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Berlin, 16 March 2015

Dear Roger,

IASB Exposure Draft ED/2014/5 *Classification and Measurement of Share-based Payment Transactions – Proposed amendments to IFRS 2*

Please find our comment letter to the IASB on the proposals of the ED appended to this letter.

Generally, our comments are in line with EFRAG's responses. Additionally, we have identified a further issue that arises in our tax environment. Lastly, we have two further drafting suggestions.

If you would like to discuss our comments further, please do not hesitate to contact Thomas Schmotz or me.

Yours sincerely,

Andreas Barckow
President



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Berlin, 16 March 2015

Dear Hans,

IASB Exposure Draft ED/2014/5 *Classification and Measurement of Share-based Payment Transactions – Proposed amendments to IFRS 2*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB's Exposure Draft ED/2014/5 (herein referred to as the 'ED'). We appreciate the opportunity to comment on the ED.

In general, we welcome the IASB's aim to clarify the specific points addressed in the ED as there seems to be diversity in practice regarding some issues that IFRS 2 does not address explicitly. However, we note general concerns regarding the standard itself and its further development.

- Although IFRS 2 is based on a general, high-level principle for the accounting of share-based payments, we wonder whether this principle appropriately depicts the transactions. Our concerns are substantiated by the significant number of issues raised by constituents for consideration by the IFRS IC since the standard was issued in 2004. In addition, when discussing the ED, we noted further ambiguities arising in connection with the application of IFRS 2 (see our comments on question 5).
- Further, and despite being based on a high-level principle, IFRS 2 contains a lot of guidance seeking to clarify individual cases rather than the general principle. This has the effect of making the standard very complex and having it appear rules-based. We think this complexity increases by amending the standard as proposed by the IASB.
- Therefore, we recommend a general revision of the standard. A Post-implementation-Review might be a good starting point in this respect.

In answering the questions raised by the IASB we assumed that the Board would not take such a general review into account in the near future. This is notwithstanding our view regarding the need for a comprehensive revision of IFRS 2.



Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany



IFRS-Fachausschuss

The attached appendix includes our responses to the questions raised by the IASB. If you would like to discuss our comments further, please do not hesitate to contact Thomas Schmotz or me.

Yours sincerely,

Andreas Barckow

President



Appendix – Answers to the questions of the Exposure Draft

Question 1

The IASB proposes to clarify that accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should follow the approach used for measuring equity-settled share-based payments in paragraphs 19–21A of IFRS 2.

Do you agree? Why or why not?

We agree with the IASB's proposal to clarify that accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should follow the approach used for measuring equity-settled share-based payments as described in paragraphs 19-21A of IFRS 2. We are of the opinion that both general types of share-based payments should be treated consistently when determining the fair value of the share-based payment transaction.

However, we think the ED is not conclusive in clarifying how market vesting conditions and non-market vesting conditions are considered in situations when the services received in connection with a share-based payment transaction qualify for asset recognition.

For a cash-settled share-based payment transaction, paragraph 30 of IFRS 2 requires an entity to remeasure the fair value of the liability at the end of each reporting date until the liability is settled. However, in determining the fair value of the liability the standard is not clear on how to reflect changes in expectations of meeting service and non-market performance conditions. We are aware that different views are considered in the accounting literature (see KPMG Insights to IFRS 2014/15, pg. 1105; Deloitte iGAAP 2014, pg. 1384) and are applied in practice:

- Under the mixed approach only changes in the fair value of the underlying equity instruments, including the effects of market and non-vesting conditions, are recognised as re-measurements. Other adjustments to the liability that are due to revisions in the estimate of the outcome of service and non-market performance conditions are considered to be a true-up and therefore similar to equity-settled share-based payments.
- Under the full fair value approach, any change in the fair value of the liability is considered to be a remeasurement.

In case the cost of services received in a cash-settled share-based payment transaction is recognised in the carrying amount of an asset, only the grant date fair value of the arrangement may qualify for asset recognition. Furthermore, a remeasurement affects the carrying amount of the liability but not the carrying amount of the asset, whereas a true-up has an effect on both. Thus, the carrying amount of the asset varies depending on what is considered a remeasurement and what is considered a true-up, subject to the accounting policy choice described



above. We recommend that the Board clarify the intended change to current practice, for example by adding an illustrative example.

Question 2

The IASB proposes to specify that a share-based payment transaction in which the entity settles the share-based payment arrangement net by withholding a specified portion of the equity instruments to meet the statutory tax withholding obligation should be classified as equity-settled in its entirety. This is required if the entire share-based payment transaction would otherwise have been classified as an equity-settled share-based payment transaction if it had not included the net settlement feature.

Do you agree? Why or why not?

In general, we support the proposed amendment with respect to the classification of those transactions.

However, we note that the ED is not conclusive in clarifying how to account about the accounting for an award involving net settlement features. Even though the ED states that “...*the share-based payment shall be accounted for in accordance with the requirements that apply to equity-settled share-based payment transactions in paragraphs 10–29,*” it remains unclear how to account for the withheld portion of the award in general. Furthermore, we observe a number of specific questions for which the principles of IFRS 2, which the ED refers to in this regard, do not seem to be sufficiently designed. Examples include, but are not limited to, the following:

- Should the payment to the tax authorities be considered a repurchase of vested equity instruments for which paragraph 29 of IFRS 2 contains guidance, or should it be considered a transaction independent from the share-based payment award?
- How should the difference between the cash payment and the cost recognised during the vesting period for the number of equity instruments needed to match the monetary value of the tax be treated?

In our opinion, these questions need to be addressed in order to avoid further diversity in practice. We propose including such guidance in the final amendment. In addition, we recommend adding an illustrative example.

