shares are required to have a par value (that is, a face value).

Examples—Measurement of transactions for goods or non-employee services with no vesting conditions

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

SME A determines that the selling price from an independent vendor in an arm's length transaction is the best measure of the fair value of the computers.

Consequently, SME A accounts for the transaction as follows:

Dr	Asset: Property, plant and equipment—Computers	CU50,000	
	Cr	Equity—Ordinary share capital	CU20,000
	Cr	Equity—Share premium account	CU30,000

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

Note: In accordance with Section 17, SME A will depreciate the computers over their estimated useful lives to their residual values, using a depreciation method that reflects the consumption of the future economic benefits of the computers.

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

Ex 14 SME A contracts a consultant to advise on a new marketing campaign. The consultant issues an invoice for CU3,000 for the advice. The consultant agrees to accept ordinary shares of SME A as payment for the advice. SME A issues 100 ordinary shares with a par value of CU10 each.

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

Dr	Profit or loss—Marketing expense	CU3,000	
	Cr	Equity—Ordinary share capital	CU1,000
	Cr	Equity—Share premium account	CU2,000

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

Ex 15 SME A contracts an IT consultancy company to set up and install its IT systems. The company provides 20 hours of consultancy services to SME A. The usual hourly billing rate of the consultant providing the services is CU10 at the start of the contract and increases to CU12 on the consultant’s promotion part way through the contract. Fifteen hours of the consultant’s work for SME A takes place before the promotion, and five hours after. The IT company agrees to accept 30 ordinary shares, with a par value of CU1 each, in SME A as compensation for its services. SME A issues new shares to the IT consultancy company.

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

Assuming that the IT services are eligible for recognition as part of the cost of SME A’s IT equipment, SME A accounts for the transaction as follows:

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

To recognise, as part of the cost of IT equipment, the IT consultancy services received in exchange for the issue of 30 SME A ordinary shares

Example—Measurement of a transaction with employees with no vesting conditions

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

The fair value of the employees' services must be measured by reference to the fair value of the shares awarded, rather than the fair value of the employee services. The fair value of the shares is measured at grant date. Because there are no vesting conditions, the services in exchange for the shares have already been provided by employees.

At grant date, SME A will account for the transaction as follows:³

Dr	Profit or loss—Staff expense	CU5,000	
	Cr	Equity—Ordinary share capital	CU1,000
	Cr	Equity—Share premium account	CU4,000

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

26.9 A grant of equity instruments might be conditional upon satisfying specified **vesting conditions** related to service or performance. An example of a **service condition** is when a grant of shares or share options to an employee is conditional on the employee remaining in the entity's employ for a specified period of time. Examples of **performance conditions** are when a grant of shares or share options is conditional on a specified period of service and on the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a **market vesting condition**). Vesting conditions and conditions that are not vesting conditions (non-vesting conditions) are accounted for as follows:

- (a) service conditions and non-market vesting conditions shall be taken into account when estimating the number of equity instruments expected to vest and subsequently adjusting the number of equity instruments included in the measurement of the transaction amount. The entity shall initially recognise an amount for the goods or services received during the vesting period based on the number of equity instruments expected to vest. The entity shall revise that estimate if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested. Service conditions and non-market vesting conditions shall not be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date.
- (b) market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date, with no subsequent adjustment to the estimated fair value, irrespective of the outcome of the market vesting conditions and non-vesting conditions, provided that all other vesting conditions are satisfied.

³ In all examples throughout this module, unless stated otherwise, the expense reflects an assumption that the employee compensation does not qualify for capitalisation (meaning that it does not qualify for recognition as an asset, for example, as part of the cost of inventory).

Educational notes

The Glossary defines a vesting condition as a condition that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. A vesting condition is either a service condition or a performance condition.

In other words, vesting conditions are the conditions that the counterparty (the employee or other service provider) needs to meet to become entitled to the share-based payment. Vesting conditions are often specified in share-based payments with employees. These conditions are intended to incentivise an employee or supplier to act in a way that provides a benefit to the entity. For example, a vesting condition might incentivise an employee to stay in service for three years and also possibly meet specified performance targets during that period.

The Glossary defines a service condition, a performance condition and a market vesting condition as follows:

Service condition

A vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the vesting period, it has failed to satisfy the condition. A service condition does not require a performance target to be met.

Performance condition

A vesting condition that requires:

- (a) the counterparty to complete a specified period of service (that is, a service condition); the service requirement can be explicit or implicit; and
- (b) specified performance target(s) to be met while the counterparty is rendering the service required in (a).

The period of achieving the performance target(s):

- (a) shall not extend beyond the end of the service period; and
- (b) 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.

A performance target is defined by reference to:

- (a) the entity's own operations (or activities) or the operations or activities of another entity in the same group (that is, a non-market vesting condition); or
- (b) the price (or value) of the entity's equity instruments or the equity instruments of another entity in the same group (including shares and share options) (that is, a market vesting condition).

A performance target might relate either to the performance of the entity as a whole or to some part of the entity (or part of the group), such as a division or an individual employee.

Market vesting condition

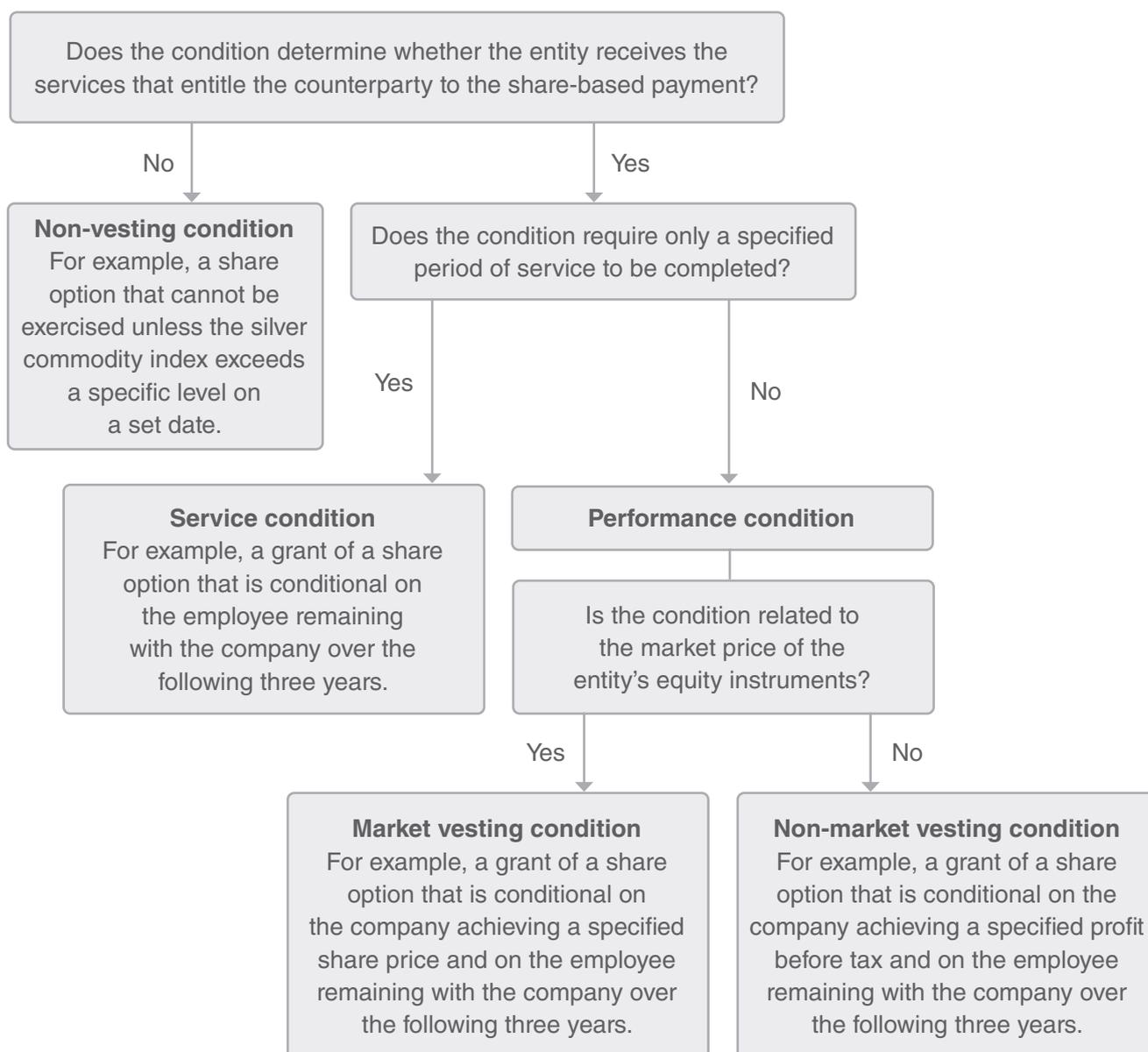
A performance condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group), such as:

- (a) attaining a specified share price or a specified amount of intrinsic value of a share option; or
- (b) achieving a specified target that is based on the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group) relative to an index of market prices of equity instruments of other entities.

A market vesting condition requires the counterparty to complete a specified period of service (that is, a service condition); the service requirement can be explicit or implicit.

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

The following decision tree illustrates how an entity evaluates whether a condition is a service condition, a performance condition—which could be either a market vesting condition or a non-market vesting condition—or a non-vesting condition, and gives an example of each of the conditions as they might apply to a share option.



Employee share-based payment transactions generally have vesting conditions. Guidance on how to reflect these conditions in the measurement of the fair value of the equity instruments is set out in paragraph 26.9. The following notes explain the differing approaches to valuing an equity instrument at the grant date and subsequently measuring the transaction, depending on the type of condition.

Service conditions and non-market vesting conditions

Service conditions and non-market vesting conditions are not taken into account in determining the grant date fair value of the equity instruments granted, so the fair value is measured as though these conditions did not exist.

Instead, these conditions are accounted for by estimating how they will affect the number of equity instruments expected to vest. The estimate of the number of equity instruments expected to vest because of these conditions is revised throughout the vesting period, as more information becomes available.

Revisions to the estimate are reflected prospectively and previous estimates are not restated, in accordance with paragraph 10.16 of Section 10 *Accounting Policies, Estimates and Errors*. Applying this approach, only the number of equity instruments satisfying these vesting conditions is ultimately recognised in the financial statements. The final charge is the grant date fair value (which was calculated by excluding these conditions) multiplied by the actual number of equity instruments that vest as a result of these conditions. If none of the equity instruments vest as a result of these conditions, the cumulative amount recognised over the vesting period would be zero. In this situation, any amounts previously recognised during the vesting period would be reversed (see Example 19).

