EFRAG
European Financial Reporting Advisory Group

Draft Comment Letter

Comments should be submitted by 30 January 2015 to commentletters@efrag.org

16 December 2014

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: Exposure Draft *Classification and Measurement of Share-based Payment Transactions (Proposed amendments to IFRS 2)*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *Classification and Measurement of Share-based Payment Transactions (Proposed amendments to IFRS 2)* (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

Our detailed comments and responses to the questions in the ED are set out in the appendix. To summarise we agree with the IASB's assessment of the issues and with its proposed amendments to address them as we believe that they provide practical solutions that would reduce divergence in the application of IFRS 2 *Share-Based Payment*.

However, EFRAG is concerned that addressing more and more specific terms and conditions of different share-based plans is resulting in ever-increasing complexity in the requirements of IFRS 2. Rather than continuing to introduce individual amendments, we suggest that the IASB should undertake a general review of IFRS 2 to consider all implementation issues so as to provide solutions in a broader principle-based context. We also note that a long-term research project is unlikely to be an appropriate solution and a post-implementation review could achieve more timely results.

If you would like to discuss our comments further, please do not hesitate to contact Hocine Kebli, Giorgio Acunzo or me.

Yours sincerely,

Roger Marshall
Acting President of the EFRAG Board

APPENDIX

EFRAG's responses to the questions raised in the ED

Question 1

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

Do you agree? Why or why not?

Notes to constituents

1 *IFRS 2* Share-Based Payment *does not specifically address the impact of vesting and non-vesting conditions on the measurement of the fair value of the liability incurred in a cash-settled share-based payment transaction.*

2 *The IASB observed that the guidance in paragraph 6A of IFRS 2, which requires an entity to follow the notion of 'fair value' in IFRS 2, requires the same notion of fair value for cash-settled and equity-settled awards. Consequently, the IASB proposed to include guidance on the impact of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment transaction, based on the analogy of the accounting treatment for an equity-settled share-based payment transaction.*

3 *Therefore, the IASB proposes to clarify that accounting for the effects of vesting and non-vesting conditions on a cash-settled share-based payment should follow the approach used for equity-settled share-based payments in paragraphs 19 - 21A of IFRS 2 which implies that:*

(a) *vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of awards included in the measurement of the transaction amount;*

(b) *the estimate of the number of awards that are expected to vest shall be revised only if subsequent information indicates that the number of awards that are expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of awards that were ultimately vested; and*

(c) *as a consequence of the above, the cumulative amount ultimately recognised for goods or services received as consideration for the cash-settled share-based payment should equal to the cash paid.*

4 *The IASB further observed that measuring the fair value of the liability incurred in a cash-settled share-based payment transaction by analogy to the guidance for equity-settled share-based payment transactions would be easier to apply in practice.*

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EFRAG's response

EFRAG agrees with the proposed amendment.

5 EFRAG agrees with the IASB's argument that the amendment is consistent with paragraph 6A of IFRS 2 *Share-Based Payment*, which requires an entity to follow the notion of 'fair value' as defined in IFRS 2 and not as defined in IFRS 13 *Fair Value Measurement*. This paragraph does not distinguish between cash-settled and equity-settled awards. The different natures of a cash-based and an equity-settled share-based payment justify a different approach to the subsequent remeasurement but do not justify different approaches in measurement.

6 Therefore, EFRAG agrees with these proposed clarifications as they result in a consistent application of the principles in IFRS 2 regarding the impact of vesting and non-vesting conditions on the determination of the fair value of share-based payment transaction.

Question 2

The IASB proposes to specify that a share-based payment transaction with employees 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 obligations 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?

