Insights into IFRS 2

Group share-based payments

Share-based payments have become increasingly popular over the years, with many entities using equity instruments or cash and other assets based on the value of equity instruments as a form of payment to directors, senior management, employees and other suppliers of goods and services.

While the general accounting principles have remained largely unchanged since the introduction of IFRS 2 'Share-based Payment' in 2004, share-based payments is an area that is not well understood in practice and entities often have difficulty in applying the requirements to increasingly complex and innovative share-based payment arrangements.

Our 'Insights into IFRS 2' series is aimed at demystifying IFRS 2 by explaining the fundamentals of accounting for share-based payments using relatively simple language and providing insights to help entities cut through some of the complexities associated with accounting for these types of arrangements.

As discussed in our article **'Insights into IFRS 2 – What is IFRS 2?'**, IFRS 2 applies to share-based payment arrangements between (a) an entity, another group entity, or a shareholder of any group entity, and (b) another party, such as an employee. Other articles in the series discuss the accounting for share-based payments when employees (or others) receive shares or rights to shares of the entity granting the award. This article discusses the accounting for share-based payment transactions when employees of an entity receive shares or rights to shares in another entity within the consolidated group, such as the parent entity.

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Group share-based payment arrangements

Share-based payment arrangements are commonly agreements between an entity and its employees, where the employees receive either (1) the entity's own equity instruments or (2) payments based on the share price of the entity's own equity instruments. However, in some cases, share-based payment arrangements may involve another group entity or a shareholder of any group entity. For example, a share-based payment arrangement may be entered into with the employees of one entity, but another group entity or shareholder of another group entity is responsible for settling the obligation associated with the share-based payment transaction. In other words, the entity receiving the services from the employee is not always the entity that is responsible for settling the share-based payment transaction.

Share-based payment arrangement (emphasis added):

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.

To determine whether an agreement represents a group share-based payment arrangement that is within the scope of IFRS 2, it is also important to understand what a 'group' is and which entities or parties should be considered. IFRS 2 refers to the guidance in IFRS 10 'Consolidated financial statements':

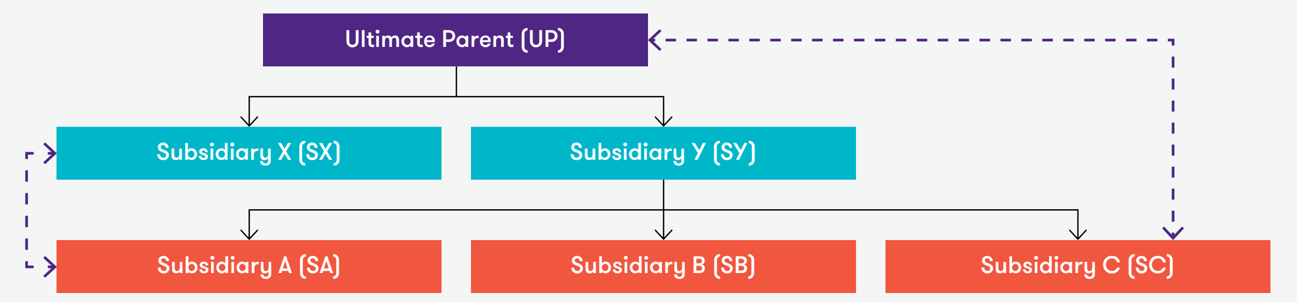
Group:

A parent and its subsidiaries

This definition is determined from the perspective of the reporting entity's ultimate parent. For example, in the organisational structure shown below in Figure 1, the group includes the ultimate parent (UP), and all of its subsidiaries. In Figure 1, the following are two examples of share-based payment arrangements that would fall under the scope of IFRS 2:

- Example 1: UP grants a share-based payment award, to be settled in its own equity instruments, to the employees of Subsidiary C (SC).
- Example 2: Subsidiary A (SA) grants a share-based payment award to its employees, that will be settled in the equity instruments of Subsidiary X (SX).