Market vesting conditions

Market vesting conditions are taken into account in determining the grant date fair value of the equity instruments granted. Having taken into account the possibility that the condition might not be satisfied in measuring the grant date fair value of the equity instruments, no subsequent adjustment is made to the measurement of the transaction amount, including the number of equity instruments included in the calculation, regardless of the outcome of the market condition. Thus, even if no equity instruments ultimately vest because of this condition not being satisfied, a charge will still be recognised in the financial statements. That charge will be equal to the grant date fair value (which was calculated by reflecting this condition) multiplied by the number of equity instruments granted and adjusted only for the number of instruments not vesting because of service conditions and any non-market vesting conditions not being satisfied.

Non-vesting conditions

Non-vesting conditions are taken into account in determining the grant date fair value of the equity instruments granted. Accordingly, no adjustment is made to the number of equity instruments included in the calculation of the transaction amount, regardless of the outcome of the condition. In other words, the treatment is identical to that of market vesting conditions.

Other points

As explained above, the effect of service conditions and non-market vesting conditions are not included in the valuation of the equity instruments at the grant date. Market vesting conditions (and non-vesting conditions) are included in the grant date valuation of the equity instruments.

Therefore, when applying the requirements in paragraphs 26.10–26.11 on measuring the fair value of shares, share options and equity-settled share appreciation rights (see pages 33–37), an entity also applies paragraph 26.9 to determine which vesting conditions to include in that fair value measurement.

Examples—Comparing the accounting treatment for different types of vesting and non-vesting conditions

Ex 17 SME A runs a copper-mining business. On 1 June 20X0, SME A provisionally awarded its sales staff a total of 1,000 SME A shares receivable on 31 May 20X3 if the copper commodity index on 31 May 20X3 is 8,000 or above, regardless of whether the sales staff remain employed on 31 May 20X3. SME A has a year end of 31 May.

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

SME A estimates that on 1 June 20X0 the fair value of its shares is CU10 each, excluding the effect of the condition attached to the share award.

The condition related to the copper commodity index set by SME A is a non-vesting condition because it does not require the employees to complete any service or performance conditions for the award to vest.

Accordingly, SME A reflects this condition in measuring the fair value of the share award. This condition is the only condition attached to the share award; the employees will receive the shares on 31 May 20X3 if the condition is met, regardless of whether they are still employed by SME A on 31 May 20X3. SME A estimates that a third party in an arm's length transaction would pay only CU7 to purchase the share awards, so the effect of the condition is to reduce the value of the shares by CU3 each at 1 June 20X0.

The amount that SME A recognises with respect to the equity-settled share-based payment transaction is CU7,000. SME A recognises this amount regardless of the copper commodity index on 31 May 20X3 and therefore regardless of whether the employees receive the shares. Because there is no vesting period, SME A recognises this amount in full on 1 June 20X0.

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

Ex 18 The facts are the same as in Example 17. However, instead of a condition that the copper commodity index on 31 May 20X3 is 8,000 or above, the sales staff must remain in SME A's employment until 31 May 20X3, meaning that remaining in employment is the only condition attached to the share award.

SME A prepares annual financial statements for the year ended 31 May.

On 1 June 20X0, SME A estimates that 800 shares will vest. On 31 May 20X1, at the end of the first year, it revises its estimate to 780. The estimate is further revised to 750 on 31 May 20X2.

On 31 May 20X3, 750 shares vest, based on the number of employees still employed on that date.

The requirement to remain in employment is a service condition, so SME A does not reflect the service condition in measuring the fair value of the share awards. The grant date fair value of each share is CU10.

SME A recognises the grant date fair value amount as an expense over the three-year service period based on the number of shares expected to vest. The estimate is revised each year until the final year (the year ended 31 May 20X3), when the total expense is adjusted to reflect the outcome of the service condition. Consequently, for each period, SME A estimates how many eligible employees are expected to be employed on 31 May 20X3.

SME A's journal entries would be:

Year 1 (Year ended 31 May 20X1)

Dr	Profit or loss—Staff costs	CU2,600	
	Cr	Equity	CU2,600

To recognise the receipt of employee services in exchange for shares

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

Year 2 (Year ended 31 May 20X2)

Dr	Profit or loss—Staff costs	CU2,400	
	Cr	Equity	CU2,400

To recognise the receipt of employee services in exchange for shares

((750 shares expected to vest × CU10 grant date fair value of each share × $\frac{2}{3}$ of vesting period elapsed) – CU2,600 recognised in Year 1 = CU2,400 recognised in Year 2.)

Year 3 (Year ended 31 May 20X3)

Dr	Profit or loss—Staff costs	CU2,500	
	Cr	Equity	CU2,500

To recognise the receipt of employee services in exchange for shares

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

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

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

The condition for the employees to remain in employment is a service condition, and the condition for the company to achieve a specified profit before tax is a non-market vesting condition. Consequently, SME A does not reflect either of these conditions in measuring the grant date fair value of the award. Accordingly, the total expense recognised in SME A's financial statements over the three years is CU10 multiplied by the number of shares that vested on 31 May 20X3.

Like Example 18, the expense recognised in the years ended 31 May 20X1 and 31 May 20X2 is based on SME A's estimate of how many shares are expected to vest on 31 May 20X3. However, in this example, the estimates are based on SME A's expectations of both how many employees will leave before 31 May 20X3 and whether profit before tax will increase by an average of 5% per year over the three-year period ended 31 May 20X3. The estimate is revised each year until the final year (year ended 31 May 20X3), when the total expense is adjusted to reflect the outcome of the vesting conditions.

If the profit before tax target is not met, meaning that no shares vested, the aggregate expense over the three years in SME A's financial statements would be zero. However, if the profit before tax target was initially expected to be met, there might be a charge in the first year or first two years, which would then be reversed in subsequent years.

If the profit before tax target is met but, because some employees had left during the three years, only 750 shares vested, the expense would be CU7,500 (CU10 × 750) in total over the three years.

Ex 20 The facts are the same as in Example 17. However, instead of a condition that the copper commodity index on 31 May 20X3 is 8,000 or above, two conditions must be met:

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

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

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

The amount that SME A would recognise with respect to the equity-settled share-based payment transaction would be CU7.50 multiplied by the number of shares it expects to vest, based on the number expected to be employed by SME A on 31 May 20X3.

Even if the target share price is not met, SME A will recognise an expense for the share awards based solely on how many shares would have vested considering only the service condition. For example, if 750 shares would have vested had the share price target been met, SME A would recognise CU5,625 ($CU7.50 \times 750$) in total for the share award scheme over the three-year period, regardless of whether any shares actually did vest.

As explained in Examples 18 and 19, the amount would initially be calculated by estimating the number of employees expected to remain employed by the entity and then revising that estimate each year. In the final year, the amount would be adjusted to reflect the actual number of employees employed on 31 May 20X3.

Examples—Measurement when there are service vesting conditions

Ex 21 On 1 July 20X0, SME A grants 100 share options to each of its 500 employees. Each grant is conditional on the employee working for SME A over the next three years ending on 30 June 20X3 (that is, the vesting condition is a service condition of three years). SME A estimates that, on the date of grant, the fair value of each share option is CU15, which is measured as if there is no service condition. SME A estimates that 20% of employees will leave during the three-year period and therefore forfeit their rights to the share options. SME A's year end is 30 June.

If everything turns out exactly as expected, SME A makes the following entries in the years during the vesting period, for services received as consideration for the share options:

Year 1 (Year ended 30 June 20X1)

Dr	Profit or loss—Staff costs	CU200,000	
	Cr	Equity	CU200,000

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

(50,000 options granted \times 80% = 40,000 options expected to vest. 40,000 \times CU15 grant date fair value of each option \times $\frac{1}{3}$ of vesting period elapsed = CU200,000 recognised in Year 1.)

Year 2 (Year ended 30 June 20X2)

Dr	Profit or loss—Staff costs	CU200,000	
	Cr	Equity	CU200,000

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

(50,000 options granted \times 80% = 40,000 options expected to vest. 40,000 \times CU15 grant date fair value of each option \times $\frac{2}{3}$ of vesting period elapsed – CU200,000 = CU200,000 recognised in Year 2. The cumulative expense at the end of Year 2 is CU400,000 (CU200,000 recognised in Year 1 and CU200,000 recognised in Year 2).)

Year 3 (Year ended 30 June 20X3)

Dr	Profit or loss—Staff costs	CU200,000	
	Cr	Equity	CU200,000

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

(40,000 options vested \times CU15 grant date fair value of each option \times $\frac{3}{3}$ of vesting period elapsed = CU600,000 recognised cumulatively to the end of Year 3. CU600,000 – CU200,000 recognised in Year 2 – CU200,000 recognised in Year 1 = CU200,000 recognised in Year 3.)

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

If the share options are subsequently exercised, SME A will give shares to the employees in exchange for receiving cash equal to the option exercise price. How this transaction is accounted for depends on applicable law or regulation in SME A's jurisdiction. In some jurisdictions, it might also depend on how the SME sources the shares that it gives to the employees. For example, SME A might issue new shares or use shares held as treasury shares.

In this example, the share options granted all vest at the same time, at the end of Year 3. In some situations, share options or other equity instruments might vest in instalments over the vesting period. For example, an employee might be granted 100 share options that vest in instalments of 25 share options at the end of each of the next four years. There is no explicit guidance in Section 26 dealing with awards that vest in instalments. Paragraph IG11 of the *Guidance on implementing IFRS 2 Share-based Payment* explains that in such a scenario, ‘the entity should treat each instalment as a separate share option grant, because each instalment has a different vesting period, and hence the fair value of each instalment will differ (because the length of the vesting period affects, for example, the likely timing of cash flows arising from the exercise of the options)⁵. The same approach could be taken by an entity applying the *IFRS for SMEs Accounting Standard*.⁵

Ex 22 The facts are the same as in Example 21. However, in this example:

- 20 employees leave during Year 1;
- SME A revises its estimate of total employee departures over the three-year period from 20% (100 employees) to 15% (75 employees) at the end of Year 1;
- 22 more employees leave during Year 2;
- SME A revises its estimate of total employee departures over the three-year period from 15% to 12% (60 employees) at the end of Year 2; and
- 15 more employees leave during Year 3.

