Swiss GAAP FER

‘Share-based payments’

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Table of Contents

Introduction

The increased use of Swiss GAAP FER, also by groups with a global reach, and the frequent use of share-based payments as form of employee remuneration has led to many questions on how to account for such arrangements. FER 31 'Complementary Recommendations for listed entities' only includes limited guidance for listed companies.

This publication provides answers to questions that, in our experience, arise frequently when assessing the accounting for share-based payment arrangements in accordance with Swiss GAAP FER. Such arrangements vary from entity to entity and typically include a variety of different clauses. A special focus lies on examples to practical challenges that Swiss GAAP FER preparers might encounter.

Entities must carefully assess whether the guidance provided in this publication is applicable to their specific facts and circumstances. This brochure does not reflect all provisions included in Swiss GAAP FER. It is a collection of questions that arose or are likely to arise in practice and approaches how to solve those questions that are, in our view, in-line with the principles outlined in Swiss GAAP FER. For significant transactions or items, we recommend consulting the official Swiss GAAP FER standards as well as seeking professional advice. PwC does not accept any liability for damages arising in connection with the use of this brochure.

General concepts and terminology

1. Share-based payments are arrangements in which an entity receives employee services or alternatively goods or other services at agreed conditions in exchange for its equity instruments or cash amounts based on the price of such instruments. Share-based payments are predominantly used as payment for employee services, accordingly the primary focus of this chapter is on these arrangements. Typically, such awards are used as a form of management compensation. Throughout this chapter we describe them as arrangements, awards, or plans.
   [FER 31/3, FER 31/13, FER 24/13]

2. Other use cases include purchasing goods or obtaining services from third parties with a settlement in shares. Such arrangements are addressed in the section 'Other than employee related share-based payments'.

3. Many share-based payment arrangements are complex which reflects the creativity and diversity in management compensation. FER 31 'Complementary Recommendations for listed entities' includes however only limited guidance for listed companies. Preparers need to solve open questions using the FER framework and reference to other true and fair view standards might be necessary. When assessing share-based payments, the economic substance of the underlying set-up should be considered, rather than just the legal structure. Below, we introduce general aspects and terms used throughout this publication.
   [Framework 6, Framework 10]

4. Sometimes it might be challenging to assess whether a transaction is a share-based payment. Such questions are addressed in the section 'Scope'. For non-public entities refer to 'Non-listed entities'.

5. Share-based payments are measured at the **grant date** at current value and are recognised as personnel expense over the **vesting period**. The corresponding entry is recognised in equity for equity-settled awards (refer to 'Equity-settled arrangements') or as a liability for **cash-settled awards** (refer to 'Cash-settled arrangements'). The classification into equity- or cash-settled is critical to the accounting treatment and is addressed in 'Classification'.

6. **Grant date** is not further defined in the standard, it is generally understood to be the date when the parties subject to the share-based payment arrangement reach a mutual understanding of the **vesting conditions** which are terms and conditions that determine whether an award vests or that impact its value. The grant date is often evidenced by a signed grant notice. Please also refer to the section 'Service period and grant date'.

7. **Vesting period** is interpreted as the period during which all vesting conditions of a share-based payment arrangement are to be satisfied. It starts at the grant date and ends when an employee is no longer required to provide service to the entity. This period is commonly referred to as **service period** and the condition to require such service is referred to as **service condition**. Please also refer to the section 'Service period and grant date'.

Equity-settled arrangements

8. An equity-settled award is remuneration in the form of equity instruments or derivatives thereon. Refer to 'Classification' to distinguish between equity- and cash-settled awards.
[FER 31/3, FER 31/13]

FAQ 8.1 – Which awards are typically equity-settled and what are their characteristics?

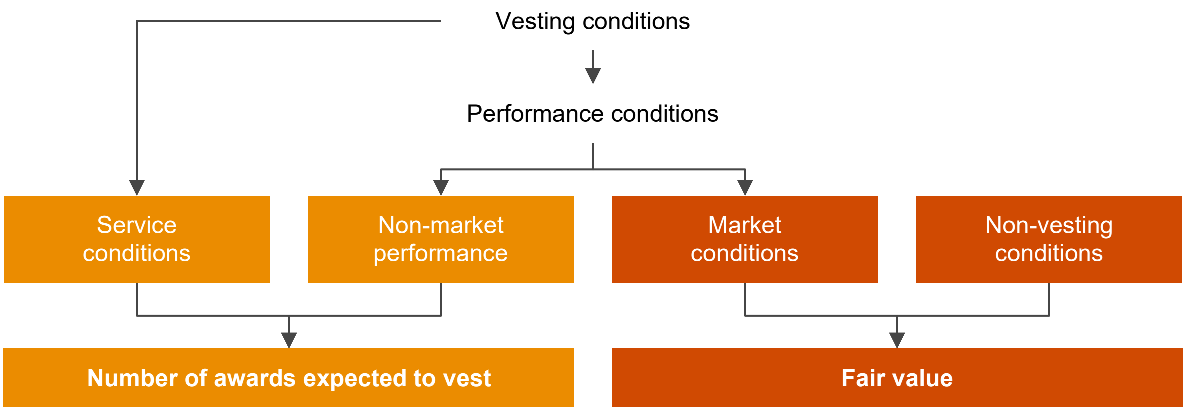
9. Share-based payments are measured at their 'current value'. Equity-settled awards are not subsequently remeasured "beside the occurrence of changes of conditions regarding exercise or acquisition (e.g., vesting period)".
[FER 31/3]

10. **Current value** is defined by the Framework as the non-discounted amount that would be necessary to settle the liability at the balance sheet date. Given that there is no subsequent remeasurement, this means for equity-settled awards that they are measured at fair value as of the grant date. This is often referred to as **grant date fair value**.
[FER 31/3, Framework 27]

11. Assessing when a subsequent remeasurement needs to happen requires judgment and depends on the interpretation of what is meant by the statement "beside the occurrence of changes of conditions regarding exercise or acquisition (e.g., vesting period)" in FER 31/3. This aspect is only relevant for equity-settled awards as cash-settled awards are remeasured to the 'current value' as of each reporting date (refer to paragraph 17). An entity should define its view in its accounting policies and apply the approach consistently.

