

Insights into IFRS 2

Share-based payment transactions with non-employees

IFRS 2 ‘Share-based payment’ is not a new Standard, however arrangements involving such transactions are becoming increasingly complex. As such, reporting entities often have difficulties in applying the Standard to their particular arrangements.

Share-based payment transactions with non-employees involve compensating parties other than employees such as suppliers of goods and services. These transactions require careful accounting to measure and recognise the fair value of goods or services received, with different approaches depending on the method of the settlement.

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 explained in our article **‘Insights into IFRS 2 – What is IFRS 2?’**, IFRS 2 applies to a range of situations as follows:

Employees are granted shares or other equity instruments (eg share options) in exchange for services received

Non-employees (eg external suppliers) are issued or paid in shares or other equity instruments, in exchange for goods or services received

Suppliers or employees are paid in cash (or other assets) in exchange for goods or services received, where the amount of the payment is based on the price of equity instruments (eg cash share appreciation rights)

As explained in our article, **‘Insights into IFRS 2 – Classification of share-based payment transactions and vesting conditions’**, a share-based payment transaction must be classified as either an equity-settled transaction or a cash-settled transaction. This applies to both share-based payments with employees and with non-employees.

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What is the definition of a non-employee?

As explained in our article, **'Insights into IFRS 2 – Basic principles of share-based payment arrangements with employees'**, employees are defined as:

Employees or others providing similar services:

Individuals who render personal services to the entity and either:

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

'Employees and others providing similar services' also encompasses all management personnel, ie those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors.

IFRS 2 does not directly define non-employees or parties 'other than employees' (hereafter referred to collectively as 'non-employees'), however, any counterparties who do not meet the definition of 'employees or others providing similar services' would be considered non-employees. It is important to consider the substance of the relationship, and not just the legal form. For example, if an entity engages an individual who has incorporated a separate legal vehicle for personal tax purposes to perform services similar to its employees, and the entity directs the work of that individual similarly to how it directs the work of its employees, the individual and the separate legal vehicle through which the individual delivers the personal services would meet the definition of an 'employee or others providing similar services', even though the entity has engaged that individual's corporation. Accounting for share-based payments with employees is addressed in other articles in our **'Insights into IFRS 2'** series.

Accounting for share-based payment transactions with non-employees

General principles

For all share-based payment transactions, whether they are with an employee or a non-employee, an entity recognises the goods or services received when the goods are obtained or as the services are received. When the goods obtained or services acquired do not qualify for recognition as assets, they are recognised as an expense.

Equity-settled share-based payment transactions with non-employees

How are equity-settled share-based payments with non-employees measured?

One of the overall principles in IFRS 2 is that an entity should measure equity-settled share-based payment transactions at the fair value of the goods or services received, unless that fair value cannot be estimated reliably, in which case the value is measured using the fair value of the equity instruments granted instead.

For transactions with non-employees, there is a rebuttable presumption in IFRS 2 that the fair value of the goods or services received can be measured reliably and therefore the share-based payment transaction is measured at the fair value of those goods or services, with a corresponding increase in equity. In rare cases, if this presumption is rebutted because the entity cannot reliably estimate the fair value of the goods or services received, then the goods or services are measured by reference to the fair value of equity instruments granted, similar to the accounting for share-based payments with employees.

The measurement date (ie the date at which the fair value of the equity instruments granted is measured) is the date the entity obtains the goods or the counterparty renders services. If the goods or services are received on more than one date, the fair value should be measured on each date that goods or services are received. The entity should apply that fair value when measuring the goods or services received on that date.

Example 1 – Equity-settled share-based payments with non-employees, measured by reference to service received

On 1 April 20X5, Entity A enters into a contract with Marketing Firm B whereby they will assist Entity A with the introduction of a new product line. In exchange for their marketing services, Marketing Firm B will receive 10,000 shares upon the launch of the product, which is targeted for 30 September 20X5. The fair value of the marketing services is available as Marketing Firm B had originally provided a quote for CU100,000, with a price increase to CU110,000 if the product launches later than 30 September 20X5. This quote was largely consistent with other marketing firms that had responded to Entity A's request for proposal.

Marketing Firm B will render its services continuously throughout the six-month period until the target launch date, regardless of whether the actual launch is delayed. On 1 September 20X5, Entity A decides to delay the product launch until 15 October 20X5.

Analysis

Entity A accounts for the transaction as follows:

Quarter	Journal entry	Dr (CU)	Cr (CU)
Quarter ended 30 June 20X5	Expenses (CU100,000 × 3/6 months) Equity	50,000	50,000
Quarter ended 30 September 20X5	Expenses (CU100,000 × 3/6 months + CU10,000) Equity	60,000	60,000

Note: that the fair value of the share-based payment transaction changes with the value of the services received and is not based on the grant date value of the services of CU100,000.