A total of 57 employees therefore forfeit their rights to the share options during the three-year period, and a total of 44,300 share options (443 employees × 100 options per employee) are vested at the end of Year 3.

SME A records the equity compensation scheme as follows:

Year 1 (Year ended 30 June 20X1)

Dr	Profit or loss—Staff costs	CU212,500	
	Cr Equity		CU212,500

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

(50,000 options granted × 85% = 42,500 options expected to vest. 42,500 × CU15 grant date fair value of each option × $\frac{1}{3}$ of vesting period elapsed = CU212,500 recognised in Year 1.)

⁵ In accordance with paragraph 10.6 of Section 10 *Accounting Policies, Estimates and Errors* of the *IFRS for SMEs Accounting Standard*, an entity is permitted but not required to consider the requirements and guidance in full IFRS Accounting Standards if the *IFRS for SMEs Accounting Standard* does not provide explicit guidance.

Year 2 (Year ended 30 June 20X2)

Dr	Profit or loss—Staff costs	CU227,500	
	Cr	Equity	CU227,500

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

(50,000 options granted \times 88% = 44,000 options expected to vest. 44,000 \times CU15 grant date fair value of each option \times $\frac{2}{3}$ of vesting period elapsed = CU440,000 recognised cumulatively to the end of Year 2. CU440,000 – CU212,500 recognised in Year 1 = CU227,500 recognised in Year 2.)

Year 3 (Year ended 30 June 20X3)

Dr	Profit or loss—Staff costs	CU224,500	
	Cr	Equity	CU224,500

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

(44,300 options vested \times CU15 grant date fair value of each option \times $\frac{3}{3}$ of vesting period elapsed = CU664,500 recognised cumulatively to the end of Year 3. CU664,500 – CU227,500 recognised in Year 2 – CU212,500 recognised in Year 1 = CU224,500 recognised in Year 3.)

Examples—Measurement when there are market vesting conditions and service conditions

Ex 23 On 1 June 20X0, SME A grants to a senior executive 10,000 share options, conditional on:

- the executive remaining in the entity's employment until 31 May 20X3; and
- the shares in SME A being valued at CU65 or more per share on 31 May 20X3.

Both conditions are satisfied on 31 May 20X3. SME A's year end is 31 May.

The first condition is a service condition, and the second condition is a market vesting condition. SME A uses an option pricing model to measure the fair value of the options at the grant date to be CU24 per option. The valuation reflects the market vesting condition but not the service condition, as explained in the educational notes following paragraph 26.9.

SME A expects the service condition to be satisfied.

SME A makes the following entries during the vesting period to recognise the services received as consideration for the share options:

Year 1 (Year ended 31 May 20X1)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

(10,000 options × CU24 × $\frac{1}{3}$ of vesting period elapsed)

Year 2 (Year ended 31 May 20X2)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

((10,000 options × CU24 × $\frac{2}{3}$ of vesting period elapsed) – CU80,000 recognised in Year 1)

Year 3 (Year ended 31 May 20X3)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

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

The executive remains in service throughout the three-year period. SME A recognises a cumulative total of CU240,000 over the period for the services received from the executive because the service condition is satisfied.

Ex 24 The facts are the same as in Example 23. However, in this example, although the executive remains in service for three years, the share options do not vest because the market condition is not satisfied. The estimated fair value of a share in SME A is CU60 at the end of the three-year period.

SME A makes the following entries during the three years to recognise the services received as consideration for the share options.

Year 1 (Year ended 31 May 20X1)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

(10,000 options × CU24 × $\frac{1}{3}$ of vesting period elapsed)

Year 2 (Year ended 31 May 20X2)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

$((10,000 \text{ options} \times \text{CU}24 \times \frac{2}{3} \text{ of vesting period elapsed}) - \text{CU}80,000 \text{ recognised in Year 1})$

Year 3 (Year ended 31 May 20X3)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

$((10,000 \text{ options} \times \text{CU}24) - \text{CU}160,000 \text{ recognised in Years 1 and 2})$

The executive remains in service throughout the three-year period. SME A recognises a cumulative total of CU240,000 for the services received from the executive because the service condition is satisfied.

Even though the market condition (share price target) is not satisfied, the accounting is not affected because the possibility that the market condition might not be met was taken into account when SME A estimated the grant date fair value of the share options at CU24. Therefore, the journal entries would be identical to those in Example 23.

Ex 25 The facts are the same as in Example 23. However, in this example, the executive forfeited the options when he resigned from SME A in Year 2 (the year ended 30 May 20X2).

At the grant date, SME A expected the service condition to be satisfied, but the executive resigned in Year 2.

SME A makes the following entries during the three years to recognise the services received as consideration for the share options:

Year 1 (Year ended 31 May 20X1)

Dr	Profit or loss—Staff costs	CU80,000	
	Cr	Equity—Reserves	CU80,000

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

$(10,000 \text{ options} \times \text{CU}24 \times \frac{1}{3} \text{ of vesting period elapsed})$

Year 2 (Year ended 30 May 20X2)

Dr	Equity—Reserves	CU80,000	
	Cr	Profit or loss—Staff costs	CU80,000

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

Year 3 (Year ended 30 May 20X3): no entries

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

Shares

- 26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:
- (a) if an observable market price is available for the equity instruments granted, use that price.
 - (b) if an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as:
 - (i) a recent transaction in the entity's shares; or
 - (ii) a recent independent fair valuation of the entity or its principal assets.
 - (c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is **impracticable**, indirectly measure the fair value of the shares using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value. Any valuation method used shall be consistent with generally accepted valuation methodologies for valuing equity instruments.

Educational notes

As noted on page 6, Section 26 sets out some specific requirements for the measurement of the equity instruments granted in an equity-settled share-based payment transaction. Therefore, Section 12 of the Standard does not apply to fair value measurements within the scope of Section 26 (see paragraph 12.1(a)). However, the starting point is fair value. For equity instruments for which there are no service conditions and no non-market vesting conditions, the measurement of fair value in accordance with Section 26 is similar to the measurement of fair value in accordance with Section 12 of the Standard.

Like Section 12, Section 26 sets out a three-tier hierarchy for measuring the fair value of shares, share options and equity-settled share appreciation rights. Under this hierarchy, an entity uses an observable market price if one is available. However, because SMEs are entities whose equity instruments are not traded in a public market, usually there will be no observable market price available for share-based payment transactions involving the shares of SMEs. Consequently, SMEs would use the second tier, or the third if necessary.

Some entities engage valuation experts to help them develop fair value estimates for shares, particularly if they have significant share-based payments or lack valuation expertise. Further guidance on approaches to valuing shares for which there is no observable market price available can be found in the educational material *IFRS 13 Fair Value Measurement: Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*.⁶ Although that guidance relates to IFRS 13, the underlying valuation approaches described in that guidance would be appropriate to use. Therefore, SMEs might find that educational material helpful.

Table 1 illustrates the valuation approaches and valuation techniques presented in that educational material.

Table 1—Valuation of unquoted equity instruments

Valuation approaches	Valuation techniques
Market approach	<ul style="list-style-type: none">• Transaction price paid for an identical or a similar instrument in an investee• Comparable company valuation multiples
Income approach	<ul style="list-style-type: none">• Discounted cash flow (or DCF) method• Dividend discount model (DDM)• Constant-growth DDM• Capitalisation model
A combination of approaches might be used	<ul style="list-style-type: none">• Adjusted net asset method

⁶ Available on ifrs.org at: <https://www.ifrs.org/-/media/feature/supporting-implementation/ifrs-13/education-ifrs-13-eng.pdf>.

Example—Fair value of shares

Ex 26 SME A, a small private company, establishes a bonus plan in which employees are granted ordinary shares conditional on achieving specified non market performance targets. Upon vesting of the shares, employees have the unconditional right to sell the shares. On 31 December 20X5, SME A grants to employees the rights to 1,500 shares. The shares will vest on 31 December 20X6 if the employees are still employed by the company at that date and the specified profit before tax target has been met. SME A has only one class of issued shares; all its shares have identical rights.

The conditions to which the share award is subject are a service condition and a non-market vesting condition. These conditions are taken into account when estimating the number of shares expected to vest, not when estimating the fair value of the shares. The fair value of the share award at the grant date (31 December 20X5) will be the same as the fair value of the existing issued shares of SME A, except for an adjustment to reflect the fact that dividends will not accrue to the employees during the vesting period (if this is the case).

Because SME A's shares are not traded in a public market, SME A first considers the second tier of the measurement hierarchy in paragraph 26.10 to establish whether it can measure the fair value of the shares using entity-specific observable market data. (An example of entity-specific observable market data could include the price resulting from a recent sale of its shares to a third party by one of the shareholders in SME A.) If such data is available, SME A would assess whether any significant changes in facts or circumstances had occurred between that sale of shares and the date of granting the share award that would affect the fair value of SME A's shares.

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

Assuming that SME A estimates the fair value of the share award at CU14 per share, the performance target is met and that none of the employees leave, SME A would make the following entry to record the share-based payment transaction:

Dr	Profit or loss—Staff costs	CU21,000	
	Cr	Equity—Reserves	CU21,000

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

(1,500 shares × CU14)

Share options and equity-settled share appreciation rights

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

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

Educational notes

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

All option pricing models take into account, as a minimum, the following factors or inputs:⁷

- the exercise price of the option;
- the life of the option;
- the current price of the underlying shares;
- the expected volatility of the share price;
- the dividends expected on the shares (if appropriate); and
- the risk-free interest rate for the life of the option.

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

- market data is used to the greatest extent possible when determining the inputs;

⁷ The factors or inputs listed here are based on those listed in paragraph of IFRS 2 and in paragraph 26.11(c) of the *IFRS for SMEs Accounting Standard*.

- paragraph 26.10 is applied in determining the input used for the price of the underlying shares; and
- the estimate of expected volatility must be consistent with the valuation methodology used to determine the fair value of the shares under paragraph 26.10.

Option pricing software is available to entities that need to develop fair value estimates for options, as is valuation guidance on selecting and applying different option pricing models. An entity is permitted but not required to consider the guidance in IFRS 2 on selecting an option pricing model and determining the inputs into the model (see paragraphs B4–B41 of IFRS 2). In addition, as noted on page 34 for share valuations, some entities engage valuation experts to assist them in this process.