Figure 1



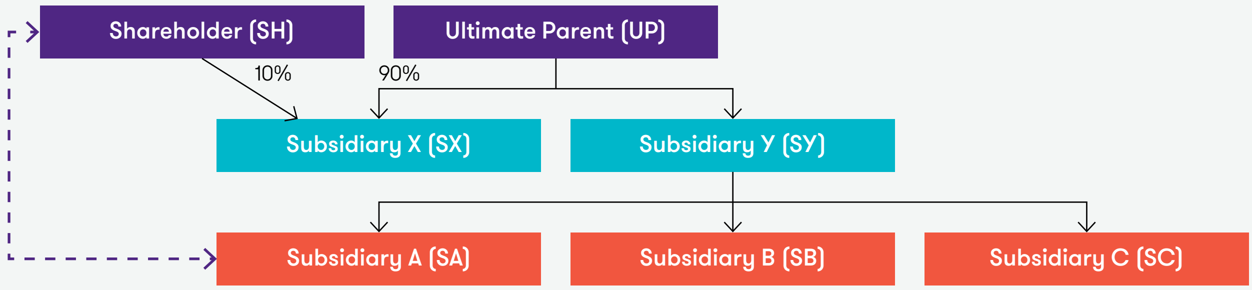
When determining whether a transaction is within the scope of IFRS 2, it is also necessary to consider the financial statements in which the share-based payment transaction is being recorded. In other words, is the arrangement being assessed from the perspective of the consolidated financial statements of the entire group, or is the arrangement being assessed from the perspective of the separate financial statements of one entity involved in the group share-based payment transaction?

In Figure 1 above, both examples are share-based payment transactions that would be recognised in the consolidated financial statements of UP, because the consolidated entity is receiving services and settling the transaction in its own equity instruments. In addition:

- Example 1: The transaction between UP and SC is a group share-based payment that would also be recognised in the separate financial statements of both UP and SC, because the settling and receiving entity are in the same group.
- Example 2: The transaction between SX and SA is a group share-based payment that would also be recognised in the separate financial statements of both SX and SA, because they are entities in the same group (from the perspective of the UP).

In Figure 2 below, shareholder (SH) grants a share-based payment award (that will be settled in cash based on the price of SX's equity instruments) to the employees of SA. When considering how to recognise the share-based payment transaction in the financial statements of SA, the transaction is within the scope of IFRS 2 because the award has been granted by a shareholder of SX, who is an entity in the same group as SA (from the perspective of the UP). However, when considering how to recognise the transaction in the financial statements of SH, the transaction is not within the scope of IFRS 2 because SH is not a part of the same group as SA (ie SA is not a direct or indirect subsidiary of SH).

Figure 2



One scenario in which Figure 2 may apply is within the private equity industry, where SH is a fund that grants a share-based payment award to employees of a subsidiary of UP. In such cases, it is important to identify the award as being within the scope of IFRS 2 despite it not being granted by an entity within the group (ie SH is a shareholder of a group entity but is not a group entity itself).

How is a group share-based payment arrangement accounted for?

As mentioned in our article, **'Insights into IFRS 2 – Classification of share-based payment transactions and vesting conditions'**, to determine the appropriate accounting treatment, share-based payment transactions must be classified as either an equity-settled transaction or a cash-settled transaction. The classification of group share-based payment transactions requires an entity to assess:

- the nature of the awards granted, and
- its own rights and obligations.

The classification depends on whether the assessment is made from the perspective of the group entity receiving the goods or services or the group entity settling the share-based payment transaction. This is an important concept when it comes to dealing with group share-based payments as the amount recognised by the entity receiving the goods or services may differ from the amount recognised by the consolidated group or by another group entity settling the share-based payment transaction.

Receiving entity

The entity receiving the goods or services (the receiving entity) measures the goods or services received as an equity-settled share-based payment transaction when:

- the awards granted are its own equity instruments, or
- the entity has no obligation to settle the share-based payment transaction.