Example 2 – Equity-settled share-based payments with non-employees, measured by reference to goods received

On 1 January 20X5, Entity Z enters into a contract with one of its vendors to acquire a piece of equipment. Due to cash constraints, Entity Z negotiates with the vendor to issue shares as consideration for the equipment.

On 1 January 20X5, the list price for the equipment is CU50,000 and the market value of Entity Z's shares is CU5 per share, and as such Entity Z agrees to pay for the equipment by issuing 10,000 shares to the vendor upon delivery. The equipment will be delivered on 15 May 20X5.

At the time of delivery on 15 May 20X5, the market value of the equipment was CU50,500 and the market value of Entity Z's shares had increased to CU5.10 per share for a total value of CU51,000.

Analysis

Entity Z accounts for the share-based transaction as follows:

Date	Journal entry	Dr (CU)	Cr (CU)
1 January 20X5	No entry is recorded because the equipment has not been delivered yet	-	-
15 May 20X5	Property, plant and equipment Equity To recognise the equipment received, measured at its fair value on the delivery date	50,500	50,500

In some cases, an approximation may be used. For example, if an entity received services continuously during a three-month period, and the entity is measuring the services by reference to the fair value of the equity instruments granted because the services cannot be measured reliably, then the entity could use the average share price during the period to estimate the fair value of the equity instruments granted if the share price did not vary significantly throughout that period.

Practical insight – Volatile share prices

When the share price fluctuates significantly, the use of an approximation would not be appropriate, and may be an indication that the instruments should not be measured by reference to the equity instruments granted, as it may not produce a more reliable measurement.

Example 3 – Equity-settled share-based payments with non-employees, measured by reference to equity instruments granted

On 1 January 20X5, Entity C enters into an agreement with Consultant D to provide general oversight over the development of Entity C's five-year strategic plan. Consultant D will receive 25,000 shares when the strategic plan is approved by Entity C's Board of directors at their meeting on 30 September 20X5.

Consultant D is not considered an employee for legal or tax purposes and the consulting services are not similar to the work undertaken by any of Entity C's in-house functions. As such, Entity C accounts for this transaction as a share-based payment with a non-employee.

Entity C determines that the fair value of the services cannot be measured reliably and therefore the consulting services are measured by reference to the fair value of the equity instruments granted.

Entity C is a mature company with a relatively stable share price. At the end of each quarter, Entity C reviews its share price performance during the quarter and determines that the share price has not moved significantly. Combined with the fact that Consultant D is rendering services continuously over the period, the average share price can be used to approximate the fair value of the shares.

The average share prices are as follows:

Quarter 1, 20X5	CU5.5
Quarter 2, 20X5	CU6
Quarter 3, 20X5	CU5

The strategic plan is presented to the Board of directors on 30 September 20X5 and is approved.

Analysis

Entity C accounts for the share-based transaction as follows:

Quarter	Journal entry	Dr (CU)	Cr (CU)
1	Expenses (25,000 × CU5.5 × 3/9 months) Equity	45,833	45,833
2	Expenses (25,000 × CU6 × 3/9 months) Equity	50,000	50,000
3	Expenses (25,000 × CU5 × 3/9 months) Equity	41,667	41,667

How should unidentifiable goods or services be measured?

In some cases, it may be difficult to demonstrate that goods or services have been, or will be, received by the entity granting the share-based payment. For example, an entity may issue shares to a charitable organisation as a donation, and no goods or services will be received in return.

In other situations, the fair value of the equity instruments granted to non-employees or the liability incurred may appear to exceed the fair value of the goods or services received, both measured at the grant date. If the identifiable consideration received by the entity, if any, appears to be less than the fair value of the equity instruments granted or the liability incurred, this is often an indication that some other consideration (ie an unidentifiable good or service), has been received by the entity. At the grant date, an entity should measure the unidentifiable goods or services as the difference between the fair value of the equity instruments and the fair value of any identifiable goods or services received (or to be received).

Unidentifiable goods or services are recognised when the goods are obtained or as the services are received, in accordance with the general recognition principles noted above for identifiable goods or services (ie when the goods obtained or services acquired do not qualify for recognition as assets, they are recognised as an expense).

Example 4 – Unidentifiable goods or services

Entity E granted shares with a total fair value of CU100,000 to non-employees who are from a particular section of the community (historically disadvantaged individuals), as a means of enhancing its image as a good corporate citizen. The economic benefits derived from enhancing its corporate image could take a variety of forms, such as increasing its customer base, attracting or retaining employees, or improving or maintaining its ability to tender successfully for business contracts.

Analysis

Entity E cannot identify the specific consideration received. For example, no cash was received and no service conditions were imposed. Therefore, the identifiable consideration (nil) is less than the fair value of the equity instruments granted (CU100,000).

Although Entity E cannot identify the specific goods or services received, the circumstances indicate that goods or services have been (or will be) received, and therefore IFRS 2 applies.

