

## ASSURANCE AND ACCOUNTING

# CANADIAN GAAP – IFRS COMPARISON SERIES

### Issue 14: Share Based Payments

Both IFRS and Canadian GAAP are principle based frameworks, and from a conceptual standpoint, many of the general principles are the same. However, the application of those general principles in IFRS can be significantly different from Canadian GAAP. Therefore, to understand the magnitude of the differences between IFRS and Canadian GAAP, it is essential to look beyond the general principles and look at the detailed guidance provided in the standards. This is our fourteenth issue in a series of publications, which will provide detailed information on the key differences between IFRS and Canadian GAAP.

In this issue, share-based payment accounting will be presented with focus on:

- Recognition and measurement of share-based transactions with employees;
- Recognition and measurement of share-based transactions with non-employees;
- Measurement and Presentation; and
- IFRS1 first time adoption and transition issues.

#### Background

A share-based payment is a transaction in which the entity receives or acquires goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity. The accounting requirements for the share-based payment under Canadian GAAP and IFRS depend on how the transaction will be settled, that is, by the issuance of (a) equity, (b) cash, or (c) equity or cash.

#### Scope

Both Canadian GAAP and IFRS apply to share-based payment transaction for the acquisition of goods and services and both have similar exclusions from the scope of their respective standards. However, there are differences in the exclusions between standards which may result in more transactions being accounted for as share-based payment transactions.

#### References

IFRS 2: Share-Based Payment  
Section 3870 Stock-based compensation and other stock-based payments and EIC 162 Stock Based Compensation for Employees Eligible to Retire before the Vesting Date.  
Be advised that this publication is a guide to the differences between Canadian GAAP and IFRS and is not meant to be a comprehensive manual. Please contact a BDO representative for specific details and information.



CANADIAN GAAP	IFRS
<p>Section 3870 does not apply to related party transactions, other than stock-based compensation plans with a principal shareholder. Related party transactions are accounted for in accordance with Section 3840 Related Party Transactions, however, management compensation arrangements are excluded from the scope of Section 3840 and therefore, management stock compensation arrangements are included in this Section.</p>	<p>No scope exemption for related party transactions is included in IFRS 2, other than for shareholders acting in their capacity as shareholders.</p>
<p>Section 3870 does not apply to equity instruments granted by an acquiring enterprise as part of the purchase consideration in a business combination, which are accounted for in accordance with Section 1581 (soon to be Section 1582) Business Combinations.</p>	<p>Like Canadian GAAP, IFRS 2 does not apply to transactions in which the entity acquires goods as part of the net assets acquired in a business combination to which IFRS 3 Business Combinations applies.</p> <p>However, IFRS 2 is more explicit than Canadian GAAP in that it contains specific guidance on equity instruments granted to employees of the acquiree in their capacity as employees (e.g. in return for continued service). These are within the scope of IFRS 2.</p> <p>The cancellation, replacement or other modification of share-based payment arrangements because of a business combination or other equity restructuring are also explicitly included within the scope of IFRS 2.</p>
<p>An employee stock purchase plan that provides a discount to employees that does not exceed the per share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering and is not extended to other holders of the same class of shares is not a compensation expense.</p> <p>Instead the discount from market price reduces the proceeds from issuing the related shares of stock.</p>	<p>This type of employee share-based purchase plan would result in a compensation expense.</p>

### Transactions with Non-Employees

The recognition and measurement of share-based payment transactions with non-employees is similar under Canadian GAAP and IFRS. Generally measurement is by way of fair value. However, there are differences, which may be significant for some entities in how the fair value of the transaction are measured when accounting using Canadian GAAP or IFRS.