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

Ex 27 On 1 January 20X1, SME A grants senior executives 15,000 share options, conditional on the executives remaining in the entity’s employment until 31 December 20X3. In addition, the share options cannot be exercised unless the value of SME A’s shares has increased from CU25 on 1 January 20X1 to above CU30 by 31 December 20X3, meaning that this vesting condition is a market condition.

If the share price is above CU30 on 31 December 20X3, the share options can be exercised at any time during the next six years (by 31 December 20X9). At 31 December 20X1, SME A expects that none of the senior executives will leave during the three-year vesting period. This estimate is revised at 31 December 20X2, when SME A estimates that executives with 2,000 options will leave by 31 December 20X3. At 31 December 20X3, none of the options vest because the share price condition is not met. However, if it had been met, 13,500 options would have vested, because the service required to earn 13,500 options was received. SME A’s year end is 31 December.

SME A uses an option pricing model to estimate the fair value of the options. As at the grant date (1 January 20X1), the model produces a fair value estimate of CU2.50 per option, which reflects the market vesting condition. SME A makes the following entries during the service period:

Year 1 (Year ended 31 December 20X1)

Dr	Profit or loss—Staff costs	CU12,500	
	Cr	Equity—Reserves	CU12,500

To recognise the receipt of employee services in exchange for SME A’s share options

(15,000 options × CU2.50 × $\frac{1}{3}$ of vesting period elapsed)

Year 2 (Year ended 31 December 20X2)

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

To recognise the receipt of employee services in exchange for SME A’s share options

((13,000 options × CU2.50 × $\frac{2}{3}$ of vesting period elapsed) – CU12,500)

Year 3 (Year ended 31 December 20X3)

Dr	Profit or loss—Staff costs	CU12,083	
	Cr	Equity—Reserves	CU12,083

To recognise the receipt of employee services in exchange for SME A's share options

$((13,500 \text{ options} \times \text{CU}2.50) - \text{CU}12,500 - \text{CU}9,167)$

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

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

- (a) if the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.
- (b) if the modification reduces the total fair value of the share based payment arrangement, or apparently is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred.

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

Educational notes

Sometimes an entity might modify the terms and conditions of an equity-settled share-based payment arrangement. For example, an entity might reduce the exercise price of employee share options during the vesting period because the value of its shares has fallen below the original exercise price of those options, resulting in out-of-the-money options that no longer provide an incentive for employees to satisfy the vesting conditions, such as remaining in service for the specified vesting period.

If an entity modifies the terms and conditions of equity instruments granted during the vesting period, it continues to account for the instruments granted based on the original terms and conditions, and the vesting period as at the grant date. In addition, the entity assesses whether the modification increased the total fair value of the instruments granted by measuring the fair value of those instruments immediately before and after the modification. If the modification has increased that total fair value, the entity also recognises the incremental fair value granted over the period from the date of the modification to the date on which the modified instruments vest.

However, if the modification has decreased the total fair value of the equity instruments granted, the entity continues to account for the instruments granted based on their original terms and conditions.

Examples—Modifications

Ex 28 SME A grants 100 share options to each of its 500 employees on 1 July 20X0. Each grant is conditional on the employee remaining in service over the next three years (to 30 June 20X3). SME A estimates that the fair value of each option at the grant date is CU15. SME A also estimates that 100 employees will leave during the three-year period and will therefore forfeit their rights to the share options. SME A's year end is 30 June.

Forty employees leave during the year ended 30 June 20X1. During the same year, the economy of the jurisdiction in which SME A operates enters recession and SME A's business, and the fair value of its shares, is adversely affected. On 30 June 20X1, SME A reprices its share options by lowering the exercise price. The repriced share options retain the original vesting date, vesting on 30 June 20X3. SME A estimates that a further 70 employees will leave during the years ended 20X2 and 20X3, meaning the total number of employees expected to leave over the three-year vesting period is 110.

SME A estimates that, at the date of repricing, the fair value of each of the original share options granted (the fair value before taking into account the repricing) is CU5 and that the fair value of each repriced share option is CU8.

During the year ended 30 June 20X2, a further 35 employees leave and SME A estimates that a further 30 employees will leave during the year ended 30 June 20X3, to bring the total number of employees expected to depart over the three-year vesting period to 105.

During the year ended 30 June 20X3, a total of 28 employees leave and so a total of 103 employees left during the vesting period. For the remaining 397 employees, the share options vested on 30 June 20X3.

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

Year 1 (Year ended 30 June 20X1)

Dr	Profit or loss—Staff costs	CU195,000	
	Cr	Equity—Reserves	CU195,000

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

$((500 \text{ employees} - 110 \text{ expected to forfeit}) \times 100 \text{ options} \times \text{CU}15 \times \frac{1}{3} \text{ of vesting period elapsed})$

Year 2 (Year ended 30 June 20X2)

Dr	Profit or loss—Staff costs	CU259,250	
	Cr	Equity—Reserves	CU259,250

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

$((500 \text{ employees} - 105 \text{ expected to forfeit}) \times 100 \text{ options} \times ((\text{CU}15 \times \frac{2}{3} \text{ of vesting period elapsed}) + (\text{CU}3 \text{ repricing} \times \frac{1}{2} \text{ of period remaining after repricing elapsed})) - \text{CU}195,000 \text{ recognised in Year 1})$

Year 3 (Year ended 30 June 20X3)

Dr	Profit or loss—Staff costs	CU260,350	
	Cr	Equity—Reserves	CU260,350

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

$((500 \text{ employees} - 103 \text{ forfeited}) \times 100 \text{ options} \times (\text{CU}15 + \text{CU}3) - \text{CU}454,250 \text{ recognised in Years 1 and 2})$

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

Ex 29 On 1 July 20X1, SME A grants 1,000 share options to each member of its sales team, conditional on the employee remaining in SME A's employment for three years and on the team selling more than 50,000 units of a particular product over the three-year period ended 30 June 20X4. The fair value of the share options is CU15 per option at the grant date.

During the year ended 30 June 20X3, SME A increases the sales target to 100,000 units. By the end of 30 June 20X4, SME A has sold 55,000 units, and the share options do not vest. Twelve members of the sales team remained in service for the duration of the three-year period.

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

Because the modification to the non-market vesting condition (from 50,000 units to 100,000 units) was not beneficial to the employees (it made it less likely that the share options would vest), SME A ignores the modified non-market vesting condition when recognising the services received. SME A therefore recognises the services received over the three-year period on the basis of the original grant.

Because none of the vesting conditions are market conditions, the charge is based on whether the options would have vested based on the original vesting conditions. Because the options would have vested based on the original sales target, SME A ultimately recognises a cumulative remuneration expense of CU180,000 over the three-year period (12 employees × 1,000 options × CU15 per option).

Cancellations and settlements

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

Educational notes

If an entity cancels or settles an equity-settled share-based payment arrangement during the vesting period, the entity accounts for the cancellation or settlement as an acceleration of vesting. In other words, it treats the equity instruments as having vested on the date of cancellation or settlement by recognising immediately the amount that otherwise would have been recognised over the remainder of the vesting period.

Section 26 does not specify how an entity should account for any payment made on cancellation or settlement of a share-based payment award. In accordance with Section 10, an entity would use its judgement to select an appropriate accounting policy to apply to the debit side of the transaction when accounting for the payment made. For example, an entity could determine that payment was made, in substance, to purchase the equity instrument granted, similar to the repurchase of a share. That would suggest that the payment should be deducted from equity.

However, in some cases the amount paid on cancellation or settlement could exceed the fair value of an equity-settled share-based payment award. When developing an accounting policy for the payment made on cancellation or settlement, the entity would need to consider its approach to determining whether such an excess exists and how to account for it. For example, Section 26 requires a modification that increases the fair value of the award, measured at the date of the modification, to be accounted for as an additional charge for the services of the employees (see page 38). Therefore, if the entity determines that the amount paid on cancellation or settlement exceeds the fair value of the award at the date of cancellation or settlement, it would be consistent with the treatment for modifications to account for that excess as an additional charge for the services of the employees. This treatment would also be consistent with that required by paragraph 28(b) of IFRS 2.⁸

Example 30 assumes that the entity adopts an accounting policy consistent with these educational notes.

Example—Cancellations

Ex 30 SME A grants 100 share options to each of its 300 employees on 1 July 20X0. Each grant is conditional on the employee remaining in service over the next three years (to 30 June 20X3). SME A estimates that the fair value of each option is CU10 on grant date. SME A expects all employees to complete the required service. SME A's year end is 30 June.

On 30 June 20X2, all employees remain employed by SME A. However, the fair value of an option has declined to CU6. SME A decides to cancel the option scheme and pay its employees CU6.50 per option.

SME A makes the following entries.

Year 1 (Year ended 30 June 20X1)

Dr	Profit or loss—Staff costs	CU100,000	
	Cr	Equity—Reserves	CU100,000

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

(300 employees × 100 options × CU10 × $\frac{1}{3}$ of vesting period elapsed)

Year 2 (Year ended 30 June 20X2)

Dr	Profit or loss—Staff costs	CU200,000	
	Cr	Equity—Reserves	CU200,000

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

((300 employees × 100 options × CU10 × $\frac{2}{2}$ of vesting period elapsed because of an acceleration of vesting) – CU100,000 expensed in Year 1)

⁸ In accordance with paragraph 10.6, an entity is permitted but not required to consider the requirements and guidance in full IFRS Accounting Standards when the *IFRS for SMEs Accounting Standard* does not provide explicit guidance.

Dr	Equity—Reserves	CU180,000 ^(a)	
Dr	Profit or loss—Staff costs	CU15,000 ^(b)	
	Cr	Asset—Cash	CU195,000 ^(c)

To recognise the cash payment in settlement of SME A's share option plan

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

On 30 June 20X2, the end of Year 2, SME A accounts for the receipt of employee services as if the share option plan had vested immediately on 30 June 20X2. A total of CU100,000 was recognised in Year 1, so an additional CU200,000 is recognised in Year 2. At the time of cancellation, the fair value of the options is CU180,000. The cash payment to employees totals CU195,000, of which CU15,000 is in excess of the fair value of the cancelled options. SME A accounts for the CU15,000 excess as an expense in profit or loss. CU180,000 is debited to equity, in effect as a purchase of the outstanding equity instruments (the share options). The total amount recognised as an expense in profit or loss for the cancelled scheme for the two-year period from the grant date to the cancellation date is CU315,000.

Cash-settled share-based payment transactions

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

continued ...