12. One interpretation is to read the above as a requirement not to change the fair value unless the vesting conditions are changed through an amendment of the terms and conditions of the award. As such, the full grant date fair value would be expensed over the service period without taking any estimate into account.

13. A different interpretation prevails in practice which we use as a basis for this publication. The principle is assessed in analogy to IFRS 2 'Share-based Payment' of the IFRS® Accounting Standards. We consider this reasonable as this better depicts the economic substance of the arrangement. IFRS 2 distinguishes between the following vesting conditions:



14. In this concept, illustrated below in FAQs 14.1 and 40.2, two types of conditions are reflected in the fair value of the award, but are not subsequently remeasured. This applies to vesting conditions that are

linked to the market price of the equity instruments of the entity, referred to as **market conditions**, and to conditions that must be met after the service period, referred to as **non-vesting conditions**.

The impact of all other vesting conditions, so-called non-market performance conditions and the service condition is excluded from the grant date fair value measurement. This is however reflected in the number of awards that are expected to vest, based on estimates of meeting the conditions. These are initially estimated and reassessed at each reporting date, with a true up as of the end of the service period.

The amount recognised in the income statement for the reporting period equals:

- the number of awards expected to vest
- multiplied by the grant date fair value
- multiplied by the ratio of the total length of service completed to the total service period
- less amounts recognised in prior periods (if any).

FAQ 14.1 – Equity-settled awards: measurement example

15. Other interpretations of the principle could in our view be acceptable as well, e.g., leaning to another true and fair view framework. Applying however a full remeasurement for equity-settled awards as applied for cash-settled awards is in our view not in line with the principle of FER 31/3.

Cash-settled arrangements

16. A cash-settled award is remuneration measured in reference to an entity's equity instruments or derivatives thereon that is settled in cash or cash equivalents or another form than the entity's equity instruments. Refer to 'Classification' to distinguish between equity- and cash-settled awards.
[FER 31/3, FER 31/13]

FAQ 16.1 – What type of awards are typically cash-settled and what are their characteristics?

17. Share-based payments are measured at their 'current value' which corresponds to the settlement amount of a liability (refer to paragraph 11) at each reporting date. The Framework refers to that measurement as fair value.
[Framework 27, FER 31/3]

18. The Framework defines liabilities to originate from past transactions or events that result in a probable future cash outflow and their settlement amount can be estimated reliably. To settle a share-based payment, we expect that both parties would reflect the probability of a payment in the measurement of a share-based payment liability.
[Framework 17]

FAQ 18.1 – What is meant by the settlement amount of a liability in the context of a share-based payment?

19. Distinguishing between the nature of vesting conditions is irrelevant when measuring cash-settled awards. The amount recognised in the income statement over the reporting period equals:
- the number of awards expected to vest
- multiplied by the fair value at each balance sheet date
- multiplied by the ratio of the total years of service completed in relation to the total service period
- less amounts recognised in prior periods (if any).

FAQ 19.1 – Cash-settled awards: measurement example

Practical questions

Scope

20. When an entity assesses how to account for an arrangement, it should first assess which guidance applies, respectively in the scope of which standard the arrangement falls. Below, we describe a few areas that are to be considered when concluding whether a specific arrangement is indeed a share-based payment.

21. Equity instruments include any equity interest in the entity such as ordinary or preference shares including derivatives based on these instruments. The glossary of FER 24 describes shares of the entity broadly as any equity instruments issued by the reporting entity, such as shares, participation certificates, non-voting entity equity securities, but also options and other derivatives on own shares, as far as they represent equity instruments. Consequently, we are of the view that only transactions involving equity instruments of the reporting entity, meaning the entity or group that prepares the (consolidated) financial statements, may fall under the definition of a share-based payment under Swiss GAAP FER.
[FER 24/glossary, FER 31/13]

22. There are several other transactions with equity instruments of the entity that appear to be similar but are not a share-based payment. Examples are:
    - Transactions with shareholders in their capacity as shareholders within the scope of FER 24, refer to the following paragraph.
    - Equity instruments used to e.g., acquire investments in another entity are part of the acquisition cost and are in the scope of FER 30. However, the accounting treatment does not differ to any acquisition of goods in exchange for shares (refer to paragraph 45).

23. Transactions with shareholders in their capacity as shareholders include capital increases and decreases (including the acquisition and disposal of own shares), dividends, contributions, hidden distribution of retained earnings, hidden contributions, and similar transactions. An entity needs to assess whether the substance of the arrangement represents a transaction with shareholders or a share-based payment, which would typically be a transaction with employees, or another service provided by shareholders that act rather in the capacity of e.g., a service provider. As per FER 24/13, share-based payments are entered in the "normal course of business that relate, e.g., to the acquisition of goods or to the purchase of labour or services at agreed conditions". In our view, a determining factor in practice is often whether an arrangement is entered into with a particular group of people or whether it is a transaction offered to all shareholders. The former is usually a share-based payment and the latter a transaction with shareholders in their capacity as shareholders.
[FER 24/4, FER 24/13, FER 24/19]

Non-listed entities

24. FER 31 the standard containing guidance on the accounting for share-based payments is applicable for listed entities. These are defined as entities, whose equity and/or debt instruments are listed, or which filed an application for a listing and therefore are establishing a listing prospectus.
[FER 31/1]

25. Share-based payments are also used by non-listed entities, often with a potential future listing in mind. Such entities need to assess on how to account for share-based payments. The Framework is applied when determining an accounting policy. The Framework states that "with the accounting principles, the framework covers what is not (yet) covered in detail by one of the existing recommendations." FER 31/3 and 31/13 provide such guidance.