Recognition and Measurement	
<p>Reciprocal transactions in which an enterprise acquires goods and services by granting equity instruments or by incurring liabilities to the supplier (other than an employee) in amounts based on the price of the enterprise's stock should be accounted for based on the more reliably measurable of:</p> <ul style="list-style-type: none"> <li>• The fair value of the consideration received;</li> <li>• The fair value of the equity instruments; or</li> <li>• Liabilities incurred.</li> </ul> <p>Usually the fair value of the equity instruments is used to measure a transaction when tradable equity instruments are granted to purchase goods and services. When non-tradable equity instruments are granted, the fair value of the goods or services received or of the equity instruments is used, depending on which is more reliably measurable.</p>	<p>Transactions with non-employees are measured at the fair value of the goods and services received unless that fair value cannot be estimated reliably.</p> <p>Only in rare cases where the entity cannot estimate reliably the fair value of the goods or services received, is the entity permitted to measure the goods or services received indirectly, by reference to the fair value of the equity instruments granted.</p> <p>Canadian GAAP does not include a rebuttable presumption that the fair value of the goods or services received can be estimated reliably.</p> <p>Therefore, this is a significant difference and may have a significant impact on entities purchasing goods and services through share-based payments.</p>

The fair value of the equity instruments issued in exchange for the receipt of goods and services from non-employees is measured by using the stock price and other measurement assumptions as of the earliest of the following:

- The date at which the non-employee's performance is complete;
- The date at which a commitment for performance by the non-employee to earn the equity instruments is reached (a performance commitment); or
- The date at which the equity instruments are granted, if they are fully vested and non-forfeitable at that date.

The measurement date for non-reciprocal transfers, is the later of:

- The date on which the detailed terms of the transfer are set; and
- The date at which the enterprise is committed to the transfer.

In addition, Section 3870 has specific guidance on how such transactions are to be measured if market and performance conditions exist.

For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

#### Cash or Equity Settled Transactions with Non-employees

Reciprocal transactions in which an enterprise acquires goods and services by granting equity instruments or by incurring liabilities to the supplier (other than an employee) in amounts based on the price of the enterprise's stock should be accounted for based on the more reliably measurable of:

- The fair value of the consideration received;
- The fair value of the equity instruments; or
- Liabilities incurred.

For share-based payments where the recipient has a choice of settlement, in cash or issuing equity instruments, the entity has granted a compound financial instrument.

For transactions with non-employees, the entity measures the equity component as the difference between the fair value of the goods or services received and the fair value of the debt component, at the date when the goods or services are received.

#### Transactions with Employees

Canadian GAAP and IFRS have similar requirements for accounting for transactions with employees. However, there are differences. For example, Canadian GAAP requirements for transactions with employees are only applied to those that are seen to be employees under law. IFRS requirements are different in that the requirements for transactions with employees may also be applied to transactions with non-employees as defined in IFRS. Other differences in accounting for transactions with employees are:

#### Definition of Employee

An employee of an enterprise is an individual over whom the enterprise exercises or has the right to exercise sufficient control to establish an employer-employee relationship as determined by law.

The definition of employee is broader than that in Canadian GAAP. Employees are defined as individuals who render personal services to the entity and either:

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

For example, the term encompasses all management personnel, (i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors).

### Cash Settled Transactions with Employees

Cash-settled share-based payment transactions with employees are measured at intrinsic value at the grant date (i.e. the amount by which the quoted market value of the shares of the enterprise's stock covered by the grant exceeds the option price or value specified, by reference to a market price or otherwise, subject to any appreciation limitations under the plan).

For cash-settled share-based payment transactions with employees, the entity measures the goods or services acquired and the liability incurred at the fair value of the liability at the grant date.

Until the liability is settled, the fair value of the liability is required to be remeasured at the end of each reporting period and at the date of settlement. The remeasurement is performed by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted and the extent to which the employees have rendered service to date.

Any changes in fair value are recognized in profit or loss for the period.

### Cash or Equity Settled Transactions with Employees

In general, Canadian GAAP requires transactions settled in equity instruments to be classified as equity settled awards and other transactions to be classified as cash or liability settled awards.

If the holder can choose the method of settlement (cash or equity) the award is treated as if it were cash settled.

