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IDW

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

Düsseldorf, 14.3.2003
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Dear Sir David,

Re: Exposure Draft ED 2: Share-Based Payment

We appreciate the opportunity to comment on the Exposure Draft mentioned above and would like to submit our comments as follows:

General Remarks

In intensive debates, some of the members of our responsible committees expressed the opinion that share-based payment transactions with employees should not lead to the recognition of expenses because such transactions would not encompass an outflow or depletion of assets of the entity granting the share-based payment. They take the view that such share-based payment transactions only represent a dilution of the value of an entity's shares. However, the majority agrees with the general objective of the Draft Standard that an entity recognises all share-based payment transactions in its financial statements, measured at fair value, so as to provide high quality, transparent and comparable information to users of financial statements.

Nevertheless, we disagree that the future delivery of goods or rendering of services results in a contribution to equity at the date when the entity obtains the goods or receives the services. Instead, we believe that the fair value of future economic benefits resulting from a share-based payment transaction should be capitalised at the

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grant date and that a corresponding contribution to equity should be recognised. In the case of services to be received from employees, the capitalised amount should be amortised over the vesting period. In our opinion, this procedure represents the only reasonable method for the recognition of expenses from a share-based payment transaction that meets the current definitions in the conceptual framework (for more detailed comments see our answer to Question 2).

Therefore, in contrast to ED 2.8 we are of the opinion that the fair value of goods or services received should be measured at grant date, irrespective of whether the fair value is measured directly or indirectly, by reference to the fair value of the equity instruments granted.

We support the IASB's objective to set standards being principle-based. However, even a principle-based standard should provide sufficient guidance so that similar share-based payment transactions are accounted for in a comparable manner and, hence, provide reliable information to users of financial statements. Because the recognition and measurement of share-based payment transactions pursuant to ED 2 is rather complex – especially regarding the application of option pricing models indirectly measuring the fair value of the future benefits to be received by the entity – we request that the Board provide more application guidance. Otherwise, there remain serious unresolved concerns whether reliable and comparable information is presented. In addition, due to the significance of that problem, we expect that sufficient field-testing is carried out proving the reliability of information before the Standard is finalised (for more detailed comments see our answer to Questions 11 through 14 and 16.

Furthermore, a complete example showing the different accounting entries required at the different stages during the life of a share option and the required disclosures would be very helpful. Such guidance would certainly enhance the comparability and reliability of financial statements.

Question 1

Paragraphs 1-3 of the draft IFRS set out the proposed scope of the IFRS. There are no proposed exemptions, apart from for transactions within the scope of another IFRS.

Is the proposed scope appropriate? If not, which transactions should be excluded and why?

We agree with the proposed scope of ED 2.

Within ED 2, it is proposed that transfers of equity instruments by an entity's shareholder, or transfers of equity instruments of the entity's parent or of another entity in the same group as the entity, to the entity's employees or to other parties that have supplied goods or services to the entity are share-based payment transactions, unless the transfer is clearly for a purpose other than payments for goods or services supplied to the entity. In this respect, further guidance is required because the entity might not be able to obtain all of the information required to apply ED 2 properly.

Question 2

Paragraphs 4-6 of the draft IFRS propose requirements for the recognition of share-based payment transactions, including the recognition of an expense when the goods or services received or acquired are consumed.

Are these recognition requirements appropriate? If not, why not, or in which circumstances are the recognition requirements inappropriate?

As mentioned in our general remarks we agree with the Board that equity-settled share-based payment transactions should be recognised as contribution to equity and expenses during the vesting period. However, in our view the contribution to equity should be recognised fully at the grant date.

For share-based payments granted to third parties other than employees as remuneration for the delivery of goods or the future rendering of services, at grant date the fair value of the goods received or the rights to receive goods in the future or the rights to future services should be capitalised as an asset and a corresponding contribution to equity should be recognised. Typically, an established market price exists for goods and, in many cases, for services rendered by parties other than employees. Therefore, it shall be presumed that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted.