... continued

26.14A A cash-settled share-based payment transaction might be conditional upon satisfying specified vesting conditions related to service or performance. Vesting conditions and conditions that are not vesting conditions (non-vesting conditions) are accounted for as follows:

- (a) service conditions and non-market vesting conditions shall be taken into account when estimating the number of awards that are expected to vest and subsequently adjusting the number of awards included in the measurement of the liability arising from the transaction. The entity shall initially recognise an amount for the goods or services received during the vesting period based on the number of awards that are expected to vest. The entity shall revise that estimate if new information indicates that the number of awards expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of awards that ultimately vested. Service conditions and non-market vesting conditions shall not be taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date.
- (b) market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the cash-settled share-based payment granted and when remeasuring the fair value of the liability at the end of each **reporting period** and at the date of settlement.

26.14B As a result of applying paragraph 26.14A, the cumulative amount ultimately recognised for goods or services received as consideration for the cash-settled share-based payment is equal to the cash paid.

Educational notes

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

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

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

Similar to equity-settled share-based payment transactions, the treatment of vesting conditions in accounting for cash-settled share-based payment transactions depends on the type of vesting condition:

- service conditions and non-market vesting conditions are not taken into account when estimating the fair value of the liability. Instead, these types of conditions are taken into account when estimating the number of awards that are expected to vest.
- market vesting conditions and non-vesting conditions are taken into account when estimating the fair value of the liability.

Example—Cash-settled share-based payment transactions

Ex 31 On 1 July 20X0, SME A grants 100 cash-settled share appreciation rights (SARs) to each of its 500 employees, on the condition that the employee remains in SME A’s employment for the next three years until 30 June 20X3. The SARs are exercisable at any time between 30 June 20X3 and 30 June 20X5. SME A’s year end is 30 June.

During the year ended 30 June 20X1, 35 employees leave. SME A estimates that a further 60 employees will leave during the years ended 20X2 and 20X3.

During the year ended 30 June 20X2, 40 employees leave and SME A estimates that a further 25 will leave during the year ended 30 June 20X3. During the year ended 30 June 20X3, 22 employees leave.

On 30 June 20X3, all SARs held by the remaining employees vest and 150 employees exercise their SARs. Another 140 employees exercise their SARs on 30 June 20X4 and the remaining 113 employees exercise their SARs on 30 June 20X5.

SME A estimates the fair value of the SARs at the end of each year in which a liability exists, as shown below. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) on 30 June 20X3, 30 June 20X4 and 30 June 20X5 are also shown below.

Year	Date	Fair value	Intrinsic value
1	30 June 20X1	CU14.40	
2	30 June 20X2	CU15.50	
3	30 June 20X3	CU18.20	CU15.00
4	30 June 20X4	CU21.40	CU20.00
5	30 June 20X5		CU25.00

The requirement for the employees to remain in SME A's employment until 30 June 20X3 is a service condition. Therefore, in accordance with paragraph 26.14A(a), the fair value of each SAR shown in the table above does not take that condition into account. Instead, the service condition is taken into account when estimating the number of SARs expected to vest, as shown in the calculation in the table below.

In Years 3 and 4, there is a difference between the intrinsic value (the amount the employees receive on exercise) and the fair value of the SARs. This difference arises because the fair value reflects the fact that the SARs are exercisable until the end of Year 5.

Consequently, in addition to the intrinsic value, the fair value includes the value of the right to participate in future increases in share price (if any) that might occur between the valuation date and the settlement date. Thus, at the end of Year 3, if an employee exercises their SARs, they would receive CU15.00 for each SAR, whereas the fair value of a SAR held by an employee choosing to exercise at a later date would be CU18.20, reflecting the right to participate in any further share price increases.

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

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- (a) The calculation for Year 3 comprises three parts. The first part multiplies the fair value at the end of Year 3 by the number of SARs that vested and that were not exercised at the end of Year 3, which gives the liability at the end of Year 3. The second part multiplies the intrinsic value at the end of Year 3 by the number of SARs that were exercised at the end of Year 3, which gives the amount of cash paid out at the end of Year 3. The third part is the deduction of the amount of the liability at the end of Year 2 to give the change in liability for the year (for convenience, it is presented as a deduction from the first amount).
- (b) The calculation for Year 4 comprises three parts. The first part multiplies the fair value at the end of Year 4 by the number of SARs that remain unexercised at the end of Year 4, which gives the liability at the end of Year 4. The second part multiplies the intrinsic value at the end of Year 4 by the number of SARs that were exercised at the end of Year 4, which gives the amount of cash paid out at the end of Year 4. The third part is the deduction of the amount of the liability at the end of Year 3 to give the change in liability for the year (for convenience, it is presented as a deduction from the first amount).
- (c) The calculation for Year 5 comprises three parts. The first part is the liability at the end of Year 5, which is CU0 because the liability has been settled. The second part multiplies the intrinsic value at the end of Year 5 by the number of SARs that were exercised at the end of Year 5, which gives the amount of cash paid out at the end of Year 5. The third part is the deduction of the amount of the liability at the end of Year 4 to give the change in liability for the year (for convenience, it is presented as a deduction from the first amount).

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

Share-based payment transactions with cash alternatives

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

- (a) the entity has a past practice of settling by issuing equity instruments;
- (b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument; or
- (c) the choice of settlement relates only to a net settlement feature (see paragraph 26.15A) and the transaction satisfies the conditions in paragraph 26.15B.

In circumstances (a) and (b), the entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraphs 26.7–26.13. In circumstance (c), the entity shall account for the transaction in accordance with paragraphs 26.15B–26.15D.

Educational notes

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

The entity accounts for these types of transactions as cash-settled share-based payments, with three exceptions. Two of these exceptions address situations in which settlement in cash is unlikely because the entity has a past practice of settling by issuing equity instruments or because the cash settlement option lacks commercial substance (see paragraphs 26.15(a)–26.15(b)). The third exception addresses situations in which the choice of settlement relates only to a net settlement feature (see paragraph 26.15(c)), which is discussed on pages 51–53.

Examples—Share-based payments with cash alternatives

Ex 32 On 1 January 20X1, SME A grants to a group of employees the right to choose either 1,000 shares or 1,000 cash-settled ‘phantom shares’, meaning a right to a cash payment equal to the fair value of 1,000 shares. The grant is conditional on the completion of three years’ service. On 31 December 20X3, each employee chooses either the shares (the equity alternative) or the phantom shares (the cash alternative). In the past, similar share-based payment transactions have never been settled in SME A’s shares.

At the grant date, the fair value of SME A's shares is CU50 per share. At the end of Years 1, 2 and 3 (that is, on 31 December 20X1, 20X2 and 20X3), the fair value of SME A's shares is CU52, CU55 and CU60 per share respectively. SME A does not expect to pay dividends in Years 1–3. SME A does not expect that any employees will leave during the three-year service period and all employees remain in service at the end of Year 3 (31 December 20X3). SME A's year end is 31 December.

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

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

Year	Calculation	Expense (CU)	Year-end liability* (CU)
1	1,000 phantom shares × CU52 × $\frac{1}{3}$	17,333	17,333
2	1,000 phantom shares × CU55 × $\frac{2}{3}$ – CU17,333	19,334	36,667
3	1,000 phantom shares × CU60 – CU36,667	23,333	60,000
	Total	60,000	

* The liability is equal to the cumulative expense recognised.

If employees choose to take shares rather than cash at the end of Year 3, there would no longer be a liability and SME A would transfer the CU60,000 out of liabilities to equity (Dr Liabilities and Cr Equity for CU60,000).

Ex 33 On 1 January 20X1, SME A grants to a number of employees the right to choose either 1,000 shares or 50 cash-settled phantom shares (a right to a cash payment equal to the fair value of 50 shares). The grant is conditional on the completion of three years' service. On 31 December 20X3, each employee chooses either the equity alternative or the cash alternative. At the grant date, the fair value of SME A's shares is CU50 per share. At the end of Years 1, 2 and 3 (that is, on 31 December 20X1, 20X2 and 20X3), the fair value of SME A's shares is CU52, CU55 and CU60 per share respectively. SME A does not expect to pay dividends in Years 1–3. SME A does not expect that any employees will leave during the three-year service period, and at the end of Year 3 (31 December 20X3) all employees remain in service. SME A's year end is 31 December.

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

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

Year	Calculation	Expense (CU)	Equity (CU)
1	1,000 shares × CU50 × $\frac{1}{3}$	16,667	16,667
2	1,000 shares × CU50 × $\frac{2}{3}$ – CU16,667	16,667	16,667
3	1,000 shares × CU50 – CU33,334	16,666	16,666
	Total	<u>50,000</u>	

Share-based payment transactions with a net settlement feature for withholding tax obligations

- 26.15A Tax laws or regulations might oblige an entity to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee's behalf. A share-based payment arrangement has a net settlement feature if the terms of the arrangement require or permit an entity to withhold the number of equity instruments equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment.
- 26.15B The share-based payment transaction described in paragraph 26.15A shall be classified as an equity-settled share-based payment transaction if:
- it would have been so classified in the absence of the net settlement feature; and
 - there is an obligation on the entity under tax laws or regulations to withhold an amount for an employee's tax obligation associated with that share-based payment.
- 26.15C For a transaction that satisfies the conditions in paragraph 26.15B, an entity shall account for the payment to the tax authority as a deduction from equity for the equity instruments withheld, except to the extent that the payment exceeds the fair value at the net settlement date of the equity instruments withheld.
- 26.15D Paragraph 26.15B does not apply to any equity instruments that the entity withholds in excess of the monetary value of the employee's tax obligation associated with the share-based payment. Such excess shares withheld shall be accounted for as a cash-settled share-based payment when this amount is paid in cash (or other assets) to the employee.

Educational notes

Some jurisdictions have tax law or regulation that obliges an entity to withhold an amount for an employee's tax obligation associated with a share-based payment and to transfer that amount, usually in cash, to the tax authority on the employee's behalf. To fulfil this obligation, the share-based payment arrangement might include a net settlement feature that permits or requires the entity to deduct, from the total number of equity instruments that it would otherwise deliver to the employee, the number of equity instruments needed to equal the monetary value of the employee's tax obligation.

Such arrangements are accounted for as equity-settled share-based payment transactions if the two conditions in paragraph 26.15B are met:

- the arrangement would be classified as an equity-settled share-based payment transaction in the absence of the net settlement feature. In other words, in all other respects, the arrangement meets the definition of an equity-settled share-based payment transaction.

- tax law or regulation obliges the entity to withhold an amount for the employee's tax obligation.