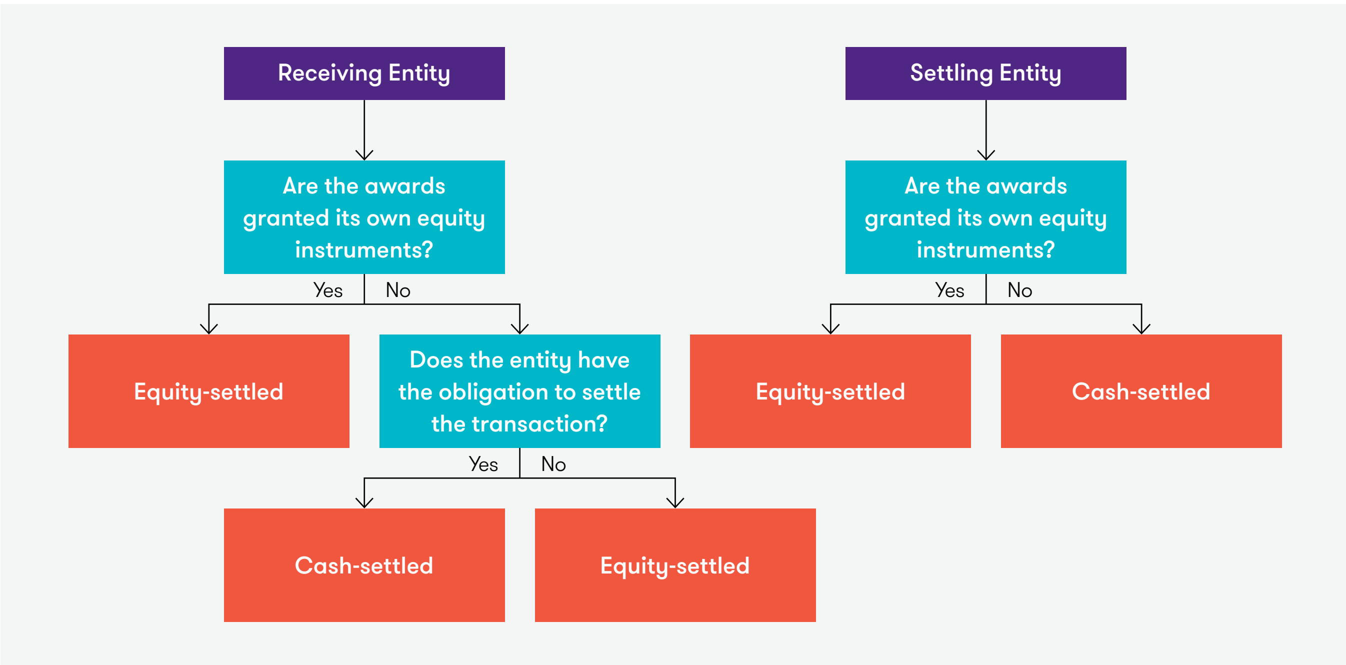
In all other circumstances, the receiving entity measures the goods or services received as a cash-settled share-based payment transaction. For example, if a subsidiary grants a share-based payment award to its employees that will be settled in the equity of its parent, and the subsidiary is responsible for settling the award, then the subsidiary will classify the transaction as cash-settled because (a) it is obligated to settle the award and (b) the award will not be settled in the subsidiary's own equity but in the equity of its parent.

All of the terms and conditions of an arrangement must be considered when determining its classification. For example, a grant of shares that are redeemable either mandatorily or at the employee's option is a cash-settled share-based payment arrangement because the entity may be obligated to ultimately settle in cash. Another scenario is where an entity, at the time of granting an award to be settled in its own equity instruments to its employees, simultaneously issues those employees put options to sell the shares back to the entity (ie as a liquidity option for the employees). The existence of a cash alternative affects the classification of such arrangements (see **'Insights into IFRS 2 – Classification of share-based payment transactions and vesting conditions'** for assessing cash alternatives).

Settling entity

The entity settling a share-based payment transaction when another entity in the group receives the goods or services (the settling entity) recognises the transaction as an equity-settled share-based payment transaction only if it is settled in the entity's own equity instruments. Otherwise, the transaction should be recognised as a cash-settled share-based payment transaction.

The following summarises the requirements:



Once the group share-based payment transactions are classified as either equity-settled or cash-settled transactions, the accounting follows the methods described in our articles, **'Insights into IFRS 2 – Equity-settled share-based payment arrangements with employees'** and **'Insights into IFRS 2 – Cash-settled share-based payment arrangements with employees'**.

Example 1: Equity-settled group share-based payment

Subsidiary A (SA) grants a share-based payment award to its employees whereby the employees will receive shares of its parent company, PA. There are 100 employees and they will each receive 10 shares, assuming that they remain employed within the group for one year. PA will settle the award with SA's employees. At the grant date, the fair value of each share is CU5.