For share-based payments granted to employees, at grant date the fair value of future economic benefits similar to those included in goodwill arising on acquisition of an entity (hereinafter referred to as “goodwill” in the remaining text) should be capitalised and recognised as a contribution to equity. If the fair value of the equity instrument granted in an equity-settled share-based payment transaction is more readily determinable than measuring the fair value of “goodwill” directly, then the fair value of “goodwill” should be measured indirectly by reference to the fair value of the equity instrument granted.

The “goodwill” represents additional employee motivation during the vesting period caused by the stock option program. Therefore, “goodwill” should be amortised over the vesting period. Such “goodwill” would have a similar quality as elements of a goodwill arising on the acquisition of an entity which according to IAS 22.42 represents a payment made by the acquirer in anticipation of future economic benefits. If an entity is acquired by means of the acquirer issuing marketable equity securities, pursuant to IAS 22.24 the acquisition costs of an entity and, therefore, the acquired goodwill are determined by the fair value of those securities. The fair value of the issued securities is measured either directly or indirectly, either by reference to their proportional interest in the fair value of the acquirer’s entity or by reference to the proportional interest in the fair value of the entity acquired, whichever fair value is more readily determinable. The entity does not acquire another entity in a share-based payment transaction, such as in a business combination, but it acquires goods or services by issuing equity instruments as consideration that is similar to IAS 22.24 in this respect. It would then be consistent to measure the fair value of the contribution only at grant date of the option.

If IASB would follow our view, there would be no need to amend the definition of expenses in paragraph 70 (b) of the framework because an expense would be recognised by amortising “goodwill”. In contrast, the proposal of the Board does not meet the definition of an expense because expenses require either an outflow or depletion of assets or the incurrence of liabilities. Both requirements are not met when goods or services are received in a share-based payment transaction. Therefore, we do not agree to the conclusion of the Board in BC 47.

If options are granted for past services, such a share-based payment transaction should not be recognised in the financial statements, because, pursuant to the framework, the perspective of the entity is relevant for accounting purposes. In these circumstances, only the value of the shares is diluted (which only affects the shareholders of the entity) without affecting any future economic benefits to be received by the entity. Therefore, an asset or “goodwill” should only be recognised if the entity expects to receive good or future services from a share-based payment transaction.

Question 3

For an equity-settled share-based payment transaction, the draft IFRS proposes that, in principle, the entity should measure the goods or services received, and the corresponding increase in equity, either directly, at the fair value of the goods or services received, or indirectly, by reference to the fair value of the equity instruments granted, whichever fair value is more readily determinable (paragraph 7). There are *no exemptions to the requirement to measure share-based payment transactions at fair value. For example, there are no exemptions for unlisted entities.*

Is this measurement principle appropriate? If not, why not, or in which circumstances is it not appropriate?

We agree that the fair value of the future economic benefits received should either be measured directly or indirectly, by reference to the fair value of the equity instrument granted, whichever fair value is more readily determinable.

Regarding the rare situation in which share-based payment programs are granted by an unlisted company, we refer to our answer to Question 6.

Question 4

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured directly, the draft IFRS proposes that fair value should be measured at the date when the entity obtains the goods or receives the services (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the goods or services received? If not, at which date should the fair value of the goods or services received be measured? Why?

No, we do not agree that the delivery or service date is the appropriate date at which the fair value of future economic benefits received by the entity should be measured. Measuring the fair value of future economic benefits, whether directly or indirectly, by reference to the fair value of the equity instrument granted, just represent two different techniques to measure the fair value of the goods and services received. Therefore, the fair value measured should be the same using either technique and, hence, the measurement date should be the same in both cases as well. This uniform measurement date should be the grant date.

This view does not depend upon our answer to Question 2. In line with our views expressed to Question 2, the problem mentioned by the Board does not exist, because the measurement date would be the grant date in any case.

Question 5

If the fair value of the goods or services received in an equity-settled share-based payment transaction is measured by reference to the fair value of the equity instru-

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ments granted, the draft IFRS proposes that the fair value of the equity instruments granted should be measured at grant date (paragraph 8).