Consequently, we expect that non-listed entities apply these principles when developing an accounting policy.
[Framework 1]

Classification

26. The standard distinguishes between equity- and cash-settled share-based payments. Equity-settled share-based payments are not subsequently remeasured except for the occurrence of changes of conditions regarding exercise or acquisition (refer to paragraph 10 and following) whereas cash-settled share-based payments are remeasured to the expected cash-settlement price (refer to paragraph 18) at every reporting date. Consequently, the classification of the award as either equity- or cash-settled is critical to the entire accounting treatment.

27. Swiss GAAP FER refers for equity-settled plans to “if no cash settlement is planned”. As such, we considered the ultimate form of settlement as decisive.
[FER 31/3]

28. In many situations, it will be clear whether settlement will be in equity instruments or in another form. In other instances, an entity will need to apply judgement on how the award will be settled. In practice, this is often the case when the arrangement contains settlement choices, repurchase rights or obligations. When making the assessment, the economic substance of the underlying set-up should be considered, not just the legal structure. Below, we describe these situations and our thought process thereon in more detail.
[FER Framework 6, FER Framework 10]

29. When assessing the classification of share-based payments, an entity needs to assess whether it has an obligation from a contractual arrangement or from past practice to pay cash and cash equivalents or to transfer another economic benefit to the counterparty. Such share-based payments are cash-settled.
[Framework 17, Framework 27, FER 31/3]

30. Beside a legal obligation, an entity might also have a constructive obligation to settle in cash. A constructive obligation is an obligation that is not based on law, a provision or a contract. Its existence can be derived from past business practice, e.g., if the body responsible for decisions of the entity has decided on or has announced a specific course of action on the basis of fair dealing or based on the fear of the outcome of a bad reputation or has defined a respective internal policy. These measures give rise to a legitimate expectation of how third parties perceive those obligations.
[FER 23/2, FER 23/14]

31. In some instances, a liability might need to be recognised even for an equity-settled award. This is the case were payments are not made for the settlement of the arrangement but reflect other obligations created by the arrangement. For example, an entity might have an obligation to reimburse an upfront payment (bad leaver provision) but the award itself is equity-settled. Also, liabilities are typically required for social security contributions related to share-based payment arrangements.

FAQ 31.1 – Interaction between the recognition of a liability and the awards classification

FAQ 31.2 – Classification: settlement choice of the employee

FAQ 31.3 – Classification: settlement choice of the entity

FAQ 31.4 – Classification: repurchase right of a privately held company

FAQ 31.5 – Classification: example of a repurchase obligation

FAQ 31.6 – Classification: post-vesting repurchase option

32. A share-based payment arrangement must be assessed from the perspective of the entity preparing the financial statements. An award is accounted for as equity-settled when the arrangement is settled by another party, such as the owner of the entity, and that party does not recharge the cost to the entity. This corresponds to the definition of an equity-settled share-based payment as there is no cash settlement planned (refer to paragraph 29). Considering the economic substance of the aforementioned, such arrangements should in our view be recognised by the entity, as it benefits from employee services while the shareholder assumes the related liability. The credit to equity, resulting from the equity-settled accounting, mirrors the implicit contribution from the shareholder. Care should be applied in assessing whether there is, also in substance, no recharge to the entity. If another entity settles the share-based payment, the entity should assess whether it controls that entity. The guidance of FER 30 'Consolidated financial statements' applies, in particular FER 30/48 for special purpose entities used in conjunction with share-based payments (refer to the separate publication on Swiss GAAP FER 30 'Consolidated financial statements').

FAQ 32.1 – Award settled by shareholders with a 'drag along' clause

FAQ 32.2 – Award settled by a trust

Service period and grant date

33. The expense of a share-based payment is recognised over the service period, regardless of whether it is equity- or cash-settled. A forfeiture is a situation in which an employee does not fulfil the service requirement and leaves the entity before the end of the service period. The number of awards expected to vest relating to this employee is adjusted accordingly. This results in a reversal of the previously recognised expenses and balances for both cash- and equity-settled plans.

34. The length of the service period is either explicitly stated in the terms or implicitly determined. As for any other aspect, the economic substance of the underlying set-up should be considered, not just the legal structure. Implicit service conditions are often embedded in so-called leaver conditions.

Examples are a requirement to remain employed until an initial public offering or another ‘exit event’ occurs. A service requirement could also be stipulated through any other trigger that causes the employees subject to the share-based payment to lose their rights to the awards if they leave the entity and no longer provide their service.

35. The beginning of the service period is commonly referred to as service commencement date. In many situations, that date coincidences with the grant date when all parties subject to the share-based payment arrangements reach a mutual understanding of the terms and conditions. There are instances where such understanding is reached prior to grant date, e.g., where another party such as a remuneration committee or a shareholder meeting that still needs to approve the arrangement. In our view, an entity needs to apply judgement to appropriately determine the service commencement date in these situations.

36. Share-based payment arrangements often contain so called ‘blocking periods’ that restrict employees from selling vested instruments. Such restriction imposes by itself no service requirement. In addition, such post-vesting transfer restrictions may have little, if any, effect on the fair value.

FAQ 36.1 – Grant date: general meeting approval

FAQ 36.2 – Grant date: discretion of a remuneration committee

FAQ 36.3 – Blocking periods

37. Swiss GAAP FER is silent on the treatment of conditions that apply to a period an employee no longer needs to provide service. In IFRS 2 ‘Share-based payment’, the impact of such non-vesting conditions is reflected in the grant date fair value (refer to paragraph 14). In our view, this treatment is the most appropriate treatment also for Swiss GAAP FER preparers.

FAQ 37.1 – Conditions beyond the service period

38. Share-based payment arrangements may include multiple elements that might need to be separated into several grants to reasonably depict the economic substance. For example, an arrangement might include multiple service periods if the award vests in tranches or there may be performance conditions that vest independently from each other.

39. Grants with gradual vesting are also referred to as staged, tranched or graded vesting. Examples include vesting of award on an annual, quarterly, or monthly basis. In our view, each tranche should be accounted for separately if this reflects the economic substance that the employees earn the entitlement faster compared to an award that vests entirely over the entire service period. Alternatively, an entity might consider such clauses to be economically similar to an ordinary service period and treat the award as if it was one grant which is recognised over one single service period.

