IFRS 2
Share-based payment

1. Objective

IFRS 2 specifies the accounting treatment of share-based payment transactions, including those where an entity benefits from services or delivery of goods provided by third parties.
This Standard does not apply to business combinations that are covered by IFRS 3.

2. Scope

An entity must apply this Standard in the following cases:

- equity-settled share-based payment transactions;
- cash-settled share-based payment transactions;
- equity-settled (in full or in part) or cash-settled share-based payment transactions, with the choice being left to the entity or to the beneficiary of the share-based payment arrangement.

3. Accounting impact

3.1 Equity-settled share-based payment transactions

The entity must measure the goods or services received, as well as the resulting increase in equity, at the fair value of the goods or services received, unless this fair value cannot be determined reliably. In this case, the entity must measure the transaction based on the fair value of the equity instruments issued or to be issued.

1° Determination of the fair value of equity instruments

The entity must measure the fair value of the equity instruments issued or to be issued, based on the market prices that might be available. This measurement is final and definitive, whether the allocation of the equity instruments is

contingent or not on the satisfaction of certain conditions.
If there are no market prices available, the entity must use **valuation techniques** to determine what would have been the price of these equity instruments on the measurement date in an arm's length transaction, between knowledgeable, willing parties.
If, in very rare cases, the entity cannot reliably estimate the fair value of the equity instruments on the measurement date, IFRS 2 provides for a specific treatment relying on fairly complex **valuation models** (Black-Scholes-Merton formula or the binomial model, for example).

2° Vesting date of equity instruments

a. Immediate vesting, without conditions

In the absence of evidence to the contrary, it is assumed that the services rendered in exchange for equity instruments were obtained by the entity. The entity must recognize these services, as well as the corresponding increase in equity, on the grant date.

Example 1: Company W grants 100 stock options to its personnel. The fair value of each stock option is 10 on the grant date.
The entity must recognize 1,000 (100 × 10) in employee expenses, with a corresponding amount being recognized in equity.
This entry is definitive, whether the stock options are exercised or not.

b. Vesting subject to conditions

The granting of equity instruments may be contingent on fulfilling precise vesting conditions (for example, minimum number of years of service, or performance of other conditions such as achievement of a specified level of profits).

In this case, the equity instrument vests when specific vesting conditions are satisfied.

a) A service condition is a condition that must be met to acquire rights obligating another party (an employee or vendor, for example) to complete a specific service period during which this person commits to provide services to the company. If during the vesting period, the other party stops providing services, the condition is not met in any case. No performance objective is tied to specified service period conditions.

b) A performance condition is a condition that must be met to acquire rights which requires:

- that the other party complete a specified service period (i.e., a service condition) - the service may be required based on a legal or a constructive obligation; and
- that one or several performance objectives are reached when the required services above are performed.

The period during which the objective(s) must be achieved:

- must not exceed the end of the service period; and
- may begin before the service period, on the condition that the date the performance objective enters into force is not substantially earlier than the beginning of the service period.

The performance objective, which may be tied to the performance of all or part of the company or its group (division, particular staff members), is defined by reference:

- either to the business of the company or a company of the same group (i.e., a condition which is not a market condition);
- or the value of the equity instruments of the company or a company of the same group (including shares and stock options, i.e., a market condition).

c) A market condition is a performance condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price of the entity's (or entity of the same group's) equity instruments. A market condition implies that the other party must complete a specified service period which may be required either by way of a legal or a constructive obligation.

The entity must recognize these services as a charge against profit or loss, together with the corresponding increase in equity, as the services are rendered by the beneficiary during the vesting period, based on the best estimate possible of the number of equity instruments expected to vest. The entity must revise this estimate annually if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.

On vesting date, the entity must revise the estimate in order to adjust it to the number of equity instruments actually issued.

Example 2: On 1 January N, company X grants 500 stock options to each of its 10 top executives, on the condition they continue working for the company for at least four years. The fair value of these options is measured at 14. The average turnover rate of the management personnel is estimated at 10%.
Company X must recognize at the end of each reporting period, regardless of the change in the stock market price, an expense of 500 × 10 × 0.9 × 14 × 1/4 = 15,750, with a corresponding amount booked to equity.

➢ *For the purposes of simplification, the impact of deferred tax is not taken into account in the example above.*

Treatment after the vesting date

The entity must not record any subsequent adjustments in equity after the vesting date.
In particular, the entity must not readjust the amount recognized for the services rendered in the past by a member of personnel if this person forfeits options held. However, the entity must record the cancellation of the cost of the services rendered in profit if the employee leaves the company workforce.

3.2 Cash-settled share-based transactions

The entity must measure the goods or services obtained, in addition to the liability contracted, at the fair value of this liability. Until the liability is settled, the entity must reassess its fair value at the beginning and at the end of each financial statement reporting period, as well as on the settlement date, by recognizing in the profit or loss any variation in fair value.