Different accounting requirements exist for share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

If the entity has a choice to settle in cash or equity instruments, the entity needs to look at the substance of the arrangement to determine the accounting treatment (i.e. is a liability or equity created).

For share-based payments where the issuer with the choice in whether to settle in cash or by issuing equity instruments the entity needs to determine whether it has a present obligation to settle in cash. If this is cash the entity accounts for the transaction in accordance with the requirements applying to cash-settled share-based payment transactions.

If no such obligation exists, the entity accounts for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions.

A present obligation to settle in cash arises where:

- The choice of settlement in equity instruments has no commercial substance (e.g. because the entity is legally prohibited from issuing shares); or
- The entity has a past practice or a stated policy of settling in cash, or generally settles in cash whenever the counterparty asks for cash settlement.

For awards that call for settlement in cash or other assets, including stock appreciation rights, compensation cost is measured as the amount by which the quoted market value of the shares covered by the grant exceeds the option price or value specified, by reference to a market price or otherwise, subject to any appreciation limitations under the plan.

Increases or decreases, in the quoted market value of those shares between the date of grant and the measurement date result in a change in the measure of compensation for the right or award.

Compensation cost accrued during the service period should not be adjusted below zero.

Changes in the amount of the liability due to stock price changes after the service period are recognized as compensation cost of the period in which the changes occur.

#### Minimum Value method

In estimating the fair value of its options granted to employees, the expected volatility of its stock over the expected life of the option is required to be considered only for an entity:

- Whose equity securities are traded in a public market;
- That makes a filing with a securities commission in preparation for the sale of any class of equity securities in a public market; or
- That is controlled by an enterprise covered by (a) or (b).

Entities not within these required have a choice to include expected volatility, or to exclude it.

The result of excluding volatility in estimating an option's value is an amount commonly termed minimum value.

#### Vesting

The compensation cost for a stock-based award to employees should be recognized over the period in which the related employee services are rendered, by a charge to compensation cost if the award is for future service.

If the service period is not defined as an earlier or shorter period, the service period should be presumed to be the period from the grant date to the date that the award is vested and its exercisability does not depend on continued employee service.

If an award is for past services, the related compensation cost should be recognized in the period in which it is granted. Where the award consists of equity instruments, the offsetting entry is to shareholders' equity.

Where the recipient has a choice of settlement, in cash or issuing equity instruments, the entity has granted a compound financial instrument.

The entity measures the fair value of the compound financial instrument at the measurement date, taking into account the terms and conditions on which the rights to cash or equity instruments were granted (e.g. the entity first measures the fair value of the debt component, and then measures the fair value of the equity component-taking into account that the counterparty must forfeit the right to receive cash in order to receive the equity instrument).

The expected volatility is required to be included in the valuation of options granted to employees.

Therefore, impact of this difference in Canadian GAAP and IFRS requirements will be limited to entities that were permitted under Canadian GAAP not to include volatility.

If the equity instruments granted to employees do not vest until a specified period of service is completed, the entity presumes that the services will be received in the future, during the vesting period.

The entity accounts for those services as they are rendered during the vesting period, with a corresponding increase in equity.