All 100 employees remain employed by SA at the end of one year.

Analysis

Subsidiary's Separate Financial Statements

SA has received services from employees in exchange for PA's equity instruments. In addition, SA does not have an obligation to settle the award as PA will deliver the shares used to settle the award to SA's employees. As a result, the transaction is classified as equity-settled. During the year, SA recognises a share-based payment expense at the grant date fair value, with the credit recognised in equity. The credit to equity is treated as a capital contribution from the parent since SA's employees are being compensated by PA.

Dr.	Expense	CU5,000	(100 employees x 10 shares x CU5 × 1/1 year)
	Cr.	Equity	CU5,000

Parent's Separate Financial Statements

PA classifies the transaction as equity-settled because it is obligated to settle the award with its own equity instruments. However, PA has not received services in exchange for its equity instruments since no employees are providing services directly to PA. In our view, there is no share-based payment expense recognised. Instead, the debit is recognised over the year as an increase in PA's investment in SA (representing a capital contribution from the parent), with a credit recognised in equity. Because the transaction is equity-settled, the amount recognised is based on the grant date fair value of the award.

Dr.	Investment in SA	CU5,000	
	Cr.	Equity	CU5,000

Consolidated Financial Statements

The overall consolidated group has received services in exchange for equity instruments of the group. As a result, the transaction is classified as equity-settled and a share-based payment expense at the grant date fair value is recognised in the consolidated financial statements during the year, with a credit recognised in equity.

Dr.	Expense	CU5,000	
	Cr.	Equity	CU5,000

Example 2: Cash-settled group share-based transaction

Subsidiary B (SB) grants a share-based payment award to its employees that will be settled in cash by its parent company, PB. PB will pay cash to SB's employees equivalent to the difference between PB's share price on vesting and PB's share price at the grant date. There are 100 employees and they will each receive 10 awards, assuming that they remain employed within the group for one year. The fair value of each award is CU5 on the grant date, and therefore the grant date fair value of the overall award is CU5,000 (100 employees x 10 awards x CU5).

All 100 employees remain employed by SB at the end of the one-year service period. The fair value of the overall award is CU7,000 on the vesting date.

Analysis

Subsidiary's Separate Financial Statements

SB has received services in exchange for PB's cash payments, which are based on the price of the PB's equity instruments, and SB does not have an obligation to settle the award. As a result, the transaction is classified as equity-settled, and a share-based payment expense at the grant date fair value is recognised over the year, with the credit recognised in equity. The credit to equity is treated as a capital contribution from the parent since SB's employees are being compensated by PB.

Dr.	Expense	CU5,000	(100 employees x 10 awards x CU5 × 1/1 year)
	Cr.	Equity	CU5,000

Parent's Separate Financial Statements

This transaction is classified as cash-settled since PB will be settling the award in cash. However, PB has not received services in exchange for the arrangement to make cash payments based on the price of its equity instruments. In our view, the transaction should first be recognised over the year as an increase in PB's investment in SB (representing a capital contribution from the parent) at the grant date fair value of CU5,000, with the credit recognised as a liability.

The liability is then remeasured at each reporting date until settlement. In our view, PB should develop an accounting policy on where to recognise the other side of the remeasurement. Some approaches observed in practice include (i) as an addition to the cost of its investment in SB, or (ii) in profit or loss.

Dr.	Investment in SB	CU5,000	
Dr.	Expense or Investment in SB	CU2,000	(depending on PB's accounting policy)
	Cr.	Liability	CU7,000

Even after a cash-settled share-based payment award has vested, the liability continues to be remeasured until it has been settled.

Consolidated Financial Statements

The share-based payment is classified as cash-settled from a consolidated perspective, because the group has an obligation to pay cash. The overall group has received services for the cash payments that are based on the price of the group's equity instruments. As a result, a share-based payment expense is recognised over the year, with the credit recognised as a liability. The liability is remeasured at each reporting date until settlement. Below is the cumulative journal entry recognised over the one-year vesting period.

Dr.	Expense	CU7,000	
	Cr.	Liability	CU7,000

Even after a cash-settled share-based payment award has vested, the liability continues to be remeasured until it has been settled.