Do you agree that this is the appropriate date at which to measure the fair value of the equity instruments granted? If not, at which date should the fair value of the equity instruments granted be measured? Why?

We refer to our answer to Question 4.

Question 6

For equity-settled transactions with parties other than employees, the draft IFRS proposes a rebuttable presumption that the fair value of the goods or services received is more readily determinable than the fair value of the equity instruments granted (paragraphs 9 and 10).

Do you agree that the fair value of the goods or services received is usually more readily determinable than the fair value of the equity instruments granted? In what circumstances is this not so?

We agree with the principle stated in ED 2.7. According to this principle, the entity shall measure goods or services received either directly or indirectly, whichever fair value is more readily determinable. However, in our view, it should be added to this principle that if an established market price does exist for goods or services received by the entity, the established market price should be used to measure the fair value of those goods or services directly. If, additionally, ED 2.8 would clarify that an established market price for services received from employees usually does not exist, a further distinction between whether employees or parties other than employees receive share-based payments as remuneration would not be necessary. Hence, ED 2.8 to 12 could be deleted.

Additional application guidance could point out that if no established market price for the goods or services exists, the fair value of the goods or services should be measured indirectly, if the company is listed and, therefore, either the options or at least the underlying shares are traded on a stock exchange.

As we understand, share-based payment programs are rare for unlisted enterprises. In our view the fair value of the future economic benefits received by the entity usually cannot be measured reliably for unlisted companies by measuring the fair value of the future economic benefits indirectly, because no market price exists for the underlying shares of the option granted. In these circumstances, measuring the fair value of the goods and services directly will usually be more reliable than measuring the fair value of goods and services indirectly, even if no established market price for goods and services exists.

In our opinion, the amendments proposed above would lead to results similar to those suggested by the Board, but in a more principles-based and less complicated manner.

Question 7

For equity-settled transactions with employees, the draft IFRS proposes that the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted, because the latter fair value is more readily determinable (paragraphs 11 and 12).

Do you agree that the fair value of the equity instruments granted is more readily determinable than the fair value of the employee services received? Are there any circumstances in which this is not so?

We refer to our answer to Question 6.

Question 8

Paragraphs 13 and 14 of the draft IFRS propose requirements for determining when the counterparty renders service for the equity instruments granted, based on whether the counterparty is required to complete a specified period of service before the equity instruments vest.

Do you agree that it is reasonable to presume that the services rendered by the counterparty as consideration for the equity instruments are received during the vesting period? If not, when are the services received, in your view?

We agree that it is reasonable for objectivity and practicality reasons, to presume that the services rendered by employees as consideration for the equity instruments are received during the vesting period, which is assumed to be the same as the service period. However, in some cases recognising expenses over the vesting period might be unreasonable, e.g. if the formal vesting period of a share-based payment transaction is five years but an employee will receive a share-based payment after five years or if he leaves the entity already after three years. In these circumstances, the service period is only three years and represents the “real” vesting period. Therefore, ED 2.14 should be amended by adding: “in the absence of evidence to the contrary” similar to ED 2.13.

In accordance with our views on the capitalisation of a “goodwill”, the services rendered by the counterparty as consideration for the equity instruments received during the vesting period will reduce the expected future benefits to be received by the entity. This reduction should be reflected by amortising the “goodwill”. In this respect, we refer to our answer to Question 2.

Question 9

If the services received are measured by using the fair value of the equity instruments granted as a surrogate measure, the draft IFRS proposes that the entity should determine the amount to attribute to each unit of service received, by dividing the fair value of the equity instruments granted by the number of units of service expected to be received during the vesting period (paragraph 15).

Do you agree that if the fair value of the equity instruments granted is used as a surrogate measure of the fair value of the services received, it is necessary to determine the amount to attribute to each unit of service received? If not, what alternative approach do you propose? If an entity is required to determine the amount to attribute to each unit of service received, do you agree that this should be calculated by dividing the fair value of the equity instruments granted by the number of units of services expected to be received during the vesting period? If not, what alternative method do you propose?