<p>At the grant date an entity may choose when / how to accrue the compensation cost.</p> <p>An enterprise may choose at the grant date to base accruals of compensation cost on the best available estimate of the number of options or other equity instruments that are expected to vest and to revise that estimate, if necessary, if subsequent information indicates that actual forfeitures are likely to differ from initial estimates.</p> <p>Alternatively, an enterprise may begin accruing compensation cost as if all instruments granted that are subject only to a service requirement are expected to vest. The effect of actual forfeitures would then be recognized as they occur.</p>	<p>IFRS provides no choice of how the compensation cost is accrued.</p> <p>An entity is required to recognize an expense over the vesting period based on the best available estimate of the number of equity instruments expected to vest.</p> <p>The estimate is revised, if necessary and if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.</p> <p>On vesting date, revise the estimate to equal the number of equity instruments that ultimately vested.</p>
<p>A choice exists when accounting with respect to graded vesting. An entity can:</p> <ul style="list-style-type: none"> <li>• Treat each installment as separate awards; or</li> <li>• Treat as one award and determine fair value using the average life of the instrument. Compensation cost is recognized on a straight-line basis over the life of the instrument.</li> </ul>	<p>IFRS does not include any option with respect to graded vesting.</p> <p>The entity must treat each installment as its own award. Therefore, each installment is measured and recognized separately.</p>
<p><b>Modifications</b></p>	
<p>A modification of the terms of an award that makes it more valuable should be treated as if it were an exchange of the original award for a new award. The incremental value should be recorded as additional cost and measured by the difference between:</p> <ul style="list-style-type: none"> <li>• The fair value of the modified option determined in accordance with the provisions of this Section; and</li> <li>• The value of the old option immediately before its terms are modified, determined based on the shorter of: <ul style="list-style-type: none"> <li>• Its remaining expected life; or</li> <li>• The expected life of the modified option.</li> </ul> </li> </ul>	<p>Similar to Canadian GAAP, an entity must recognize the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. However, where the additional compensation cost is recorded depends on when the modification occurs.</p> <p>If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognized for services received over the period from the modification date until the date when the modified equity instruments vest.</p> <p>If the modification occurs after vesting date, the incremental fair value granted is recognized immediately, or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.</p>
<p><b>Cancellations</b></p>	
<p>The requirements under Canadian GAAP and IFRS are similar although IFRS provides more guidance than Canadian GAAP.</p>	

### Transition for First Time Adopters

At the date of transition to IFRS, an entity must retrospectively apply IFRS 2. However, some relief from retrospective application is provided to entities in IFRS 1 First-time Adoption of International Financial Reporting Standards (IFRS 1).

In the case of share-based payments, IFRS 1 provides different options in how to apply IFRS 2 for the first time. Effectively IFRS 1 allows an entity to:

- Elect to apply IFRS retrospectively to all share-based payment transactions occurring before the date of transition to IFRS; or
- Elect not to apply retrospective treatment to the following:
  - Equity instruments granted on or before November 7, 2002;
  - Equity instruments granted after November 7, 2002 that vested before the date of transition to IFRS; or
  - Liabilities arising from share-based payment transactions that were settled before the date of transition to IFRS.

The key date for the IFRS 1 election is November 7, 2002, which is earlier than the transitional date of January 1, 2004 for employee stock options in Section 3870. Therefore, if an entity decided to use the prospective application option when Section 3870 was implemented in 2004 and the entity does not want to apply retrospective treatment for items granted before January, 2004, they will need to use the option of not applying IFRS 2 to instruments which have already vested prior to the date of transition.

In addition, it is important to note that an entity is permitted to use the retrospective treatment beyond the transition date if, and only if, they have previously disclosed publicly the fair value of those instruments.

### The Future

The International Accounting Standards Board (IASB) in 2009 issued amendments to IFRS 2 to clarify the accounting requirements with respect to group cash-settled share-based payment arrangements. The amendments to IFRS 2 also incorporated guidance previously included in IFRIC 8 Scope of IFRS 2; IFRIC 11, IFRS 2 – Group and Treasury Share Transactions. Subject to certain transitional provisions these amendments are effective for annual periods beginning on or after January 1, 2010.

### Conclusion

In general, the principles relating to accounting for share-based payment transactions under Canadian GAAP and IFRS have a lot of similarities. However, when looking at the details of each standard there are some significant differences which an entity needs to be aware of and needs to evaluate the impact of moving to IFRS.

If you require further guidance on share-based payment transactions under IFRS or any other IFRS information or reference sources, please contact your local BDO Canada LLP office or visit [www.bdo.ca/ifrs](http://www.bdo.ca/ifrs).

---

The information in this publication is current as of January 1<sup>st</sup>, 2010.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO Canada LLP, a Canadian limited liability partnership, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms.