Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany

® Der Standardisierungsrat

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

London EC4M 6XH
United Kingdom

Berlin, 2 June 2006

Dear Sir David

Re: Exposure Draft of Proposed Amendments to IFRS 2 Share-based Payment *Vesting Conditions and Cancellations*

We appreciate the opportunity to comment on the Exposure Draft of Proposed Amendments to IFRS Share-based Payment *Vesting Conditions and Cancellations* (ED IFRS 2amend). We agree that these issues that were initially comprised in IFRIC D11 should better be dealt with by means of an amendment of IFRS 2 rather than an Interpretation.

While we support the IASB's proposals on vesting conditions and effective date / transitional provisions we disagree with the IASB's conclusion that cancellations by employees should be accounted for in the same way as cancellations by the entity, i.e. through acceleration of vesting. We are not aware of any technical argument for this treatment and doubt that the purely pragmatic rationale set out in the Basis for Conclusions is sufficient to justify the IASB's proposal. In our view, the economic differences between cancellations by employees and cancellations by the entity warrant a different accounting treatment of these two types of cancellations. In particular, we believe that the economic substance of a cancellation by an employee and an employee's decision not to exercise an option is similar. Consequently, the cancellation should not affect accounting, meaning that the recognition of the expense should be continued over the remainder of the vesting period.

Vorstandsausschuss:
Heinz-Joachim Neubürger (Vorsitzender), Dr. Helmut Perlet (Stellvertreter), Dr. Werner Brandt (Schatzmeister), Dr. Kurt Bock
Generalsekretärin: Liesel Knorr

Our responses to the questions raised in the Invitation to Comment section of ED IFRS 2amend are set out below.

If you would like further clarification of the issues set out in this comment letter, please do not hesitate to contact me.

Yours sincerely,

Prof. Dr. Harald Wiedmann
President

Comments to the Questions of ED IFRS 2amend

Question 1 – Vesting conditions

The Exposure Draft proposes that vesting conditions should be restricted to performance conditions and service conditions. Do you agree? If not, what changes do you propose, and why?

We support the clarification that vesting conditions are restricted to service and performance conditions. We agree that other features of share-based payment transactions – such as an employee's requirement to make regular contributions to an employee share purchase plan (ESPP) over a specified period – should not be regarded as a vesting condition.

Question 2 – Cancellations

The Exposure Draft proposes that cancellations by parties other than the entity should be accounted for in the same way as cancellations by the entity.

Do you agree that all cancellations should be treated in the same way? If not, please specify the nature of any differences between types of cancellations and explain how they influence the selection of appropriate accounting requirements.

In paragraph BC8 of ED IFRS 2amend four ways of accounting for employee cancellations are stated. It can be clearly derived from the amended definition of vesting conditions that alternative a) (reversal of the expense) is not appropriate because the requirement to contribute payments to a plan or to abstain from selling an initial grant of shares during a specified period cannot be considered to represent a vesting condition. Furthermore, we agree that alternative b) (cease recognizing future expense from the date of cancellation) would contradict the grant date measurement approach inherent to IFRS 2 because – already at grant date – the probability of future cancellations by employees has to be taken into account in the determination of the fair value of the equity instruments granted.

While we support the view that the full expense (measured at grant date) for the service has to be recognised we disagree with the IASB's proposal that the recognition of the expense has to be accelerated once the employee has cancelled his/her plan participation. The GASB supports alternative c), (i.e. continue recognising the expense as if the cancellation had not occurred), because of the similarity – in terms of economic substance – between cancellations and the employee's choice not to exercise the option to buy shares after the vesting period has ended. The GASB understands the rationale of the IASB's choice for alternative d) in the case of cancellations by employers (on the one hand it is an anti abuse regulation as set out in IFRS 2.BC237, on the other hand there is a very high probability that the employer will be forced to adequately compensate the employees in some other way when cancelling a plan). However, in the case of cancellations by employees these arguments are

evidently not applicable. This emphasises the difference in substance between cancellations by employees and cancellations by the entity.

The rationale for the IASB's decision to account for all cancellations in the same way relies on two pragmatic, non-technical arguments: the avoidance of structuring incentives and convergence with US GAAP. We believe that both arguments are questionable.

In paragraphs BC14-15 of ED IFRS 2amend the IASB denies the existence of suitable non-arbitrary and unambiguous criteria to distinguish between cancellations by employees and cancellations by the entity and concludes that a different accounting treatment of these two types of cancellations would create an incentive for structuring transactions to achieve the desired accounting result. We disagree with this assessment and believe that professional judgement could and should be applied in such events.

With regard to convergence with US GAAP concerning the accounting for cancellations by employees we have doubts that this aim is entirely achieved by the IASB's proposal because it can be derived from US GAAP literature that both alternatives c) and d) might be consistent with US GAAP. There is no indication in FAS 123 (rev. 2004) whether the accounting treatment set out for cancellations in paragraph 57 (acceleration of vesting) refers to both cancellations by the entity and by employees. The same is true for paragraphs B197-198 of FAS 123 (rev. 2004). Another possible source for accounting guidance on this issue is FTB 97-1. While an employee's cessation to have withheld an amount of money from his salary (i.e. the cessation to pay an amount into the plan) is not explicitly dealt with in FTB 97-1, paragraph 20 of FTB 97-1 contains a statement on decreases in withholding amounts. Since decreases can be permanent and as low as zero, the statement in paragraph 20 might also apply to a cessation of payment. Paragraph 20 of FTB 97-1 states: "Any decreases in the withholding amounts (or percentages) should be disregarded for purposes of recognizing compensation cost unless the employee services that were valued at the grant date will no longer be provided to the employer due to a termination". This statement implies that decreasing or ceasing contributions should be treated as failure to exercise an option, with the result being that the originally measured compensation cost would be recognised over the original service period. This accounting treatment corresponds to alternative c). In summary, current US GAAP literature can be considered insufficiently clear with regard to the question if cessations of payment and plan cancellations by employees have to be accounted for in the same way than cancellations by the entity.

Question 3 – Effective date and transition

The proposed changes would apply to periods beginning on or after 1 January 2007, and would be required to be applied retrospectively. Earlier application would be encouraged.

Should the IASB proceed with the proposals we generally agree with the effective date and the transitional requirement. However, retrospective application of the proposed changes might cause significant problems in the following situation: In the past, an entity has treated certain conditions as vesting conditions and due to a failure to satisfy these conditions the equity instruments did not vest (leading to a forfeiture). If these conditions are not consistent with the modified definition of vesting conditions the entity would be required to restate past accounts to include these conditions in the grant date fair value and to recognise cancellations instead of a forfeiture. Besides of the problem that, in these cases, the relevant information for retrospective application might not be available, it might be difficult to demonstrate that any adjustment to the fair value in respect of the condition, which is no longer a vesting condition, represents a valid estimate at the grant date without the use of hindsight.