40. Arrangements that include performance conditions which are independent from each other might be split into separate grants for accounting purposes. The terms of these arrangements might lead to situations where only a portion of the award vest.

FAQ 40.1 – Staged vesting: example

FAQ 40.2 – Performance share unit (PSU) example with multiple performance conditions

41. The ultimate number of the awards allocated to the beneficiaries of the arrangement will typically only be able to be determined at the end of the vesting period and it is not uncommon that the number ultimately allocated deviates from the initial estimate of awards expected to vest. Decisive for the determination of the grant date is however, whether the parties have reached a common understanding of the terms and conditions of the arrangement. Variability from meeting or not meeting vesting conditions will not defer the grant date.

FAQ 41.1 – Grant date: grant with multipliers

Modifications and cancellations

42. Modifications are amendments to the terms and conditions of the share-based payment. For example, an entity might alter the performance conditions to increase the probability that employees reach a target. Cancellations revoke a share-based payment resulting in the loss of the entitlement of the affected employees. Swiss GAAP FER preparers need to develop an accounting policy when dealing with these matters as the standard does not provide guidance thereon.

43. Cash-settled plans are measured at the settlement amount (refer to paragraph 17). Any modification or cancellation will be reflected in measuring that amount.

44. Establishing a policy for equity-settled plans is more demanding. Other true and fair view accounting standards include anti-abusive requirements. For example, cancellations are treated as an accelerated vesting resulting in the full recognition of the grant date fair value. In case of modifications, only beneficial modifications are accounted for, and an entity needs to continue to record at least the amounts of the initial arrangement. We believe it is appropriate to apply this logic also under Swiss GAAP FER. Alternatively, a cancellation may be treated under Swiss GAAP FER in analogy to a forfeiture (refer to paragraph 33). Similarly, for modifications we are of the view that an entity may also reflect both beneficial and non-beneficial modifications.

Other than employee related share-based payments

45. FER 31 refers to a recognition of share-based payment expenses as personnel cost which is in our view a consequence of the predominant use of share-based payment arrangements as a form of employee remuneration.

46. Swiss GAAP FER refers to the acquisition of other goods and services as another form of share-based payment, but it does not specify the accounting treatment.
[FER 24/13]

47. Share-based payments other than for employee services should in our view be accounted for in analogy with employee related share-based payment arrangements. An entity will need to assess whether the transaction represents the acquisition of a good or the consumption of a service. The applicable standard is determined based on the substance of the transaction, referring to the nature of the good or service acquired. An expense is recognised if the asset recognition criteria of the relevant standard are not met, or where it is obvious that the fair value of the equity instruments issued is significantly in excess of the cash purchase price of the asset acquired.

48. For example, when an entity acquires an intangible asset through the payment of shares, it will assess the capitalisation criteria of FER 10 'Intangible assets'. As the transfer of shares represents an equity-settled share-based payment, we consider it reasonable to measure the transferred shares at fair value and reflect them in the acquisition cost of the acquired asset.

49. Presentation of expenses follows the entity's general considerations of how to classify expenses. For example, when an entity incurs services from a third parties and usually presents such costs as other operating expenses, we would expect such presentation also if they are settled through a share-based payment.

Presentation and disclosure

50. Information on share-based payment arrangements often receives special attention from readers of the financial statements as they are mostly linked to key management compensation and usually result in dilution of other shareholdings in the entity. Besides the limited requirements included in FER 31/3 and FER 24/13, an entity should consider the overall objective of disclosures to provide readers of the financial statements with sufficient information to understand the implication of transactions to the financial statements. An entity should consider the specific facts and circumstances when determining the extent of disclosures necessary to understand how share-based payment arrangements impact the entity. While additional information might be included in other parts of the annual reports, all material information on the arrangements relevant to the financial statements should be provided in the financial statements themselves.
[FER 6/2]

51. Presentation of share-based payment arrangements is specified in FER 31. Arrangements that do not result in the recognition of an asset must be expensed through profit or loss. An entity should consider the nature of the services obtained through the share-based payment arrangement. This is a personnel expense if the nature of the arrangement is related to employee remuneration. Other services, for example from advisors, should be presented in line with how the entity would present other expenses incurred with these parties.

52. An entity presents the balance sheet amount as a liability if the arrangement is cash-settled and within equity if the arrangement is equity-settled. We would expect that an entity presents a liability based on its nature in analogy to the aspects mentioned above.

53. FER does not define the equity category in which an equity-settled award should be recognised. In our view, a presentation in capital reserves, retained earnings or as separate reserve is most reasonable and corresponds to the current practice of Swiss GAAP FER preparers. A recognition in a reserve such as cumulative exchange differences or in the column showing goodwill offset within equity would not be appropriate.

54. As a minimum, an entity must disclose as per FER 31/3:
    - the general conditions of the contract (e.g., conditions regarding exercise, number of equity instruments granted, way of settlement)
    - the basis of the calculation of the current cost and
    - the expense recognised in the result of the period.

55. FER 24 requires further disclosures that are often relevant for share-based payments, e.g. on treasury shares, options or other derivates on equity instruments, authorised and contingent capital and components of equity.

56. Share-based payment arrangements need to be considered as potentially dilutive instruments when calculating earnings per share. Entities in the scope of FER 31 shall apply FER 31/5. The dilutive impact can be of significance, especially for less mature companies.

Frequently asked questions

FAQ 8.1 – Which awards are typically equity-settled and what are their characteristics?

Share-based payments come in many forms. Equity-settled examples include:

- Shares with immediate allocation or allocation after a certain time (service condition) and tied to goals (performance condition)
- Share purchase plan with preferred conditions, fixed or variable pricing
- Share expectancy rights providing a right to receive shares after a predefined period depending on specific conditions such as 'Restricted Share Units' (RSUs) or 'Performance Share units' (PSUs). RSUs generally have only a service condition. PSUs typically have in addition one or more performance conditions.
- Options providing a right but not an obligation to acquire a share during a specific period or at a specific point in time in the future at a predefined price. This also includes a right to convert the option into shares.