In this situation, because Entity E cannot identify the specific goods or services received, the presumption under IFRS 2 – that the fair value of goods or services received from non-employees can be estimated reliably – is rebutted. Entity E should instead measure the goods or services received by reference to the fair value of the equity instruments granted.

How are modifications to the terms and conditions accounted for?

An entity might modify the terms and conditions on which the equity instruments were granted. Modifications to share-based payment transactions with non-employees that are measured by reference to the fair value of the equity instruments granted are accounted for in the same manner as modifications to terms and conditions to equity instruments granted to employees.

For further information on accounting for modifications, refer to our article '[Modifications of share-based payment arrangements with employees](#)'.

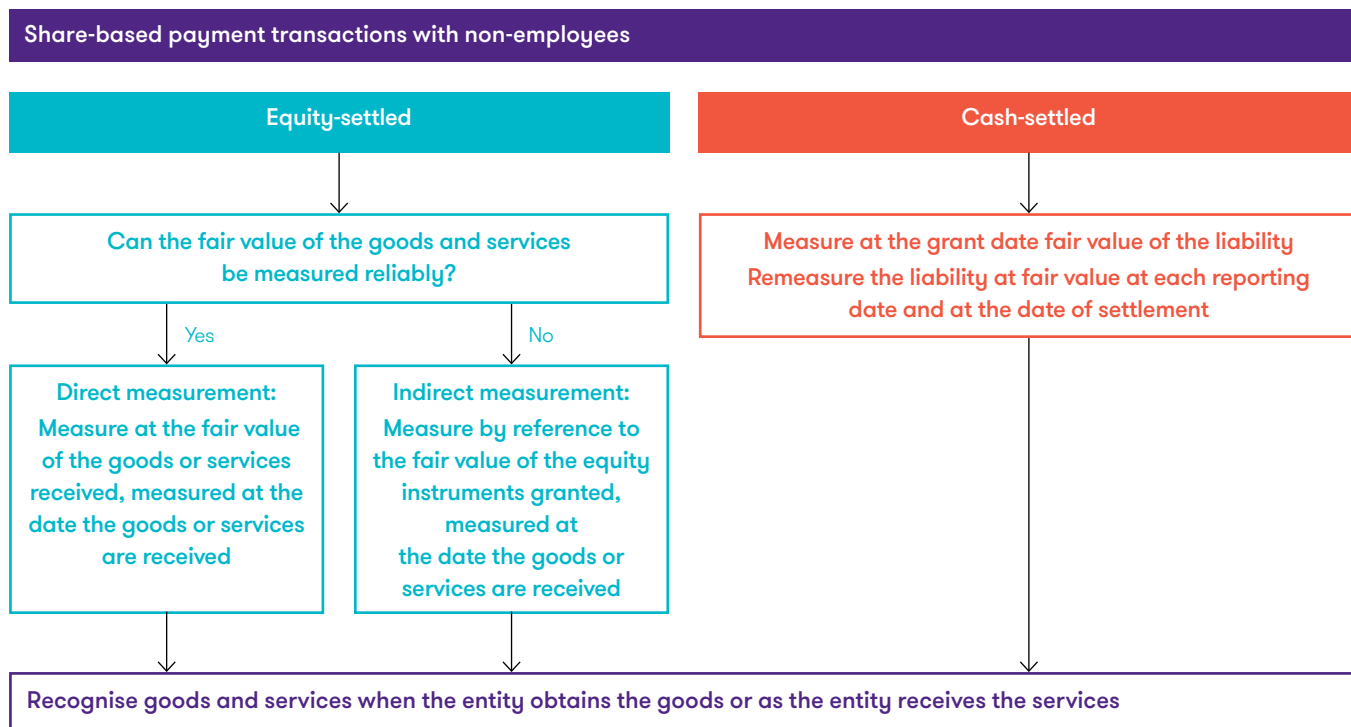
Cash-settled share-based payment transactions with non-employees

How are cash-settled share-based payments with non-employees measured?

For cash-settled share-based payment transactions with non-employees, the goods or services received and the liability incurred are measured at the fair value of the liability, first at the grant date. The liability is then remeasured at each reporting date and ultimately at the settlement date, with any changes in fair value being recognised in profit or loss for the period. This treatment is consistent with the accounting for cash-settled share-based payment transactions with employees. For further information on accounting for cash-settled share-based payment transactions with employees, refer to our article '[Insights into IFRS 2 – Cash-settled share-based payment arrangements with employees](#)'.

Summary of share-based payment transactions with non-employees

The flowchart below summarises the recognition and measurement of share-based payment transactions with non-employees:



When equity-settled share-based payments with non-employees are indirectly measured by reference to the fair value of the equity instruments granted, and this exceeds the identifiable consideration received, this often indicates that other unidentifiable goods or services have been or will be received by the entity and will need to be recognised.

How we can help

We hope you find the information in this article helpful in giving you some detail 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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