However, if the payment made to the tax authority exceeds the fair value of the equity instruments withheld, or if the equity instruments withheld exceed the monetary value of the employee's obligation, that excess is accounted for as a cash-settled share-based payment (see paragraphs 26.15C–26.15D).

Example—Share-based payments with a net settlement feature

Ex 34 The tax law in SME A's jurisdiction requires entities to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount in cash to the tax authority on the employee's behalf.

On 1 January 20X1, SME A grants an award of 1,000 shares to an employee, conditional on the employee completing three years' service. SME A expects the employee to complete the service period. SME A's year end is 31 December.

The terms of the arrangement require SME A to withhold shares on settlement of the award to settle the employee's tax obligation. The employee's tax obligation is calculated based on the fair value of the shares on vesting date (31 December 20X3). The employee's applicable tax rate is 25%. The fair value of SME A's shares is CU6 per share on grant date and CU10 per share on vesting date.

Because the share award meets the two conditions in paragraph 26.15B, SME A accounts for the share award as an equity-settled share-based payment transaction.

The fair value of the shares on the vesting date is CU10,000 (1,000 shares × CU10 per share), so the employee's tax obligation is CU2,500 (CU10,000 × 25%). Accordingly, on the vesting date, SME A withholds 250 shares (CU2,500 tax obligation ÷ CU10 per share) and issues 750 shares to the employee (1,000 shares granted – 250 shares withheld). SME A also pays CU2,500 to the tax authority on the employee's behalf.

SME A makes the following journal entries:

Year 1 (Year ended 31 December 20X1)

Dr	Profit or loss—Staff costs	CU2,000	
	Cr	Equity—Reserves	CU2,000

To recognise the receipt of employee services in exchange for shares

(1,000 shares × CU6 × $\frac{1}{3}$ of vesting period elapsed)

Year 2 (Year ended 31 December 20X2)

Dr	Profit or loss—Staff costs	CU2,000	
	Cr	Equity—Reserves	CU2,000

To recognise the receipt of employee services in exchange for shares

((1,000 shares × CU6 × ²/₃ of vesting period elapsed) – CU2,000 recognised in Year 1)

Year 3 (Year ended 31 December 20X3)

Dr	Profit or loss—Staff costs	CU2,000	
	Cr	Equity—Reserves	CU2,000

To recognise the receipt of employee services in exchange for shares

((1,000 shares × CU6) – CU4,000 recognised in Years 1 and 2)

Dr	Equity—reserves	CU2,500	
	Cr	Cash	CU2,500

To recognise the cash payment to the tax authority in settlement of the employee's tax obligation

Group plans

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

Educational notes

A parent might establish a group share-based payment plan in which it grants share-based payment awards (such as shares, share options or share appreciation rights) to employees of its subsidiaries. The parent would account for the plan in both its consolidated and separate financial statements (if prepared) in accordance with Section 26. Each subsidiary, as the recipient of employee services under the plan, would also account for the plan in accordance with Section 26. However, as a practical expedient, paragraph 26.16 permits each subsidiary to measure its share-based payment expense based on a reasonable allocation of the group's share-based payment expense, instead of applying the detailed requirements in paragraphs 26.3–26.15D of Section 26.

Section 26 does not give further guidance on how an entity determines a reasonable allocation of the expense for the group.

Example—Group plans

Ex 35 Entity A is a listed company that prepares financial statements in accordance with full IFRS Accounting Standards. Entity A has four subsidiaries, SME W, SME X, SME Y and SME Z, all of which prepare individual financial statements in accordance with the IFRS for SMEs Accounting Standard.

Entity A grants 50 share options in Entity A to each of the sales employees at the subsidiaries, conditional on the completion of three years' service with the subsidiary. The parent does not require the subsidiaries to pay for the shares needed to settle the grant of share options.

SME W has three times as many sales employees as each of SME X, SME Y and SME Z. All sales employees of SME W, SME X and SME Y are expected to meet the specified service condition. Only half of the sales employees in SME Z are expected to meet the service condition. These estimates do not change during the vesting period.

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

The expense might be allocated between the subsidiaries for the purposes of preparing the subsidiaries' individual financial statements based on the number of sales employees expected to receive the awards at the subsidiaries. Because SME W has three times as many sales employees as each of SME X, SME Y and SME Z, and because only half of the sales employees in SME Z are expected to receive the awards, the expense might be allocated between SME W, SME X, SME Y and SME Z using the ratio: 6: 2: 2: 1. That is, SME W accounts for an expense equal to $6/(6+2+2+1) = 6/11$ of the expense recognised by the parent.

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

SME W, SME X, SME Y and SME Z might account for the share-based payments in their individual financial statements as follows:

SME W:

Years 1–3

Dr	Profit or loss—Staff costs	CU6,000	
	Cr	Equity—Capital contribution from parent	CU6,000

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

(CU11,000 × $\frac{6}{11}$)

SME X and SME Y:**Years 1–3**

Dr	Profit or loss—Staff costs	CU2,000	
	Cr	Equity—Capital contribution from parent	CU2,000

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

(CU11,000 × ²/₁₁)

SME Z:**Years 1–3**

Dr	Profit or loss—Staff costs	CU1,000	
	Cr	Equity—Capital contribution from parent	CU1,000

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

(CU11,000 × ¹/₁₁)

Unidentifiable goods or services

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

Educational notes

Section 26 applies to share-based payment transactions in which an entity receives goods or services in a share-based payment arrangement. Usually, the nature of the goods and services received and when they were (or will be) received can be identified by considering the terms and conditions of the arrangement. For example, if an entity has granted shares to its employees on the condition that they remain in its employment for three years, the vesting condition indicates both the nature of the goods or services that will be received (employee services) and when they are received (over the three-year vesting period).

However, in some cases, the entity might not be able to identify whether (or when or what) goods or services were (or will be) received. In the absence of specifically identifiable goods or services, other circumstances might indicate that goods or services have been or will be received, in which case Section 26 applies (see paragraph 26.1B).

In particular, if the identifiable consideration received by the entity (such as goods, services or cash) appears to be less than the fair value of the equity instruments granted or liability incurred, typically other consideration (that is, unidentifiable goods or services) has been (or will be) received. The entity measures the unidentifiable goods or services as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received, measured at the grant date (see paragraph 26.17).

Example—Entity cannot identify the specific goods or services received

Ex 36 Following the introduction of new legislation, SME A gives 100 shares to each of 10 employees who meet specific criteria. The employees do not pay any cash consideration for the shares and there are no vesting conditions. For example, the employees are not required to complete a specified service period. Dividends declared on the shares are paid to the employees when they are paid by the entity. The employees are free to sell the shares whenever they wish but, under conditions imposed by the entity, if they sell them within the first five years, they must be sold to another person meeting the same criteria as themselves. SME A estimates that the fair value of a share, taking account of the restrictions with respect to its future sale, is CU6.

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

Disclosures

- 26.18 An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period:
- (a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (for example, whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.
 - (b) the number and weighted average exercise prices of share options for each of the following groups of options:
 - (i) outstanding at the beginning of the period;
 - (ii) granted during the period;
 - (iii) forfeited during the period;
 - (iv) exercised during the period;
 - (v) expired during the period;
 - (vi) outstanding at the end of the period; and
 - (vii) exercisable at the end of the period.
- 26.19 For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.
- 26.20 For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.
- 26.21 For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.
- 26.22 If the entity is part of a group share-based payment plan, and it measures its share based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).
- 26.23 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its **financial position**:
- (a) the total expense recognised in profit or loss for the period; and
 - (b) the total **carrying amount** at the end of the period for liabilities arising from share-based payment transactions.

Ex 37 SME A owns and operates several hotels. During the period ended 31 December 20X5, SME A had four types of employee share-based payment arrangements.

SME A discloses information about its share-based payment arrangements as follows:⁹

Notes to the financial statements for the year ended 31 December 20X5 (extract)				
Note 8—Share-based payment				
During the year ended 31 December 20X5, the company had four share-based payment arrangements, as follows:				
Type of arrangement	Senior management share option plan	General employee share option plan	Executive share plan	Senior management share appreciation rights
Date of grant	1 January 20X4	1 January 20X5	1 January 20X5	1 July 20X5
Number granted	50,000	75,000	50,000	25,000
Contractual life	10 years	10 years	4 years	3 years
Settlement type	Equity	Equity	Equity	Cash
Vesting conditions	One and a half years' service and achievement of a room occupancy target, which was achieved.	Three years' service.	Four years' service and achievement of a target growth in profit before tax.	Three years' service and achievement of a target increase in revenue per available room.
<p>The estimated fair value of each share option granted in the general employee share option plan is CU23.60. The fair value of each share option granted was estimated by applying a binomial option pricing model. The model inputs were the estimated fair value of each share at grant date of CU50.00, exercise price of CU50.00, expected volatility of 30%, no expected dividends, contractual life of 10 years, and a risk-free interest rate of 5%. To allow for the effects of early exercise, it was assumed that the employees would exercise the options after vesting date on which the estimated fair value of each share was twice the exercise price. The directors chose the binomial option pricing model because it allows for the early exercise of options and is suitable for options with long lives.</p> <p style="text-align: right;"><i>continued ...</i></p>				

⁹ The illustrative example is not intended to be a template or model and is therefore not exhaustive. It does not, for instance, illustrate the disclosure requirements in paragraph 26.21 because there were no modifications during the period.

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

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

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

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

Details of the expense recognised in profit or loss for the period and the closing balance of the liability for the share appreciation rights are set out as follows:

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

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs Accounting Standard* to transactions or other events often requires an entity to use its judgement. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful to a user of the entity's financial statements when assessing the entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6 of Section 8 *Notes to the Financial Statements*, an entity discloses the judgements management has made when applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

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

Other sections of the Standard require disclosure of information about particular judgements and estimation uncertainties.

Fair value estimates

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

Because shares in an SME are not traded in an active market, an SME must use its judgement to select the most appropriate valuation method to determine the fair value of its shares. Furthermore, such entities must make significant estimates and other judgements when applying the chosen valuation method. For example, when using an income-based approach to determine the value of an entity (and its shares), estimates and judgements made include estimates of future cash flows (or income and expenses) and determining the discount rate.

To estimate the fair value of share options and equity-settled share appreciation rights, an option pricing model would usually be used. All option pricing models take into account, as a minimum, the following inputs:

- the exercise price of the option;
- the life of the option;
- the current price of the underlying shares;
- the expected volatility of the share price;
- the dividends expected on the shares (if appropriate); and
- the risk-free interest rate for the life of the option.