FAQ 14.1 – Equity-settled awards: measurement example

An entity grants 10 options to 20 employees at 1.1.20X1. Employees leaving the company within three years lose their entitlement to the award. The options may be converted into shares of the entity at the end of year 3. The following table includes the estimate as of the grant date and as of each reporting date.

Date	Employees expected to stay	Option fair value in CHF
01.01.20X1 (Grant date)	20	60
31.12.20X1	20	66
31.12.20X2	18	69
31.12.20X3 (Actual)	15	78

How is this equity-settled award accounted for?

The personnel expense in each period is calculated as per paragraph 14 as follows:
[Awards expected to vest] x [grant date fair value] x [percentage of completed service] less cumulative prior period expenses.

The number of awards expected to vest equals the 10 options granted to each employee multiplied by the number of employees expected to stay.

The grant date fair value is CHF 60 which is subsequently not remeasured as it is an equity-settled plan. No expense is however recorded at the grant date as the employees have not performed any service.

Over the three years, as the employees render their services, the expense with a credit to equity is recognised as follows:

Date	Awards to vest [1]	Grant date fair value [2]	Service completed [3]	Subtotal = 1 x 2 x 3	Less cumulative prior period effect	Expense (income) in the period
01.01.20X1	200	60	0	0	0	0
31.12.20X1	200	60	1/3	4'000	0	4'000
31.12.20X2	180	60	2/3	7'200	-4'000	3'200
31.12.20X3	150	60	3/3	9'000	-7'200	1'800

FAQ 16.1 – What type of awards are typically cash-settled and what are their characteristics?

Any type of award listed as equity-settled in FAQ 8.1 that is settled in cash instead of shares of the entity is a cash-settled award. Other frequent examples are:

- Phantom participations ("Phantom stocks") in the form of shares or options which mirror the economic effects of a real participation instrument but are settled in cash.
- Transfer of shares and options with repurchase rights or obligations (refer to FAQ 31.4 respectively FAQ 31.5 for an illustration).

FAQ 18.1 – What is meant by the settlement amount of a liability in the context of a share-based payment?

An entity sets up a cash-settled share-based payment with its employees. It will need to pay CHF 1 million to its employees if they remain in service for at least two years and in case certain performance conditions are met. Leaving employees are entitled to a pro-rata amount. After one year, the entity assesses the performance conditions and estimates the probability that it will need to pay the amount as 40 percent.

What is the settlement amount at the end of first year?

Employees have performed half of their services. As a consequence of the performance conditions, they might however not receive any payment at the end of the 2-year service period. Evidently, the employees would not agree to settle the arrangement for nil consideration as they would also anticipate the 40 percent chance to earn the entitlement. In case of a settlement, the cash outflow is presumed to be probable. As per Framework 17, the amount needed to settle the liability must be determined or estimated reliably. Therefore, we are of the view that the entity should reflect the probability in the measurement of the share-based payment liability.

The entity would recognise a liability of CHF 0.2 million as of year end (= MCHF 1 * 40% / 2).

FAQ 19.1 – Cash-settled awards: measurement example

We build on the example in FAQ 14.1. However, employees receive cash instead of shares at the end of year 3 if they remain in service.

Date	Employees expected to stay	Option fair value in CHF
1.1.20X1 (Grant date)	20	60
31.12.20X1	20	66
31.12.20X2	18	69
31.12.20X3 (Actual)	15	78

How is this award accounted for?

The award is cash-settled as employees receive cash determined on the amount of the value of equity instruments of the company.

The personnel expense in each period is calculated as per paragraph 19 as follows:
[Awards expected to vest] x [fair value as of the balance sheet date] x [percentage of completed service] less cumulative prior period expenses.

The number of awards expected to vest equals the 10 options granted to each employee multiplied by the number of employees expected to stay.

The entity determines the settlement amount at each balance sheet date using the fair value of each option as of that date. No expense is however recorded at the grant date as the employees have not performed any service.

Over the three years, as the employees render their services, the expense with a credit to a liability is recognised as follows:

Date	Awards to vest [1]	option fair value [2]	Service completed [3]	Subtotal = 1 x 2 x 3	Less cumulative prior period effect	Expense (income) in the period
01.01.20X1	200	60	0	0	0	0
31.12.20X1	200	66	1/3	4'400	0	4'400
31.12.20X2	180	69	2/3	8'280	-4'400	3'880
31.12.20X3	150	78	3/3	11'700	-8'280	3'420

The liability is remeasured through the income statement using the best estimate until settlement. This also applies when the settlement takes place after the end of the vesting period. The settlement amount may still be subject to change, e.g., because it is linked to the share price at the settlement date.

FAQ 31.1 – Interaction between the recognition of a liability and the awards classification

Employees can buy shares from their employer at a discount of 16 percent to their fair value. The shares cannot be sold within a blocking period of three years. Leavers within that period shall sell their shares back at the initial purchase price. All other employees retain their shares.

Is the arrangement equity- or cash-settled?

The entity has an obligation to repay cash to leavers and the repayment is outside of the control of the entity. However, the ultimate form of settlement of employees fulfilling a three-year period of service is in shares of the entity. The arrangement is equity-settled but the entity must record a liability for the cash received to reflect the present obligation to repay cash (refer to FAQ 31.5 for a numerical example).

FAQ 31.2 – Classification: settlement choice of the employee

A share-based payment arrangement might provide the employee with a choice whether to request a settlement in equity instruments or in cash. Often, both settlement alternatives have the same value, but the settlement in equity instruments might also be incentivised through a favourable pricing.

Is the arrangement equity- or cash-settled?

A settlement choice of the employee means that the employee has the ultimate right to request a settlement either in equity instruments or another form. The type of settlement is not in the entity's control. In our view, the entity should treat the arrangement as cash-settled award as there is an obligation to settle in cash.