In case of services to be received from third parties others than employees, rights to future services should be recognised as an asset and a contribution to equity at grant date. These rights should be derecognised affecting net income according to the services rendered by the third party.

As mentioned in our answer to Question 2, in case of services to be received from employees the “goodwill” should be expensed over the vesting period (which is assumed to be the same as the service period). In our opinion, the total fair value of options granted should be used in measuring the fair value of the “goodwill” at the grant date. If options lapse due to the failure of employees to complete the required period of service, the “goodwill” should be derecognised against equity, and thereby not affect the income statement. This is reasonable because when options lapse during the vesting period the remaining additional motivation originally caused by the stock option program which has not already been recognised as expense in the past is “withdrawn” and the stock options granted are “returned” by the employee. Since a share-based payment transaction to employees can be seen as a contribution of “goodwill” to equity, a lapse of options can be seen as a withdrawal of “goodwill” and a corresponding decrease in equity without affecting net income.

Question 10

In an equity-settled share-based payment transaction, the draft IFRS proposes that having recognised the services received, and a corresponding increase in equity, the entity should make no subsequent adjustment to total equity, even if the equity instruments granted do not vest or, in the case of options, the options are not exercised (paragraph 16). However, this requirement does not preclude the entity from recognising a transfer within equity, i.e. a transfer from one component of equity to another.

Do you agree with this proposed requirement? If not, in what circumstances should an adjustment be made to total equity and why?

Having recognised future economic benefits received by the entity and a corresponding increase in equity, the entity should make no subsequent adjustment to equity for services already rendered. As pointed out in our answer to Question 9, only if options lapse during the vesting period "goodwill" is derecognised against equity without affecting net income.

Question 11

The draft IFRS proposes that the entity should measure the fair value of equity instruments granted, based on market prices if available, taking into account the terms and conditions of the grant (paragraph 17). In the absence of a market price, the draft IFRS proposes that the entity should estimate the fair value of options granted, by applying an option pricing model that takes into account various factors, namely the exercise price of the option, the life of the option, the current price of the underlying shares, the expected volatility of the share price, the dividends expected on the shares (where appropriate) and the risk-free interest rate for the life of the option (paragraph 20). Paragraph 23 of the proposed IFRS explains when it is appropriate to take into account expected dividends.

Do you agree that an option pricing model should be applied to estimate the fair value of options granted? If not, by what other means should the fair value of the options be estimated? Are there circumstances in which it would be inappropriate or impracticable to take into account any of the factors listed above in applying an option pricing model?

We agree that an option pricing model should be applied to estimate the fair value of options granted. Further, we appreciate that, pursuant to ED 2, no specific option pricing model must be used.

However, as the Board itself stated in BC 267, performance-related employee share plans are common in Europe and performance conditions are often even required by law. In any case, current option pricing models are difficult to apply in order to reflect performance conditions. Consequently, pursuant to ED 2.24 an appropriate adjustment should be made to the value produced by the option pricing model. In our opinion, it is clearly not adequate to just require an “appropriate adjustment”. Hence, the Board should provide more guidance to enable the preparation of reliable and comparable financial statements. In our view, the Standard should be finalised only if the Board is able to provide such guidance.

Moreover, in our view the Board should perform field-testing in this respect. In order to improve reliability and comparability of the financial statements, the IDW would prefer additional non-prescriptive guidance concerning the application of option-pricing models – especially with respect to absolute performance conditions.

Question 12

If an option is non-transferable, the draft IFRS proposes that the expected life of an option rather than its contracted life should be used in applying an option pricing model (paragraph 21). The draft IFRS also proposes requirements for options that are subject to vesting conditions and therefore cannot be exercised during the vesting period (paragraph 22).

Do you agree that replacing an option’s contracted life with its expected life when applying an option pricing model is an appropriate means of adjusting the option’s fair value for the effects of non-transferability? If not, do you have an alternative suggestion? Is the proposed requirement for taking into account the inability to exercise an option during the vesting period appropriate?