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Example 3: On 1 January N, company Y granted to its sales representatives a bonus equal to 10% of the increase in the share price during the next three reporting periods, on the condition that they still worked for the company on 31 December N+2.
On the grant date, the fair value was estimated at 150,000.

On 31 December N and on 31 December N+1, the change in the stock market price led to a reassessment of the fair value of this liability to 180,000 and 165,000 respectively.
On 31 December N+2, this bonus was finally determined at 175,000.
On 31 December N, the company had to recognize a liability equal to 180,000/3 = 60,000.
On 31 December N+1, the company had to recognize an additional liability equal to:
[(165,000 × 2/3) – 60,000] = 50,000.
On 31 December N+2, the expense for the reporting period would be equal to:
175,000 – 60,000 – 50,000 = 65,000.

➢ *For the purposes of simplification, the impact of deferred tax is not taken into account in the example above.*

3.3 Full or partial cash-settled or equity-settled share-based payment transactions

When the payment of a transaction is share-based within the framework of an agreement leaving the choice up to either of the parties whether to receive settlement in cash (or other assets) or to be issued equity instruments, the entity must recognize this transaction, taking into account the characteristics of the contract or practices of the entity:

- either as a share-based cash-settled payment transaction;
- or as a share-based equity-settled payment transaction.

Example 4: On 1 January N, company Z granted to its 3 senior executives, on the condition that they remain in the company for at least three years, either 1,000 bonus shares that they must keep at least 2 years or a bonus equal in value to 750 shares.
On 1 January N, the stock market price stood at 50. It increased by 2 per annum over the period. The fair value of the shares was as assessed at 40 due to the obligation to keep them for two years.

On the grant date, the fair values were as follows:

- if settled in cash: 50 × 750 × 3 = 112,500
- if settled in shares: 40 × 1,000 × 3 = 120,000

"the liability component" would equal 112,500 and "the equity component" would equal:
120,000 – 112,500 = 7,500. This amount is definitive.
"The liability component" changes each year based on the share's stock market price. Since the share increases by 2 each year, "the liability component" will to increase each year by (2 × 3 × 750)/3 = 1,500.

On 31 December N, company Z booked the following entry:
Personnel expenses (P&L) 41,500
Liabilities (B/S) (52 × 750 × 3)/3 39,000
Equity (B/S) (7,500/3) 2,500

On 31 December N+1, the entry should be booked as follows:
Personnel expenses (P&L) 44,500
Liabilities (B/S) (54 × 750 × 3) × 2/3 – 39,000 42,000
Equity (B/S) (7 500/3) 2,500

On 31 December N+2, company Z would record the following:
Personnel expenses (P&L) 47,500
Liabilities (B/S) (56 × 750 × 3) – 39 000 – 42 000 45,000
Equity (B/S) (7 500/3) 2,500
Total liabilities at 31 December N+2 would amount to 56 × 750 × 3 = 126,000.

If one of the executives opts for payment in shares and the two others for payment in cash, the entries to be recorded on 31 December N+2 would be as follows:
Liabilities (B/S) (126,000/3) 42,333
Equity (B/S) 42,333
Liabilities (B/S) (126,000 × 2/3) 84,667
Cash (B/S) 84,667

➢ *For the purposes of simplification, the impact of deferred tax is not taken into account in the example above.*

3.4 Share-based payment transactions which include cash settlement terms to satisfy withholding tax obligations

Entities must retain certain amounts in connection with share-based payment transactions to satisfy the tax obligations of their staff members. These transactions must be recognized in full as share-based payment transactions and settled in equity instruments if recognized as such unless cash settlement terms apply.

Example 5: Company P grants bonus compensation to executive staff by way of issuing equity instruments with a fair value valued at 150. Local tax rules provide for a withholding tax on this type of additional earnings in the amount of 20. The company thus recognizes the transaction as follows:
Personnel expenses: 150
Equity instruments: 130
State tax due: 20

If the conditions provide for cash settlement, the transaction would be recognized as follows:
Personnel expenses: 150
Equity increase: 150
Personnel expenses: 20
State tax due: 20

4. Disclosure

An entity must disclose the following information to enable users to understand:

- the nature and extent of share-based payment arrangements that existed during the period and in particular:
  - ✓ a description of each type of share-based payment arrangement, including the general terms and conditions of the arrangement, such as the vesting requirements, the maximum term of options granted, and the method of settlement (in cash or equity vesting provisions),
  - ✓ the number and weighted average exercise price of share options for the reporting period,
  - ✓ the weighted average price at the exercise date of the share options exercised during the period,
  - ✓ the share options outstanding at the end of the period, the range of exercise prices and the weighted average remaining contractual life;

- the method for determining the fair value of the goods or services received, or the fair value of the equity instruments granted during the period, in particular:

- ✓ the weighted average fair value of these options at the measurement date for those options granted during the period, and information on how that fair value was measured,
- ✓ the number and the weighted average fair value of the other equity instruments on the date of their measurement, and the conditions for determining their fair value;

- the effects of share-based payment transactions on the comprehensive profit or loss of the period and on the entity's financial position.

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