When the equity instruments are favourably priced, the employee might still request a payment in cash. Consequently, we believe it depicts the economic circumstances best when the entity treats the award up to the cash amount as cash-settled and only any exceeding portion as equity-settled.

FAQ 31.3 – Classification: settlement choice of the entity

An entity has a choice to settle its share-based payment awards either in the form of cash or by transferring equity instruments.

Which factors does the entity consider when concluding on the classification of this award?

Legally, the entity can control the type of settlement. However, the settlement choice by the entity leads to a classification as cash-settled if the entity has a constructive obligation to settle in cash.

Decisive for the classification is therefore the economic substance and not the mere possibility to settle in both forms. An entity should consider the principles of FER 23/14 when making this assessment.

Two frequently encountered situations resulting in a cash settlement are:

- Past business practice to the settle such arrangements in cash.
- The company is non-listed. Private entities rarely allow employees who leave the entity to continue to hold its shares. As such there is often a practice to settle in cash and employees expect an entity to do so (refer to FAQ 31.4).

A variety of factors such as the ownership structure, an entity's exit strategy and many other aspects may impact the classification when the entity has a settlement choice.

FAQ 31.4 – Classification: repurchase right of a privately held company

A non-public entity granted a share-based payment award to its employees. Shares are transferred to the employees after the completion of a three-year service period. The entity has the right to repurchase the shares when an employee leaves the entity. Shares can only be sold to other employees or to the entity.

Is the arrangement equity- or cash-settled?

The receipt of shares after the completion of a three-year service period might lead to the impression that the award is equity-settled. However, the entity has a choice to ultimately settle the award in cash. We expect that the company uses this right in a non-public environment. Additionally, there is an incentive for the entity to repurchase the shares as it no longer benefits from the employee service. Such arrangements often result in a classification as cash-settled.

FAQ 31.5 – Classification: example of a repurchase obligation

Employees can buy shares from their employer at a discount of 16 percent to their fair value of CHF 100 at 01.01.20X0. The shares cannot be sold within a blocking period of three years. Employees leaving entity A within that period must sell their shares back at the initial purchase price of CHF 84. Employees who remain with the entity for at least three years retain their shares. Assume that 200 shares were bought as part of the offer. The entity estimates that employees holding 50 shares resign within the three-year service period. All employees remain with the entity. The entity bought the 200 shares at the stock market for a price of CHF 90 and held the shares in treasury until they were transferred to the employees at 01.01.20X0.

How is the award accounted for?

As per FAQ 31.1, the arrangement is equity-settled but the entity needs to record a repurchase obligation as it has an obligation to repay cash to leavers and the repayment is outside of the control of the entity. In our example, a liability of CHF 16’800 (= 200 x CHF 84) is recognised. If not used, the repayment liability is derecognised as credit to equity.

The entity estimated the fair value of the award at the grant date which is presumed to be CHF 16 per share (as the difference of the fair value of the share of CHF 100 less the CHF 84 paid by the employees).

The personnel expense in each period is calculated as per paragraph 15 as follows:
[Awards expected to vest] x [grant date fair value] x [percentage of completed service] less cumulative prior period expenses.

The number of awards respectively shares expected to vest are initially 150 and subsequently revised to the actual number of 200 shares. The grant date fair value is CHF 16 which is subsequently not remeasured as it is an equity-settled plan.

Over the three years, as the employees render their services, the expense with a credit to equity is recognised as follows:

Date	Awards to vest [1]	Grant date fair value [2]	Service completed [3]	Subtotal = 1 x 2 x 3	Less cumulative prior period effect	Expense (income) in the period
01.01.20X1	150	16	0	0	0	0
31.12.20X1	150	16	1/3	800	0	800
31.12.20X2	150	16	2/3	1’600	-800	800
31.12.20X3	200	16	3/3	3’200	-1’600	1’600

The arrangement results in the following journal entries (in CHF):

When purchasing the treasury shares:
Dr. Treasury shares (equity) 18’000 (= CHF 90 * 200 shares)
Cr. Cash and cash equivalents 18’000

01.01.20X0:
Dr. Cash and cash equivalents 16’800 (= CHF 84 * 200 shares)
Cr. Repayment obligation 16’800

Dr. Equity 18’000 (transfer of shares)
Cr. Treasury shares (equity) 18’000

31.12.20X1 and 20X2 (in each year):
Dr. Personnel expense 800 (as per above table)
Cr. Equity 800

31.12.20X3:
Dr. Personnel expense 1’600 (as per above table)
Cr. Equity 1’600

Dr. Repayment obligation 16’800 (derecognition of liability)
Cr. Equity 16’800

In our view, the entity should record the transfer of the treasury shares to the employees at 01.01.20X0 as the shares are transferred to the employees. Cumulatively, the above entries result in a total personnel expense of CHF 3'200, a net cash outflow of CHF 1'200 and a credit to equity of CHF 2'000.

What if employees holding 150 shares were leaving in 20X3?

Only employees holding 50 shares will fulfil the service condition. The cumulative expense equals CHF 800 which is the actual awards to vest of 50 shares times CHF 16 as the grant date fair value. The entity recognised cumulative expenses of CHF 1'600 in 20X1 and 20X2 resulting in a reversal of expenses of CHF 800. The repayment liability is settled with a repayment of CHF 12'600 (= CHF 84 * 150 shares) and a credit to equity of the remaining amount of CHF 4'200 (= CHF 16'800 - CHF 12'600).

The entity recognises the following entries as at 31.12.20X3:

Dr. Equity	800	
Cr. Personnel expense		800
Dr. Repayment obligation	16'800	
Cr. Cash and cash equivalents		12'600
Cr. Equity		4'200
Dr. Treasury shares (Equity)	12'600	(CHF 84 * 150 shares)
Cr. Equity		12'600

Cumulatively, the above entries result in a total personnel expense of CHF 800, an acquisition of treasury shares of CHF 12'600, a net cash outflow of CHF 13'800 and a debit to equity of CHF 400.