We agree that non-transferability of an option affects its fair value. However, we have doubts whether using expected life rather than contractual life in the valuation model is an appropriate means to take into account this effect. Obviously, proponents of the expected life approach argue that for the lack of transferability employees may never be able to realise the time value component of the option and that non-transferable options are usually exercised before termination of the contractual term. However, in our view it should be taken into account that the employee – during the vesting period at least theoretically and after the option vested even practically – can realise the time value component by writing a corresponding option with equivalent terms (in particular, with the same strike price and remaining period to maturity). Furthermore, the expected life approach involves a higher degree of subjectivity (and maybe even arbitrariness) than the contractual life approach. We therefore suggest that the Board further discuss this issue.

Question 13

If a grant of shares or options is conditional upon satisfying specified vesting conditions, the draft IFRS proposes that these conditions should be taken into account when an entity measures the fair value of the shares or options granted. In the case of options, vesting conditions should be taken into account either by incorporating them into the application of an option pricing model or by making an appropriate adjustment to the value produced by such a model (paragraph 24).

Do you agree that vesting conditions should be taken into account when estimating the fair value of options or shares granted? If not, why not? Do you have any suggestions for how vesting conditions should be taken into account when estimating the fair value of shares or options granted?

In our opinion, it is not adequate to require an “appropriate adjustment” as pointed out in ED 2.24. The Board should provide further guidance. In this respect, we refer to our answer to Question 11.

Question 14

For options with a reload feature, the draft IFRS proposes that the reload feature should be taken into account, where practicable, when an entity measures the fair value of the options granted. However, if the reload feature is not taken into account in the measurement of the fair value of the options granted, then the reload option granted should be accounted for as a new option grant (paragraph 25).

Is this proposed requirement appropriate? If not, why not? Do you have an alternative proposal for dealing with options with reload features?

We disagree with ED 2.25 as well as BC 180.

If the reload feature were already agreed upon at the grant date, it should be taken into account when the entity measures the fair value of the options granted because the vesting period is extended due to the reload feature. In our view, problems measuring the fair value of the reload feature do not justify an exemption from the principle stated above. Therefore, only if the reload feature is agreed upon after the grant date, the incremental value should be treated like a new option grant. We agree that this might cause reliability problems, but these issues can be solved by providing sufficient application guidance rather than by violating a reasonable principle.

Question 15

The draft IFRS proposes requirements for taking into account various features common to employee share options, such as non-transferability, inability to exercise the option during the vesting period, and vesting conditions (paragraphs 21-25).

Are there other common features of employee share options for which the IFRS should specify requirements?

We have not identified other common features of employee stock options for which ED 2 should specify requirements.

Question 16

The draft IFRS does not contain prescriptive guidance on the estimation of the fair value of options, consistently with the Board's objective of setting principles-based standards and to allow for future developments in valuation methodologies.

Do you agree with this approach? Are there specific aspects of valuing options for which such guidance should be given?

We agree with the Board's objective of setting principle-based standards. However, if a principle-based standard does not provide sufficient guidance, similar share-based payment transactions will not be treated equivalently and this will not be conducive to the comparability of financial statements. In order to improve the reliability and comparability of financial statements, the IDW would prefer additional non-prescriptive guidance on the application of option pricing models – especially concerning absolute performance conditions (see our answer on Question 11).

In this respect, we believe that meaningful field-testing by the Board is essential before the Standard is finalised and published.

Question 17

If an entity reprices a share option, or otherwise modifies the terms or conditions on which equity instruments were granted, the draft IFRS proposes that the entity should measure the incremental value granted upon repricing, and include that incremental value when measuring the services received. This means that the entity is required to recognise additional amounts for services received during the remainder of the vesting period, i.e. additional to the amounts recognised in respect of the original option grant. Example 3 in Appendix B illustrates this requirement. As shown in that exam-

ple, the incremental value granted on repricing is treated as a new option grant, in addition to the original option grant. An alternative approach is also illustrated, whereby the two grants are averaged and spread over the remainder of the vesting period.