Notes to constituents

7 *Some share-based payment transactions have terms that require or permit the entity to deduct from the total number of equity instruments the number of equity instruments needed to equal the monetary value of the employee's tax obligation in order to meet applicable tax withholding obligations.*

8 *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 its statutory tax withholding requirements, should be classified as equity-settled in its entirety, if in the absence of such a net settlement feature, the entire share-based payment transaction would have been classified as an equity-settled share-based payment.*

9 *The IASB had considered and rejected an alternative accounting approach under which, each component of the share-based payment would have been accounted for in a manner that is consistent with the manner of settlement. Under this rejected approach, the portion withheld by the entity for which the entity had incurred a liability to pay cash, would be accounted for separately and be classified as a cash-settled share-based payment transaction in accordance with the manner of settlement.*

10 *However, in reaching its conclusions, the IASB concluded that this would impose a significant operational challenge and cause an undue burden when applying IFRS 2, because it would have required an entity to estimate changes in tax laws, including changes in tax rates, that affect the amount that is required to be withheld and remitted by the entity and, as the estimate changes, the entity would have needed to reclassify a portion of the share-based payment between cash-settled and equity-settled.*

11 *The amendments propose to add guidance to IFRS 2 in the form of an exception to the requirements in IFRS 2 that is limited to the situation in which a law or an agreement with the employee requires an entity to withhold a certain amount of the employee's tax obligation associated with share-based payments in order to meet the employer's statutory tax withholding requirements.*

EFRAG's response

EFRAG agrees with the proposed amendment because we believe that a plan with the specific characteristics described in paragraph 33D is, in substance, an equity-settled plan in its entirety. EFRAG recommends that the IASB clarifies the accounting for the settlement of the withholding tax, consistently with the analysis that the plan is in substance an equity-settled plan.

12 EFRAG observes that the proposed amendments examine a specific set of circumstances whereby:

(a) an entity is obliged by the tax laws to withhold a certain amount of the counterparty's taxes associated with the share-based payment, and transfer the amount in cash, or other assets, to the taxation authorities; and

(b) the share-based payment arrangement permits or requires the entity to deduct from the total number of equity instruments the number of equity instruments needed to equal the monetary value of the counterparty's tax liability for the purpose of meeting the tax withholding requirements.

13 EFRAG welcomes the amendment as we acknowledge that the definition of a cash-settled plan, as written, may lead to requiring the entity to classify the portion corresponding to the future withholding tax as a cash-settled plan. EFRAG believes that a plan with the specific characteristics as described in paragraph 33D of the ED is in substance an equity settled plan and should be accounted for as such. The reason is that, absent of the withholding plan, the plan would qualify as an equity settled plan, and the withholding tax is not an expense of the company, rather a tax paid on behalf of the employee. We therefore do not agree to qualify this outcome as an exception to IFRS 2 requirements and that this outcome is justified only in order to avoid burden to preparers due to a necessary complex assessment, because the amount may depend on the current value of the instruments at vesting or delivery and tax regimes may change. Rather the IASB could signal that applying the definition of cash settled plan literally might get to a conclusion that would not be consistent with the substance of the arrangement.

14 As a result of giving precedence to the substance of the arrangement, the amendment avoids different treatments for cases when the entity directly deducts a number of vested instruments and cases when the entity issue all the instruments but delivers some of them to a broker to sell them on the market and use the proceeds to settle the tax obligation of the beneficiary.

15 EFRAG notes that when the entity settles the withholding tax, the cash payment is likely to differ from the cost recognised during the vesting period for the number of equity instruments needed to equal the monetary value of the tax. The amendment does not address the treatment of any such difference and it is not clear whether the provisions in paragraph 29 of IFRS 2 would apply. We recommend that the IASB clarifies this, possibly by adding an Illustrative example. The outcome of the example should be consistent with the underlying analysis that the plan is an equity-settled plan and the withholding tax an expense of the beneficiary, not of the entity.

16 While we support the amendment, as explained in paragraph 30 below EFRAG believes that the IASB should consider a general review of the Standard. In that context, the IASB should re-consider in a more comprehensive way how a net settlement feature (be it due to tax regulations, contractual terms or other facts) affects the classification of a share-based plan.

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 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 would be 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 should be derecognised upon the modification and the equity-settled share-based payment should be 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 should be recorded in profit or loss immediately.

Do you agree? Why or why not?