FAQ 31.6 – Classification: post-vesting repurchase option

We build on FAQ 31.5. The fact pattern differs as follows. The entity has a post-vesting right to buy back any shares held by employees after 20X3 at the higher of the price paid by the employee and the market price per share.

How is the arrangement accounted for?

Entity A has a settlement choice whether to buy back shares for cash or to let the employee leave with shares. Accordingly, entity A assesses whether it has a present obligation to settle in cash (refer to paragraphs 29-31 and FAQ 31.3). The entity will classify the arrangement as cash-settled if the entity concludes that it will buy the shares.

FAQ 32.1 – Award settled by shareholders with a 'drag along' clause

An entity grants shares to its employees. The shares remain restricted until the entity is acquired by another party. Upon this so-called exit event a 'drag along' clause takes effect which requires the employees to sell their shares to the buyer of the entity.

Is the arrangement equity- or cash-settled?

The award is settled by transferring shares to the employees and qualifies as equity-settled under the condition that the entity has no obligation to refund the payment made by the shareholder. The employees might receive a cash payment in the exit event. However, the settlement in cash is not an obligation of the entity and will be paid by the buyer. The outcome would be different if the terms of the share-based payment require the entity to repurchase any outstanding shares.

FAQ 32.2 – Award settled by a trust

Awards of a share-based payment arrangement are settled by a trust that is not part of the consolidation of the reporting entity.

What should the reporting entity assess in such a situation?

FER 30/49 requires consolidation of special purposes entities that provide an economic benefit to the reporting entity. This definition includes trusts, foundations, and any other form of special purpose entities. The classification of the award into equity- or cash-settled is determined on a consolidated view based on the same principles outlined above. We expect that the consolidation often leads to a change in the classification from equity- to cash-settled as the consolidated entity often presumes an obligation to settle the award in cash. For further information refer to the separate publication on Swiss GAAP FER 30 'Consolidated financial statements'.

FAQ 36.1 – Grant date: general meeting approval

An entity establishes a share-based payment arrangement with its executive committee. The terms and conditions are defined at the beginning of the fiscal year of the entity and employees acknowledge their agreement by signing a grant notice. The awards are subject to a vote at the annual general meeting that takes place in March of the same year. The approval is a precondition of the share-based payment arrangement.

What is the grant date in this example?

The grant date is at the approval date of the general meeting.

However, we believe that an entity should estimate the fair value at grant date at the date the employees and the entity reach their mutual understanding of the terms which is earlier than the date of the general meeting. This date is called the service commencement date. The expense should be recognised over the longer period from the service commencement date to the end of the vesting period. The entity should estimate the fair value of the grant at the service commencement date and revise it at the grant date.

FAQ 36.2 – Grant date: discretion of a remuneration committee

A share-based payment arrangement includes several vesting conditions. The remuneration committee has discretion whether awards vest even if the targets were not achieved.

When is the grant date in this example?

The ability to adjust the terms and conditions might impact the assessment of the grant date if it is substantive. An entity should assess whether the discretion is so significant that the parties cannot reach a mutual understanding of the terms and conditions until the remuneration committee has set the final remuneration. Typically, we expect that such rights are only formal clauses that do not alter the grant date.

In case such rights are nonetheless substantive, we believe an entity should conclude that there was already a service commencement date. An entity should estimate the fair value of the award and expense it over the period the employees earn their remuneration similar to the situation explained in FAQ 36.1. The adjustment to the final compensation should be treated as modification (refer to paragraph 42).

FAQ 36.3 – Blocking periods

Employees can buy shares from their listed employer at a discount of 16 percent to their fair value. The purchase price is determined in reference to the volume weighted average share price of the first months of the calendar year. Employees that are not under notice may use that offer. The shares cannot be sold within a blocking period of three years. The employee has no rights or obligations to transfer the shares back to the entity.

How is the arrangement accounted for?

This is an equity-settled share-based payment. The discount to the fair value is a benefit to the employee. The employee does not need to provide future services and the grant date fair value of the benefit is expensed at the time the employee acquires the shares.

Refer to FAQ 31.5 for a similar fact pattern in which other restrictions impose a service requirement.

FAQ 37.1 – Conditions beyond the service period

The number of awards transferred to employees in an entity's share-based payment arrangement is determined based on the achievement of selected financial targets over a cumulative period of three years. Employees retain their entitlement if they complete a one-year service period.

How is the arrangement accounted for?

The achievement or non-achievement after the service period of one year represents a non-vesting condition. These conditions are therefore reflected in the grant date fair value. The entity estimates the number of awards to vest based on the employees expected to leave within the service period. The expense is recognised over the one year service period. .

FAQ 40.1 – Staged vesting: example

Employees are entitled to share options of an entity on 1 January 20X1. Employees earn the awards on an annual pro rata basis and the last option is fully vested after a three-years period ending at 31 December 20X3. As of 31 December 20X1, employees have earned 1/3 of the award and as of 31 December 20X2 they have earned 2/3. Employees keep their entitlement for the earned awards if they leave after the end of the calendar year but lose any not yet fully vested awards.

How is such a clause accounted for?

A pro-rata vesting results in multiple service periods. Each tranche should be accounted for as a separate grant given that the employees earn their entitlement to the award not over three years but in tranches.

In our example, the award is earned as follows:

- 20X1: Employees have earned the award portion vested at 31.12.20X1 plus 1/2 of the award vesting at 31.12.20X2 and 1/3 of the award vesting at 31.12.20X3.
- 20X2: Employees have earned the remaining portion of the award vesting at 31.12.20X2 and another 1/3 of the award vesting at 31.12.20X3.
- 20X3: Employees have earned the remaining portion of the award vesting at 31.12.20X3.

If an entity would assume that the above fact pattern consists only of one service period, this would not reflect the fact that employees retain their entitlement when leaving early. For example, an employee leaving after two years is entitled to two thirds of the total entitlement. When assuming only one service period, the employee would have failed the service requirement. Consequently, we are of the opinion that a stagged vesting should be treated as separate grants with separate service periods. Such treatment also affects the timing of the expense recognition as illustrated below.