Do you agree that the incremental value granted should be taken into account when measuring the services received, resulting in the recognition of additional amounts in the remainder of the vesting period? If not, how do you suggest repricing should be dealt with? Of the two methods illustrated in Example 3, which is more appropriate? Why?

We believe that the first approach illustrated in Appendix B, Example 3 is the most appropriate because it reflects the treatment of the incremental value as a new option and the recognition of the incremental value separately from the original option. In accordance with our position in our answer to Question 2, the incremental value of options granted with regard to future services should be capitalised as “goodwill” and recognised as a contribution to equity at the repricing date. This “goodwill” should be amortised over the vesting period of the “new option grant”.

Question 18

If an entity cancels a share or option grant during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied), the draft IFRS proposes that the entity should continue to recognise the services rendered by the counterparty in the remainder of the vesting period, as if that grant had not been cancelled. The draft IFRS also proposes requirements for dealing with any payment made on cancellation and/or a grant of replacement options, and for the repurchase of vested equity instruments.

Are the proposed requirements appropriate? If not, please explain why not and provide details of your suggested alternative approach.

No, we do not agree with this proposal. The requirement to continue to account for a transaction that no longer exists appears illogical.

Furthermore, we believe that a cancellation will arise because alternative compensation is being paid by other means or because both parties agree that there is no further value to be received from the employee’s services related to the rights to receive shares. Consequently, the entity should not continue to charge expenses over the vesting period for cancelled share or option grants.

In accordance with our answer to Question 2, ”goodwill“ should be derecognised against equity without affecting net income if the entity cancels a share or option grant during the vesting period, because a cancellation would represent a withdrawal of “goodwill” and a return of the stock options by employees.

Question 19

For cash-settled share-based payment transactions, the draft IFRS proposes that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity should remeasure the fair value of the liability at each reporting date, with any changes in value recognised in the income statement.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

We agree in principle that the entity shall measure goods or services acquired and the liability incurred at the fair value of the liability. As mentioned in our answer to Question 2, for services to be received the entity acquires a right or – in case of services from employees – “goodwill”. Consequently, irrespective of whether the share-based payment transaction is equity-settled or cash-settled, the right or “goodwill” shall be capitalised at grant date, and for a cash-settled transaction a corresponding liability should be recognised. The subsequent measurement of the right or “goodwill” would be performed in the same manner as in case of equity-settled transactions, whereas the liability would be measured at fair value at each reporting date. If options lapse, the right or “goodwill” would be impaired and the liability has to be reduced, both affecting net income.

If a cash-settled share-based payment transaction were granted for past services, only a liability would have to be recognised. Because there are no future economic benefits to be received by the entity, in the amount of the fair value of the liability an expense has to be shown in the income statement.

Question 20

For share-based payment transactions in which either the entity or the supplier of goods or services may choose whether the entity settles the transaction in cash or by issuing equity instruments, the draft IFRS proposes that the entity should account for the transaction, or the components of that transaction, as a cash-settled share-based payment transaction if the entity has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if no such liability has been incurred. The draft IFRS proposes various requirements to apply this principle.

Are the proposed requirements appropriate? If not, please provide details of your suggested alternative approach.

We agree that an entity should account for a share-based payment transaction as a cash-settled share-based payment transaction if the entity does not control whether it settles the share-based payment transaction in cash or shares and, therefore, has incurred a liability.

If the reporting entity has the choice of settlement in cash or shares, the transaction should be treated as a cash-settled share-based payment transaction only if the entity has a constructive obligation for a cash settlement. It should be made clear in ED 2.42 that "past practice" can only provide evidence that the entity has such a constructive obligation.

Question 21

The draft IFRS proposes that an entity should disclose information to enable users of financial statements to understand:

(a) the nature and extent of share-based payment arrangements that existed during the period,

(b) how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined, and

(c) the effect of expenses arising from share-based payment transactions on the entity's profit or loss.