Notes to constituents

17 *A modification to the terms and conditions of a share-based payment transaction may change the transaction from cash-settled to equity-settled. Cash-settled share-based payment may also be settled and replaced by a new equity-settled share-based payment. IFRS 2 does not specifically address such situations.*

18 *The IASB proposes to amend IFRS 2 so that:*

(a) *the share-based payment transaction would be 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 derecognised 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.*

19 *In the IASB's view, the principles for the modification of equity-settled share-based payments in paragraphs 27 and B42–B44 of IFRS 2 (requiring to always recognise a minimum amount for the share-based payment following modifications to the terms and conditions of an equity-settled share-based payment transaction) should not be applied by analogy to account for the fact pattern considered in the amendments, because the original cash-settled share-based payment is considered to be settled and replaced by the promise to issue equity instruments.*

20 *Therefore, applying the requirement in paragraph 27 of IFRS 2 would be inconsistent with the requirement in paragraph 30 of IFRS 2 to always remeasure the fair value of the liability of a cash-settled share-based payment transaction at the end of each reporting date and until the liability is settled (that is, in the considered fact pattern, until the date it is replaced by the new equity settled transaction.*

EFRAG's response

EFRAG agrees with the proposed amendment.

21 EFRAG believes that the manner of settlement is a fundamental feature in a share-based payment. A cash-settled plan is significantly different from an equity-settled plan. As a consequence, EFRAG agrees with the IASB's assessment that replacing a cash-settled plan with an equity-settled plan is more like a settlement of the original award rather than a modification.

22 EFRAG agrees that the replacement award should be measured at the replacement date, which is consistent with the grant-date approach for equity-settled plans. The replacement date is the date when the entity and the beneficiary agree on the terms of replacement award. Moreover, it is likely that the beneficiary will require an assessment of the replacement date fair value to accept the change. Requiring the entity to use for accounting purposes the fair value at a different date (such as the grant date of the original award) would possibly be burdensome.

23 EFRAG also agrees that any difference between the liability and the amount of equity recognised in equity should be charged to profit or loss. This is consistent with the general requirements applied to the extinguishment of liabilities.

24 In our view, these amendments will reduce diversity in practice in accounting for these types of transactions.

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?

EFRAG's response

EFRAG would prefer that the amendments are subject to the general requirement in paragraph 24 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that requires retrospective application of new pronouncements unless it is impracticable.

25 EFRAG generally believes that amendments should be applied retrospectively, unless it is impracticable.

26 EFRAG is not persuaded by the argument in paragraph 22 of the Basis for Conclusions that the first amendment should be applied prospectively as it only affects the amount and timing of the expense recognised at each reporting date. We think that information about the comparative period is useful in itself and enhances comparability

27 Therefore we believe that the Amendments should be applied retrospectively, in accordance with paragraph 22 of IAS 8, unless it is impracticable to do so, in which case the changes are applied as at the beginning of the earliest period for which retrospective application is practicable*.*

28 Furthermore, from the discussion in paragraph 22 and 23 of the Basis for Conclusion, we understand that the IASB intends requiring entities to adopt the three amendments in the same way - that is, an entity should apply all three amendments together, either prospectively or retrospectively (this being subject to the availability of the required information for all of them). If the IASB retains this view, EFRAG suggests that the second sentence in paragraph 63D is clarified as follows (added words underlined):

However, an entity may instead apply all the amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors provided that the entity has the information necessary to do so for all the amendments, and this information is available without the use of hindsight.

Question to constituents

29 Do you agree with EFRAG's recommendation that the amendments should be applied retrospectively unless impracticable, in accordance with the general requirements in IAS 8?

Question 5

Do you have any other comments on the proposals?

EFRAG's response

EFRAG is not persuaded that the IASB should continue to introduce changes to IFRS 2 as a way to address implementation issues in relation to specific terms, conditions or features of share-based plans, as this results in ever-increasing complexity of the requirements. Instead, the IASB should consider a more general review of IFRS 2 to address all implementation issues in a principles-based way.

30 Although EFRAG is not opposed to any of the three proposed amendments, EFRAG is concerned about the continuous changes to IFRS 2 (including exceptions to the existing principles) to address implementation issues created by specific facts, circumstances or features of share-based plans. EFRAG believes that this approach creates complexity and may result in internal inconsistencies and unintended consequences.

31 For this reason, EFRAG would like to caution the IASB against continuing to make narrow-scope changes; the IASB should rather consider a general review of the Standard to ensure that all issues are addressed in a principle-based way. This could be achieved with a post-implementation review of the Standard.