Without a listed share price, making judgements and estimates about these inputs can be difficult—for example, in estimating the expected volatility of shares for which there is no record of historical volatility.

If the share-based payment transaction is cash-settled, it is necessary for an entity to estimate the fair value of the liability at each year end until settlement.

Effect of vesting and non-vesting conditions

Management is required to make various estimates when accounting for vesting and non-vesting conditions. For example, a grant of equity instruments might be conditional on employees satisfying specified vesting conditions related to service or performance. All vesting conditions related to employee service or to a non-market vesting condition are taken into account when estimating the number of equity instruments expected to vest.

Subsequently, an entity is required to revise that estimate if new information suggests that the number of equity instruments expected to vest differs from previous estimates. All market vesting and non-vesting conditions are taken into account when estimating the fair value of the shares or share options at the measurement date, with no subsequent adjustment, regardless of the outcome.

Other judgements

Other judgements might include determining whether the parties in a share-based payment arrangement are 'employees and others providing similar services.' Equity-settled share-based payment transactions with employees and others providing similar services are measured by valuing the equity instruments granted.

Other equity-settled share based payment transactions are measured by valuing the goods or services received, unless that fair value cannot be estimated reliably (in which case, they are measured by reference to the instruments granted).

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs Accounting Standard* is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted. Changes made to Section 26 from the second edition of the Standard are summarised on page 7.

Appendix A of the Standard includes requirements for entities making the transition from the second to the third edition of the Standard.

Share-based payment

Scope of Section 26 *Share-based Payment*

- A37 An entity shall prospectively apply paragraph 26.1C for transactions occurring on or after the date of initial application.

Definition of fair value measurement

- A38 An entity shall prospectively apply paragraphs 26.1D–26.1E from the date of initial application.

Definition of a vesting condition

- A39 An entity shall prospectively apply the amendments to paragraph 26.9, the amended definitions of ‘**vesting condition**’ and ‘**market vesting condition**’ and the new definitions of ‘**performance condition**’ and ‘**service condition**’ to **share-based payment transactions** with a **grant date** on or after the date of initial application.

Effects of vesting conditions on the measurement of a cash-settled share-based payment

- A40 An entity shall prospectively apply paragraphs 26.14A–26.14B to share-based payment transactions that are unvested at the date of initial application and to share-based payment transactions with a grant date on or after the date of initial application. For unvested share-based payment transactions granted before the date of initial application, an entity shall remeasure the liability at that date and recognise the effect of the remeasurement in the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

Share-based payment transactions with a net settlement feature for withholding tax obligations

- A41 An entity shall apply the amended requirements in paragraphs 26.15–26.15D to share-based payment transactions that are unvested (or vested but unexercised) at the date of initial application and to share-based payment transactions with a grant date on or after the date of initial application. For unvested (or vested but unexercised) share-based payment transactions that were previously classified as cash-settled but then became classified as equity-settled in accordance with the amended requirements in paragraphs 26.15–26.15D, an entity shall reclassify the carrying amount of the share-based payment liability to equity at the date of initial application.

Educational notes

The transition requirements in Appendix A of the Standard require the changes made to Section 26 to be applied prospectively, from the date of initial application. The transition requirements include more detail on how to prospectively apply the new requirements on:

- the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payment transactions. The entity remeasures the liability for unvested share-based payment transactions by applying the new requirements at the date of initial application, with a corresponding adjustment to the opening balance of retained earnings (or another component of equity, as appropriate).
- the classification of share-based payment transactions with a net settlement feature for withholding tax obligations. For unvested (or vested but unexercised) share-based payment transactions that are reclassified from cash-settled to equity-settled as a result of applying the new requirements, the carrying amount of the liability is reclassified to equity at the date of initial application.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

When accounting for and reporting share-based payment transactions for periods beginning on 1 January 2027, the main differences between the requirements of full IFRS Accounting Standards (see IFRS 2) and the *IFRS for SMEs Accounting Standard* (see Section 26) are that:

- Section 26 is drafted in simpler language than that used in IFRS 2.
- Section 26 contains less guidance on how to account for modifications, cancellations and settlements than IFRS 2.
- Section 26 contains fewer disclosure requirements overall than IFRS 2. However, Section 26 contains three disclosure requirements not in IFRS 2.

The main other differences between Section 26 and IFRS 2 are that:

- In the rare cases in which the fair value of equity instruments granted cannot be estimated reliably, IFRS 2 requires the entity to measure the instruments at their intrinsic value. The intrinsic value is determined initially and then revised at the end of each reporting period and on final settlement (see paragraph 24 of IFRS 2). Section 26 does not have a similar requirement, requiring entities to instead use a valuation method to determine the fair value of the equity instruments. Section 26 emphasises that when choosing a valuation technique for the fair value of shares, the entity's directors should use their judgement.
- Section 26 contains a simplification from IFRS 2 for share-based payment transactions with cash alternatives. In general, paragraph 26.15 of the *IFRS for SMEs Accounting Standard* requires a share-based payment transaction that gives either the entity or the holder a choice of settlement in cash or equity instruments to be accounted for as a cash-settled share-based payment transaction, subject to some exceptions. IFRS 2, on the other hand, requires that:
 - o if the counterparty has the choice of how the transaction is settled, the entity recognises a compound financial instrument and accounts for the debt and equity components separately; and
 - o if the entity has the choice of how the transaction is settled, the entity accounts for the transaction as a cash-settled share-based payment transaction to the extent it has incurred a liability to settle in cash (or other assets) and an equity-settled share-based payment transaction to the extent that no such liability has been incurred.
- Section 26 provides a simplification for group entities. If a parent grants an award to employees of its subsidiary and the parent presents consolidated financial statements (using the *IFRS for SMEs Accounting Standard* or full IFRS Accounting Standards), the subsidiary is permitted to measure the expense and related capital contribution on a reasonable allocation of the group expense. IFRS 2 does not include a similar simplification and instead provides detailed requirements for accounting for share-based payments among group entities.
- Section 26 contains less guidance on measuring the fair value of the equity instruments granted than is in IFRS 2. For example, IFRS 2 provides guidance on selecting an option pricing model and on the inputs to an option pricing model.

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements in Section 26 *Share-based Payment* of the *IFRS for SMEs* Accounting Standard by answering the questions provided.

Assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those supplied on page 70.

Mark the box next to the most correct statement.

Question 1

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

- (a) when it receives the goods or services during the vesting period.
- (b) at the end of the vesting period.
- (c) on the date that the share-based payment award is granted.

Question 2

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

- (a) the entity defers recognition of the services rendered by the employees until the exercise date because there is no vesting period.
- (b) the services are recognised immediately on the grant date because it is presumed the employees have already provided the related services.
- (c) the entity accounts for those services as they are rendered by the employee during the period from the grant date to the exercise date.

Question 3

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

- (a) always at the fair value of the goods and services received.
- (b) always at the fair value of the equity instruments granted.
- (c) at the fair value of the goods or services received unless that fair value cannot be estimated reliably.

Question 4

For equity-settled share-based payment transactions for employee services, an entity measures the fair value of the equity instruments:

- (a) on the grant date.
- (b) on the vesting date.
- (c) on the exercise date.
- (d) on the vesting date or exercise date, whichever is later.

Question 5

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

- (a) the grant date.
- (b) the vesting date.
- (c) the date on which the entity obtains the goods or the counterparty renders service.
- (d) the exercise date.

Question 6

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

- (a) does not revise its previous estimate of the number of equity instruments expected to vest.
- (b) revises the estimate of the number of equity instruments expected to vest so that it equals the number of equity instruments that ultimately vest for vesting conditions related to employee service and to non-market vesting conditions.
- (c) revises the estimate of the number of equity instruments expected to vest so that it equals the number of equity instruments that ultimately vest for vesting conditions related to employee service and to market vesting conditions.
- (d) revises the estimate of the number of equity instruments expected to vest so that it equals the number of equity instruments that ultimately vest for all vesting conditions.

Question 7

When measuring the fair value of shares in an equity-settled share-based payment transaction, an entity:

- (a) always uses observable market prices of the entity's own shares.
- (b) uses observable market prices but only for non-employee share-based payment transactions.
- (c) uses prices established by the entity's directors for that type of share-based payment transaction.
- (d) uses observable market prices if available, and if not, uses other measures according to a measurement hierarchy.

Question 8

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

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

Question 9

A cash-settled share-based payment transaction is a share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on:

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

Question 10

A cash-settled share-based payment transaction might be conditional on satisfying specified vesting conditions related to service or performance. An entity accounts for vesting conditions by:

- (a) taking all vesting conditions into account when estimating the fair value of the liability at the grant date, at each reporting date and at the date of settlement.
- (b) taking all vesting conditions into account when estimating the number of awards expected to vest and subsequently revising that estimate to equal the number of awards that ultimately vested.
- (c) taking market vesting conditions into account when estimating the fair value of the liability at grant date, at each reporting date and at settlement date; and taking service conditions and non-market vesting conditions into account when estimating the number of awards expected to vest and subsequently revising that estimate to equal the number of awards that ultimately vested.

Question 11

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

- (a) as an equity-settled share-based payment transaction if the entity has the choice of settlement or as a cash-settled share-based payment transaction if the counterparty has the choice of settlement.
- (b) as an equity-settled share-based payment transaction, unless the entity has a past practice of settling in cash.
- (c) as a cash-settled share-based payment transaction, unless the option to settle in cash has no commercial substance.
- (d) as a cash-settled share-based payment transaction, unless one of three exceptions applies (for example, the entity has a past practice of settling by issuing equity instruments).

Question 12

Under an employee long-term incentive plan operated by SME A, 1,000 of SME A's shares will be issued to employees in three years' time if the value of a share has risen to CU34 at the end of the three-year period and if the employees are still employed by SME A on the same date.