Are these disclosure requirements appropriate? If not, which disclosure requirements do you suggest should be added, deleted or amended (and how)?

In absence of a commonly usable method to calculate existing share-based payment arrangements, we see a strong need for detailed disclosures, including reliable information about the calculation itself. Therefore, we agree with the IASB proposal in principle. However, some disclosures seem to be particularly burdensome and do not appear to enable the users of the financial statements to understand the nature and extent of the share-based payment arrangements.

The Board should clarify if the weighted average share price pursuant to ED 2.46 (c) should be a composite weighted average share price for all options exercised during the period. Furthermore, the requirement pursuant to ED 2.48 (a) (ii) – especially the comparisons between historical and expected volatility – is unclear. Because this requirement could be very burdensome if an entity issues a large number of option grants during the year, the assumptions disclosed should be either weighted or should be provided as a range.

ED 2.48 (f) does not seem to provide very useful information. In this respect we refer to our answer to Question 12. Further, it is questionable whether the requirement in ED 2.52 (b) is helpful for a user of financial statements. In this respect the Board should consider the relative costs and benefits of this requirement. If the Board retains this requirement, ED 2.52 (b) should be stated more clearly.

Under the approach of ED 2 the disclosure of the future expenses to be recognised in the income statement for the following periods should be included in ED 2. In our "goodwill" approach, however, as primarily explained in our answer to Question 2, such a disclosure would not be necessary because the information concerned is indicated by the "goodwill" capitalised.

Furthermore, as already stated in our general remarks, due to the complexity of the disclosure requirements stated in ED 2, the Board should provide an example containing all required disclosures. This would improve the reliability and comparability of the financial statements.

Question 22

The draft IFRS proposes that an entity should apply the requirements of the IFRS to grants of equity instruments that were granted after the publication date of this Exposure Draft and had not vested at the effective date of the IFRS. It also proposes that an entity should apply retrospectively the requirements of the IFRS to liabilities existing at the effective date of the IFRS, except that the entity is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure such liabilities at their settlement amount (i.e. the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured).

Are the proposed requirements appropriate? If not, please provide details of your suggestions for the IFRS's transitional provisions.

We disagree with the proposed partial retrospective approach. Pursuant to ED 2.54, for equity-settled share-based payment transactions the entity shall apply the Standard to all grants of equity instruments after 7 November 2002 that have not vested at the Standard's effective date. The purpose of this regulation appears to be to avoid abuse. However, there are other controls, e.g. shareholder approval, that would hinder entities from granting higher levels of equity instruments than usual prior to the Standard coming into force.

Because of the information that an entity will need to comply with the rather complicated and complex Standard, the application of the Standard to grants awarded on or after a specified effective date should be permitted. However, a fully retrospective application of the Standard should be encouraged.

Question 23

The draft IFRS proposes a consequential amendment to IAS 12 (revised 2000) Income Taxes to add an example to that standard illustrating how to account for the tax effects of share-based payment transactions. As shown in that example, it is proposed that all tax effects of share-based payment transactions should be recognised in the income statement.

Are the proposed requirements appropriate?

We might agree with the proposal of the IASB if one follows the position of the Board, in which expenses and the contribution to equity are recognised during the vesting period. However, based on our proposal (see Question 2), "goodwill" would be reflected directly in equity. Therefore, IAS 12.61 has to be applied.

Question 24

In developing the Exposure Draft, the Board considered how various issues are dealt with under the US standard SFAS 123 Accounting for Stock-Based Compensation, as explained further in the Basis for Conclusions. Although the draft IFRS is similar to SFAS 123 in many respects, there are some differences. The main differences include the following.