As a reminder, once the classification of the group share-based transaction is determined (ie equity-settled transaction vs cash-settled transaction), the transaction is accounted for over the vesting period as the employee provides the service, consistent with the normal requirements of IFRS 2 for accounting for equity-settled or cash-settled transactions. Note that in Example 2 above, the measurement of the transaction differs depending on whether the transaction is being accounted for in the subsidiary's financial statements or parent's financial statements, as a result of the different classifications:

- In Subsidiary B's separate financial statements, the group share-based payment is classified as equity-settled. As explained in our article **'Insights into IFRS 2 – Equity-settled share-based payment arrangements with employees'**, equity-settled transactions are measured at the grant date fair value, and then only the number of units that are expected to, and ultimately do vest, are adjusted to reflect the effect of service conditions or non-market performance conditions (in this case, any employee forfeitures or departures during the one-year service period). In other words, Subsidiary B does not change the measurement of the share-based payment from the grant date fair value of CU5 per award.
- In the parent's separate financial statements as well as in the group's consolidated financial statements, the same group share-based payment is classified as cash-settled. As explained in our article **'Insights into IFRS 2 – Cash-settled share-based payment arrangements with employees'**, cash-settled transactions are adjusted for changes in fair value throughout the vesting period and for the actual outcome of vesting and non-vesting conditions. As a result, in Example 2, due to classifying the award as a cash-settled transaction, the parent and the consolidated group must remeasure the liability throughout the vesting period. At the vesting date, the cash-settled share-based is remeasured to the then fair value of CU7,000. If the award is not settled on that date, the liability must continue to be remeasured until it is settled.

It is also important to note that the above are only examples of some potential group arrangements, and that many different scenarios are possible. For example, a subsidiary may grant its parent's equity to its employees and have the obligation to settle the transaction itself. The subsidiary would account for such a share-based payment award as cash-settled, regardless of how the subsidiary obtains the instruments to settle the award.

How does an entity account for intragroup repayment arrangements?

Some group transactions include repayment arrangements in which one group entity is required to pay another group entity for providing share-based payments to its employees. For example, a parent company may charge a subsidiary for the equity instruments or cash that it provided to the subsidiary's employees. In these situations, the receiving entity accounts for the share-based payment transaction in accordance with the guidance discussed above, regardless of whether an intragroup repayment arrangement exists. In other words, the receiving entity should classify the transaction as equity-settled or cash-settled without considering the intragroup repayment arrangement. In the previous example, the existence of an intragroup repayment arrangement requiring a subsidiary to reimburse its parent for the cost of granting the awards does not mean – for the purpose of classifying the group share-based payment arrangement – that the subsidiary has the obligation to settle the award to its employees.

IFRS 2 does not address the accounting treatment for intragroup repayment arrangements. In our view, the entities should first assess whether the repayment arrangement is directly related to the share-based payment. For example, entities may consider repayment arrangements where the amount of the repayment is based on the value of the share-based payment (eg repayment is based on the grant-date fair value of an equity-based share-based payment) to be directly related. This assessment will depend on facts and circumstances and may vary by arrangement and jurisdiction.

When repayment arrangements are not directly related to the share-based payment, our view is that it is more appropriate for the subsidiary to recognise an expense for the repayment arrangement (note that this would result in a debit to expense in the subsidiary for both the IFRS 2 share-based payment expense and the repayment).

In contrast, our view is that repayment arrangements that are directly related to the share-based payment should be accounted for in the separate financial statements (ie parent and subsidiary in the above example) as an adjustment to the capital contribution recognised from the share-based payment. When the repayment arrangement is directly related to the share-based payment and the intragroup repayment charge exceeds the capital contribution recognised in respect of the share-based payment, the entity should develop an accounting policy to account for the excess. Some approaches observed in practice are as follows:

Parent's separate financial statements:

1 the excess is credited to the income statement of the parent as dividend income, or
2 the excess is credited against the investment in the subsidiary (ie applies even if the repayment amount exceeds the capital contribution(s) previously debited to the investment in the subsidiary for the share-based payment).

Subsidiary's separate financial statements:

1 the excess is expensed (ie the full amount of the repayment arrangement is expensed, in addition to the expense related to the share-based payment), or
2 the excess is debited to reduce other equity.