Assuming a grant date fair value of CHF 30 for all three tranches for simplification purposes, employees earn the following percentage of the total award in each period leading to a front-loading effect.

Year	Tranche 1	Tranche 2	Tranche 3	Expense in CHF	% of total expense
Earned over	1 year	2 years	3 years		
20X1	1	1/2	1/3	55 = 30 + 15 + 10	61%
20X2		1/2	1/3	25 = 15 + 10	28%
20X3			1/3	10	11%
Total				90	100%

FAQ 40.2 – Performance share unit (PSU) example

An entity awards its management with PSUs requiring employees to remain in service for at least three years as from the grant date. Vesting conditions are measured over the same period and include targets relating to basic earnings-per-share (EPS) and relative total shareholder return (rTSR). The rTSR is measured in terms of percentile ranking as compared to a peer group of listed companies.

The vesting depends on the achievement rate of following targets over the vesting period:

a) 50% weight to three-year average EPS
- EPS is above CHF 7: 200%
- EPS below CHF 7 but at least CHF 6: 100%
- EPS below CHF 6 but at least CHF 5: 50%
- EPS below CHF 5: 0%

b) 50% weight to rTSR
- Above 75th percentile: 200%
- 50-74th percentile: 100%
- 25-49th percentile: 50%
- Below 25th percentile: 0%

For example, the employee will for each PSU receive an entitlement to
- 0.25 shares (50% weight x 50% achievement) if the average EPS is CHF 5.50 and additionally
- 0.50 shares if the rTSR is on the 60th percentile (50% weight x 100% achievement).

In total, that employee earned an entitlement to 0.75 shares per PSU assuming that the service condition is fulfilled.

How is this award accounted for?

The award is equity-settled as the employee will be rewarded in shares. The award is earned over a three-year service period. The award is split into two grants as the performance conditions are independent of each other.

Applying the concept outlined in paragraph 14, the vesting conditions are treated as follows:

- The employee needs to remain in service which represents a **service condition**.
- The other vesting conditions are **performance conditions**:

- rTSR is measured as relative performance to a peer group based on the entity's share price and is a **market condition**. The entity reflects the rTSR in the grant date fair value of each PSU but does not remeasure this amount subsequently. Below we refer to this element as "rTSR grant".
- Basic EPS is the entity's earnings divided by the weighted average of shares outstanding which represents a **non-market performance condition**. Below we refer to this element as "EPS grant".

- The expected number of awards to vest needs to be determined:
  - For the rTSR grant, the company estimates the number of awards expected to vest based on the number of expected leavers (through the service period).
  - For the EPS grant, this estimate additionally reflects the impact of the average EPS expected to be achieved over the vesting period.
  - These estimates are remeasured at each reporting date.

- The entity needs to estimate the grant date fair value for both the rTSR grant (reflecting the effect of meeting the rTSR target) and the EPS grant (excluding the effect of meeting the EPS target).

Example

rTSR grant

The personnel expense in each period is calculated as per paragraph 14 as follows:

[Awards expected to vest] x [grant date fair value] x [percentage of completed service] less cumulative prior period expenses.

The number of awards expected to vest equals the 10 PSUs granted to each employee multiplied by the number of employees expected to stay. The entity has provided 5 employees with 10 PSUs each. It expects that all employees fulfil the service condition. The entity estimates the number of employees to fulfil the service condition as of each reporting date.

The grant date fair value which reflects the market condition is estimated to be CHF 30 which is subsequently not remeasured.

Over the three years, as the employees render their services, the expense with a credit to equity is recognised as follows:

Date	Awards to vest [1]	Grant date fair value [2]	Service completed [3]	Subtotal = 1 x 2 x 3	Less cumulative prior period effect	Expense (income) in the period
01.01.20X1	50	30	0	0	0	0
31.12.20X1	50	30	1/3	500	0	500
31.12.20X2	50	30	2/3	1'000	-500	500
31.12.20X3	50	30	3/3	1'500	-1'000	500

The expense is recognised linearly over the service period as there is no change in the estimated and actual number of leavers. Consequently, the entity would also recognise a share-based payment expense if the rTSR performance condition results in a payout of nil unless the employees leave within the service period.

EPS grant

The personnel expense in each period is calculated as per paragraph 14 as follows:

[Awards expected to vest] x [grant date fair value] x [percentage of completed service] less cumulative prior period expenses.

The number of awards expected to vest equals the 10 PSUs granted to each employee multiplied by the number of employees expected to stay and the EPS achievement rate, as it relates to a non-market performance condition that is estimated at each reporting date. The EPS achievement rate is assumed to be as follows:

Date	Expected EPS in CHF	Achievement rate
31.12.20X1	5.50	50%
31.12.20X2	6.10	100%
31.12.20X3	6.60	100%

The grant date fair value is assumed to be CHF 30 which is subsequently not remeasured as it is an equity-settled plan.

Over the three years, as the employees render their services, the expense with a credit to equity is recognised as follows:

Date	Awards to vest [1]	Grant date fair value [2]	Service completed [3]	Subtotal = 1 x 2 x 3	Less cumulative prior period effect	Expense (income) in the period
01.01.20X1	50 * 50%	30	0	0	0	0
31.12.20X1	50 * 50%	30	1/3	250	0	250
31.12.20X2	50 * 100%	30	2/3	1000	-250	750
31.12.20X3	50 * 100%	30	3/3	1500	-1000	500

The increase in the estimate of the EPS achievement rate in 20X2 results in a catch-up effect of CHF 250.

FAQ 41.1 – Grant date: grant with multipliers

An entity provides its employees with performance share units (PSUs) at the beginning of a three-year service period. The entity applies a multiplier factor of 0-200 percent to each PSU at the end of year 3. The multiplier depends on the outcome of the vesting conditions over the vesting period.

What are the implications on the grant date?

The grant date in the example is at the beginning of the service period assuming that the parties reach a mutual understanding of the terms and conditions. The variability in the number of awards expected to vest does not impact the grant date.

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