On the grant date, the fair value of the shares granted is estimated to be CU30 per share in accordance with Section 26. SME A plans to pay no dividends over the next three years. All eligible employees remain employed by SME A at the end of the three-year period. Assuming that none of the employee compensation qualifies for capitalisation, SME A would:

- (a) recognise over the three-year vesting period a total remuneration expense of CU35,000 ($\text{CU}35 \times 1,000$) if the share price on the vesting date is CU35; and recognise over the three-year vesting period a total remuneration expense of CU0 if the share price on the vesting date is CU32.
- (b) recognise over the three-year vesting period a total remuneration expense of CU35,000 ($\text{CU}35 \times 1,000$) if the share price on the vesting date is CU35; and recognise over the three-year vesting period a total remuneration expense of CU32,000 ($\text{CU}32 \times 1,000$) if the share price on the vesting date is CU32.
- (c) recognise over the three-year vesting period a total remuneration expense of CU30,000 ($\text{CU}30 \times 1,000$) if the share price on the vesting date is CU35; and recognise over the three-year vesting period a total remuneration expense of CU0 if the share price on the vesting date is CU32.
- (d) recognise over the three-year vesting period a total remuneration expense of CU30,000 ($\text{CU}30 \times 1,000$) regardless of the share price on the vesting date.

Question 13

A transaction outside the scope of Section 26 would be one in which:

- (a) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a plot of land classified as property, plant and equipment.
- (b) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a plot of land classified as investment property.
- (c) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a plot of land classified as inventory.
- (d) an entity issues 100 of its own ordinary shares to an independent contractor in exchange for accounting services.
- (e) an entity issues 100 of its own ordinary shares to an independent third party in exchange for a business.
- (f) an entity issues 100 of its own ordinary shares to its employees in exchange for employee services.

Answers

- Q1 (a)—See paragraph 26.3.
- Q2 (b)—See paragraph 26.5.
- Q3 (c)—See paragraph 26.7.
- Q4 (a)—See paragraph 26.8.
- Q5 (c)—See paragraph 26.8.
- Q6 (b)—See paragraph 26.9.
- Q7 (d)—See paragraph 26.10.
- Q8 (c)—See paragraph 26.12.
- Q9 (c)—See the Glossary.
- Q10 (c)—See paragraph 26.14A.
- Q11 (d)—See paragraph 26.15.
- Q12 (d)—See paragraph 26.9(b).
- Q13 (e)—See paragraphs 26.1C(a) and 19.1.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements in Section 26 *Share-based Payment* of the *IFRS for SMEs* Accounting Standard by completing the case studies provided.

Once you have completed the case studies, check your answers against those on pages 72, 74 and 77.

Case study 1

SME A entered into three share-based payment transactions between 20X1 to 20X3:

- on 30 January 20X1, SME A received marketing services in exchange for 365 of its shares. The counterparty initially quoted a price of CU9,500 based on its normal market rates, but agreed to accept SME A's shares rather than cash payment. The fair value for SME A's shares on 30 January was estimated at CU26 per share.
- on 31 December 20X2, SME A set up a supplementary annual bonus plan for its sales manager. Its intention was to make the bonus approximately equal to 1% of the pre-bonus salary. Upon receipt of the shares on 31 December, the sales manager had the immediate and unconditional right to sell them. SME A granted 3,000 shares under the plan. Management estimated that the fair value of SME A's shares on 31 December was CU28 per share. The pre-bonus salary was CU8,401,050.
- on 2 October 20X3, SME A purchased office equipment by issuing 3,790 of its ordinary shares. The selling price for the equipment is CU110,000. Management estimated that the fair value of SME A's shares on 2 October was CU29 per share.

Prepare SME A's journal entries for these share-based payment transactions. Ignore the journal entries required with respect to the shares themselves. Assume that none of SME A's employee compensation qualifies for capitalisation.

Answer to Case study 1

30 January 20X1

Dr	Profit or loss—Marketing expense	CU9,500	
	Cr	Equity	CU9,500

To recognise the receipt of marketing services in exchange for 365 of SME A's shares

Note: the normal market rate of the marketing services, assuming the purchase is from an independent vendor, is the best measurement of the fair value of the marketing services received. However, if the fair value of the marketing services cannot be estimated reliably, SME A would measure the services received, and the corresponding increase in equity, at the fair value of the shares granted (as 365 shares × CU26 per share = CU9,490) (see paragraph 26.7).

31 December 20X2

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

To recognise receipt of employee services in exchange for 3,000 of SME A's shares

Note: because the share-based payment vests at the grant date (on 31 December 20X2), the sales manager has an unconditional right to sell the shares. No part of the award is for future services and therefore the full amount is recognised as an expense on 31 December 20X2. The fair value of the sales manager's services is measured at the fair value of the shares granted in exchange for those services (as 3,000 shares × CU28 per share = CU84,000) (see paragraph 26.7).

2 October 20X3

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

To recognise the receipt of equipment in exchange for 3,790 of SME A's shares

Note: the normal selling price, assuming the purchase is from an independent vendor, is the best measurement of the fair value of the equipment received. However, if the fair value of the equipment cannot be estimated reliably, SME A would measure the equipment received, and the corresponding increase in equity, at the fair value of the shares granted (as 3,790 shares × CU29 per share = CU109,910) (see paragraph 26.7).

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

Case study 2

On 1 January 20X1, SME B grants 10 share options to each of its 1,000 employees. Each grant is conditional on the employee remaining in service over the next three years. SME B uses an appropriate option pricing model to estimate the fair value of each option at CU5 on grant date.

SME B estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the share options. Forty employees leave during 20X1. On 31 December 20X1, SME B estimates that a further 70 employees will leave during 20X2 and 20X3, making the total expected employee departures over the three-year vesting period 110 employees.

By 31 December 20X1, the market in which SME B operates has declined significantly, negatively affecting the fair value of SME B's shares. SME B reprices its share options on 1 January 20X2. The repricing of the share options increases the fair value of each share option, estimated at the date of the repricing, by CU2. Because the vesting date is unchanged, the repriced share options will vest on 31 December 20X3.

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

During 20X3, 28 employees leave, meaning that there were 103 employee departures during the vesting period. For the remaining 897 employees, the share options vested on 31 December 20X3.

To answer the case study:

- (a) determine the estimated amount of total remuneration at the grant date, before any repricing, to be recognised over the three-year vesting period.
- (b) prepare the journal entries to record remuneration expense in 20X1, 20X2 and 20X3. Assume that the employee compensation does not qualify for capitalisation.

Answer to Case study 2

- (a) The condition that an employee remains in service over the next three years is a service condition. The grant date estimate, before any repricing, of total remuneration to be recognised over the three-year vesting period is CU45,000 ((1,000 employees – 100 expected forfeiture) × 10 options each × CU5 fair value per option). If no repricing took place and, as expected, 100 employees left, SME B would record CU15,000 remuneration expense in each of the years ended 31 December 20X1, 20X2 and 20X3.
- (b) SME B makes the following journal entries during the vesting period, for services received as consideration for the share options granted, taking into account the repricing and updated information on expected vesting.

For the year ended 31 December 20X1

Dr	Profit or loss—Staff costs	CU14,833	
	Cr	Equity—Reserves	CU14,833

(1,000 employees – 110 expected forfeiture) × 10 options × CU5 × $\frac{1}{3}$ of vesting period elapsed

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

For the year ended 31 December 20X2

Dr	Profit or loss—Staff costs	CU23,950	
	Cr	Equity—Reserves	CU23,950

(1,000 employees – 105 expected forfeiture) × 10 options × (CU5 original × $\frac{2}{3}$ of vesting period elapsed) + (CU2 repricing × $\frac{1}{2}$ of vesting period remaining after repricing elapsed) – CU14,833 recognised in 20X1

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

For the year ended 31 December 20X3

Dr	Profit or loss—Staff costs	CU24,007	
	Cr	Equity—Reserves	CU24,007

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

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

Note: entities are required to recognise the effects of modifications that increase the total fair value of the equity instruments granted or are otherwise beneficial to the employee, measured immediately before and after the modification. Consequently, SME B is required to recognise the incremental CU2 fair value per option that results from the repricing. Because the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date (1 January 20X2) until the date on which the modified equity instruments vest (31 December 20X3)—the last two years of the three-year vesting period. The amount recognised based on the incremental fair value granted (CU2 per share option) is in addition to the amount recognised based on the grant date fair value of the original equity instruments granted (CU5 per share option), which is recognised over the original three-year vesting period ending on 31 December 20X3.

Case study 3

SME C establishes a programme of share appreciation rights (SARs) in which its executives are entitled to receive cash equal to the growth (if any) in the fair value of the ordinary shares over a four-year period. On 1 January 20X1, the executives were granted 40,000 SARs conditional on each executive remaining in the employment of SME C for the next four years (until 31 December 20X4). The fair value of SME C's shares on 31 December 20X0 was CU30.

The executives will be paid the cash in February 20X5, equal to the increase (if any) in the fair value of the shares over the four years to 31 December 20X4. The fair value of the SARs is measured at CU6 per SAR on 1 January 20X1, CU9 on 31 December 20X1, CU15 on 31 December 20X2, CU8 on 31 December 20X3 and CU12 on 31 December 20X4. The intrinsic value of the SARs at the date of exercise (which equals the cash paid out) was also CU12. All executives remain employed by SME C during the four years.

To answer the case study:

- (a) prepare a four-year (20X1–20X4) schedule calculating the employee compensation for the 40,000 SARs granted to the executives.
- (b) prepare the journal entries for employee compensation expense in each of the four years for the 40,000 SARs and the journal entry for the cash payment in 20X5. Assume that the employee compensation does not qualify for capitalisation.

Answer to Case study 3

(a) Employee compensation schedule for SARs

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

(b) Journal entries for employee compensation expense

For the year ended 31 December 20X1

Dr	Profit or loss—Staff costs	CU90,000	
	Cr	Liability—Employee share appreciation plan	CU90,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of SME C over four years (first year)

For the year ended 31 December 20X2

Dr	Profit or loss—Staff costs	CU210,000	
	Cr	Liability—Employee share appreciation plan	CU210,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of SME C over four years (second year) and the increase in the fair value of the SARs

For the year ended 31 December 20X3

Dr	Liability—Employee share appreciation plan	CU60,000	
	Cr	Profit or loss—Staff costs	CU60,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of SME C over four years (third year) and the decline in the fair value of the SARs, which reverses part of the charge in prior years

For the year ended 31 December 20X4

Dr	Profit or loss—Staff costs	CU240,000	
	Cr	Liability—Employee share appreciation plan	CU240,000

To recognise the receipt of employee services in the current year in exchange for 40,000 SARs of SME C over four years (final year) and the increase in the fair value of the SARs

For the year ended 31 December 20X5

Dr	Liability—Employee share appreciation plan	CU480,000	
	Cr	Asset—Cash	CU480,000

To recognise the payment of cash to employees under the share appreciation plan for the four years ended 31 December 20X4

NOTES



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