There is also no specific guidance under IFRS 2 on the timing of when the entity receiving the services should recognise intragroup repayment arrangements. As a result, an entity should determine an appropriate accounting policy, which may consider the following:

1 when the intra-group repayment arrangement is more formal (ie contractual), it may be more appropriate to recognise the repayment arrangement over the vesting period, if any, of the share-based payment to which it is directly related, starting from when the parties have a shared understanding of the terms and conditions of the repayment arrangement (often when the parent and subsidiary entered into the contractual arrangement), or
2 when the intra-group repayment arrangement is informal (ie non-contractual) and thus potentially not binding until payment is made, it may be more appropriate to recognise the repayment arrangement when the repayment is charged or due.

Example 3: Intragroup repayment arrangement

Subsidiary C (SC) grants a share-based award to its CEO on January 1, 20X3. The CEO receives 1,000 options to purchase shares in SC's parent company (PC) for an exercise price of CU27, subject to remaining employed by SC at the end of one year (January 1, 20X4). PC will settle the award with SC's CEO. On March 15, 20X3, PC and SC also enter into a repayment arrangement whereby SC will reimburse PC for the options at their value on the grant date. The award is classified as follows in each entity's separate financial statements (as noted above, the repayment arrangement is not included in this classification assessment):

- SC classifies the transaction as equity-settled because it will receive services from its CEO in exchange for the award, but it does not have an obligation to settle the award to the CEO, and
- PC classifies the transaction as equity-settled because it has the obligation to settle the award with its own equity instruments.

The CEO provides the required service and remains employed by SC on January 1, 20X4. The recharge payment is made on the vesting date of January 1, 20X4, and the CEO also exercises the options on the same date. The values of the options and the price of PC's shares are as follows:

Date	Share Price (CU)	Option Value (CU)
January 1, 20X3	27	10
January 1, 20X4	30	5

Analysis

The journal entries to recognise the share-based payment transaction are as follows:

Parent's Separate Financial Statements

December 31, 20X3: Recognise the share-based payment transaction and repayment arrangement

Dr.	Investment in SC	CU10,000	(1,000 options x CU10 × 1/1 year)
	Cr.	Equity	CU10,000

Dr.	Due from SC	CU10,000	
	Cr.	Investment in SC	CU10,000

January 1, 20X4: Recognise the receipt of cash for the repayment arrangement and the receipt of the exercise price

Dr.	Cash	CU10,000	
	Cr.	Due from SC	CU10,000

Dr.	Cash	CU27,000	(1,000 options x CU27)
	Cr.	Equity	CU27,000

Subsidiary's Separate Financial Statements

December 31, 20X3: Recognise the share-based payment transaction and repayment arrangement

Dr.	Expense	CU10,000	
	Cr.	Equity	CU10,000

Dr.	Equity	CU10,000	
	Cr.	Due to PC	CU10,000

January 1, 20X4: Recognise the payment of cash for the repayment arrangement

Dr.	Due to PC	CU10,000	
	Cr.	Cash	CU10,000

How does an entity account for transfers of employees between group entities?

When a share-based payment arrangement has a service condition that references a group rather than a particular entity, employees may sometimes transfer between different entities in the group during the vesting period. For example, a parent may grant an award to an employee of one of its subsidiaries that is subject to remaining employed by the group for a specified period. As a result, the employee may transfer employment from one subsidiary to another without affecting the service condition.

As discussed previously, if the subsidiaries have no obligation to settle the transaction, then the arrangement is classified as an equity-settled transaction. Each subsidiary will measure the services received by the employee at the grant date fair value of the award, for the portion of the vesting period that the employee served with each subsidiary.

If the subsidiaries have an obligation to settle the transaction in the parent's equity instruments, then the arrangement is classified as a cash-settled transaction. Each subsidiary measures the services received by the employee at the grant date fair value of the award for the portion of the vesting period that the employee was employed by that subsidiary, and recognises any change in fair value of the award during the employee's service period with each subsidiary.

If an employee that has transferred between group entities fails to meet a vesting condition other than a market condition (eg the employee leaves the group before completing the service condition), each subsidiary adjusts the amount previously recognised in accordance with the principles discussed in our article **'Insights into IFRS 2 – Equity-settled share-based payment arrangements with employees'**. This is because the vesting condition is service to the group.

How we can help

We hope you find the information in this article helpful in giving you insight into aspects of IFRS 2. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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