Further, we do not consider it appropriate to qualify the proposed solution as an exception to the requirements of IFRS 2 as the accounting outcome as described in the ED is the appropriate result from the existing guidance of the standard.

In addition to the above, we would like to bring an issue to the IASB's attention that we observe in our jurisdiction. The issue concerns share-based payment transactions in which an entity grants equity instruments, the settlement of which often involves a cash feature that exclusively



arises for reasons unrelated to the share-based payment agreement. The following two examples might illustrate that issue:

- (1) Some share-based payment arrangements foresee that the total value of the shares to be transferred equal a certain amount. Thus, the number of shares to be transferred is variable, for example in case of share-settled stock appreciation rights. According to IFRS 2.BC 106 et seqq. those transactions are classified as equity-settled share-based payments. In a case where the shares in which the transaction is to be settled foresee delivery of par value shares, the amount to be transferred usually cannot exactly be replicated due to the shares' denomination. (For example, the amount to be transferred is equal to CU 100 and one share's par value is CU 15.) Therefore, entities may transfer both shares and cash where the cash payment is solely made to iron out the gap that cannot be settled in shares. (In the example above, the entity would transfer six shares with a total value of CU 90 and CU 10 in cash.)
- (2) In some jurisdictions, in which the individual income tax is based on a progressive tax system – as is the case in Germany –, the value of the total number of shares withheld at the exercise date may exceed the value of cash paid by the entity to the taxation authorities. This is because entities that have granted equity instruments to a high number of beneficiaries are – due to time constraints or for other administrative reasons – often required to calculate the amount of withheld shares based on an approximation, e.g. an average income tax rate. (For example, upon exercise the entity withholds shares with a total value of CU 100, whereas the 'correct' amount determined later, taking into account the beneficiary's individual gross income tax situation and then filed with the taxation authorities, amounts to CU 90. It should be noted that the CU 90 is not the final income tax either as under a progressive tax system the final tax rate will only be known after the individual has filed his tax return at yearend.) The positive difference between the value of withheld shares and the actual payment to the taxation authorities will then be paid in cash by the entity to the beneficiary. (In the example, the balancing payment is CU 10.)

We are of the opinion that both of the cases mentioned above would not taint a classification as equity-settled share-based payment transaction as the cash amount involved in the settlement does not have anything to do with the character of the agreement per se – i.e. it does not depend on market factors or performance conditions –, but is solely due to facilitating the settlement.

**Question 3**

The IASB proposes to specify the accounting for modifications to the terms and conditions of a cash-settled share-based payment transaction that results in a change in its classification from cash-settled to equity-settled. The IASB proposes that these transactions should be accounted for in the following manner:

- (a) the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification;
- (b) the liability recognised in respect of the original cash-settled share-based payment is de-recognised upon the modification, and the equity-settled share-based payment is recognised to the extent that the services have been rendered up to the modification date; and
- (c) the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

Do you agree? Why or why not?

We agree with the IASB's proposal as it is consistent with the standard's principle for the accounting for cash-settled share-based payments. The liability recognised in connection with a cash-settled share-based payment award needs to reflect the expected amount of resources to be transferred by the entity to the beneficiary. For that reason, IFRS 2 requires remeasuring the liability arising from a cash-settled share-based payment transaction at fair value at the end of each reporting date until the liability is settled. Based on the assumption that the original award is settled and replaced by a new equity-settled award, the modification date fair value of the new award reflects the entity's expectations at the modification date as regards the value of the equity instruments to be transferred when the award is finally settled. Therefore, we agree that the minimum requirement of IFRS 2.27 should not apply in these situations, as stated in BC18 of the ED.

However, we think that the wording of paragraph B41 of the ED might undesirably create the impression of a contradiction with paragraph 27 of IFRS 2. Although B41 states, "*The equity-settled share-based payment transaction is measured at the fair value of the equity instruments granted as of the modification date,*" it implicitly overrides the principle of paragraph 27. Therefore, we recommend that the IASB incorporates the guidance of BC18 of the ED into paragraph B41.



Question 4

The IASB proposes prospective application of these amendments, but also proposes to permit the entity to apply the amendments retrospectively if it has the information needed to do so and this information is available without the use of hindsight.

Do you agree? Why or why not?

We agree with the IASB's proposal to apply the amendments prospectively and to permit retrospective application, if the entity has the information needed to do so and this information is available without the use of hindsight.

Question 5

Do you have any other comments on the proposals?

As mentioned in our cover letter we note a further issue for which diversity in accounting practice exists. This involves modifications to the terms and conditions of an equity-settled share-based payment transaction that results in a change in its classification from equity-settled to cash-settled. In the accounting literature, there are different views on how to account for the difference between the liability to be recognised at the modification date and the total amount that has been recognised in equity until the modification date in connection with the equity-settled award, in the case that the liability to be recognised exceeds the amount recognised in equity until that date.

Some are of the opinion that equity is debited with the full amount of the liability to be recognised, irrespective of whether the debit exceeds the amount recognised in equity until the modification date (approach 1).

Others take the view that the debit entry to equity shall not exceed the amount recognised in equity until the modification date in connection with the equity-settled award. This would lead to accounting for the resulting difference as an expense in the period in which the modification occurs (approach 2).

A third opinion exists according to which both approaches are acceptable and entities should choose an accounting policy as to which approach to apply.

The different approaches result in different total expenses recognised until the end of the vesting period, and only under approach 2 will the total expenses be equal to the liability at the end of the vesting period.

This example and the number of issues raised by constituents for consideration by the IFRS IC over recent years give rise to the conclusion that the general principle underlying IFRS 2 is not robust enough. We therefore recommend a general and comprehensive review of the standard.