(a) Apart from transactions within the scope of another IFRS, the draft IFRS does not propose any exemptions, either from the requirement to apply the IFRS or from the requirement to measure share-based payment transactions at fair value. SFAS 123 contains the following exemptions, none of which are included in the draft IFRS:

- *employee share purchase plans are excluded from SFAS 123, provided specified criteria are met, such as the discount given to employees is relatively small;*
- *SFAS 123 encourages, but does not require, entities to apply its fair value measurement method to recognise transactions with employees; entities are permitted to apply instead the intrinsic value measurement method in Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees*

(paragraphs BC70-BC74 in the Basis for Conclusions give an explanation of intrinsic value); and

- *unlisted (non-public) entities are permitted to apply the minimum value method when estimating the value of share options, which excludes from the valuation the effects of expected share price volatility (paragraphs BC75-BC78 in the Basis for Conclusions give an explanation of minimum value).*

(b) For transactions in which equity instruments are granted to employees, both SFAS 123 and the draft IFRS have a measurement method that is based on the fair value of those equity instruments at grant date. However:

- *under SFAS 123, the estimate of the fair value of an equity instrument at grant date is not reduced for the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas the draft IFRS proposes that the possibility of forfeiture should be taken into account in making such an estimate.*
- *under SFAS 123, the transaction is measured at the fair value of the equity instruments issued. Because equity instruments are not regarded as issued until any specified vesting conditions have been satisfied, the transaction amount is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted are forfeited. Under the draft IFRS, the transaction is measured at the deemed fair value of the employee services received. The fair value of the equity instruments granted is used as a surrogate measure, to determine the deemed fair value of each unit of employee service received. The transaction amount is ultimately measured at the number of units of service received during the vesting period multiplied by the deemed fair value per unit of service. Hence, any amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.*

(c) If, during the vesting period, an entity settles in cash a grant of equity instruments, under SFAS 123 those equity instruments are regarded as having immediately vested, and therefore the amount of compensation expense measured at grant date but not yet recognised is recognised immediately at the date of settlement. The draft IFRS does not require immediate recognition of an expense but instead proposes that the entity should continue to recognise the services received (and hence the resulting expense) over the remainder of the vesting period, as if that grant of equity instruments had not been cancelled.

(d) SFAS 123 does not specify a measurement date for transactions with parties other than employees that are measured at the fair value of the equity instruments issued. Emerging Issues Task Force Issue 96-18 Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services requires the fair value of the equity instruments issued to be measured at the earlier of (i) the date a performance commitment is reached or (ii) the date performance is complete. This date might be later than grant date, for example, if there is no performance commitment at grant date. Under the draft IFRS, the fair value of the equity instruments granted is measured at grant date in all cases.

(e) SFAS 123 requires liabilities for cash-settled share appreciation rights (SARs) to be measured using an intrinsic value measurement method. The draft IFRS proposes that such liabilities should be measured using a fair value measurement method, which includes the time value of the SARs, in the same way that options have time value (refer to paragraphs BC70-BC81 of the Basis for Conclusions for a discussion of intrinsic value, time value and fair value).

(f) For a share-based payment transaction in which equity instruments are granted, SFAS 123 requires realised tax benefits to be credited direct to equity as additional paid-in capital, to the extent that those tax benefits exceed the tax benefits on the total amount of compensation expense recognised in respect of that grant of equity instruments. The draft IFRS, in a consequential amendment to IAS 12 (revised 2000) Income Taxes, proposes that all tax effects of share-based payment transactions should be recognised in profit or loss, as part of tax expense.

For each of the above differences, which treatment is the most appropriate? Why? If you regard neither treatment as appropriate, please provide details of your preferred treatment.

(Respondents may wish to note that further details of the differences between the draft IFRS and SFAS 123 are given in the FASB's Invitation to Comment.)

We have already considered the aspects of this question in our answers to previous questions. Regarding questions (a), (b), (d) to (f), we prefer the Board's proposal. With respect to question (c), we prefer the rationale behind FASB's solution and we refer to our answer to Question 18. It should be noted that with respect to question (f) we come to a different conclusion based on our "goodwill" approach. Please refer to our answer to Question 23.

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Question 25

Do you have any other comments on the Exposure Draft?

Apart from our general comments and those to specific questions we have no further comments.

Yours sincerely

Gerhard Gross

Executive Officer