

**ED 2 SHARE-BASED PAYMENT**

SIR,

I appreciate the opportunity to comment on ED 2 which gives the impression of a properly developed project aiming for high quality.

**Questions 1 to 4**

I agree to the scope of the draft which does not give room to exemptions (question 1). The recognition requirements are appropriate (question 2). This is also true for the measurement principle (question 3). It is also appropriate that directly measured transactions are measured at the date when the entity obtains the goods or receives the services (question 4).

**Question 5**

If the transaction is to be measured indirectly the grant date is only appropriate when the entity has obtained the goods or received the services until that date. Otherwise the granting of equity instruments by the entity represents a promise to deliver on receipt of goods or services. As long as this has not happened the transaction is pending and does not justify an accounting entry (see in analogy par. 58 of the Framework)

**Question 6**

It is acceptable to presume that the fair value of goods and services received from parties other than employees is more readily determinable than the fair value of equity instruments granted as consideration as long as this remains a rebuttable presumption.

**Question 7**

For equity-settled transactions with employees a surrogate measure can be accepted provided it starts as a preliminary estimate as in most cases the services or the performance expected will have to be realised after the entity has granted the equity instruments as their consideration, leaving the grant of the entity as an offer to deliver equity instruments if, and only if, certain conditions are satisfied. Thus the surrogate measure has to take place when the conditions of the offer are satisfied i.e. at vesting

date. Any measurement between granting date and vesting date is of preliminary character as neither side could claim anything.

The rationale of the draft which has been outlined in the Basis for Conclusions appears to be a mixed one. On one side the surrogate measure shall replace a direct one to overcome practical difficulties of measuring the so-called “services of the employees” between grant date and vesting date. On the other hand the draft stipulates a measurement before having received any services. Consequently a measurement at grant date could only be a preliminary estimate which has to be remeasured at least until vesting date. Thus the argument of the Board that “if the fair value of equity instruments granted is used as a surrogate measure of the fair value of the services received vesting date and exercise date are inappropriate because the services received during a particular accounting period is not affected by subsequent changes in the fair value of the equity instrument” (BC 87).is not correct.

The surrogate measurement model of the draft mixes inconsistently elements from liability accounting and from equity accounting and does not explore sufficiently the so-called “services of employees”:

First: The choice of grant date as measurement date which means accounting for a share-based equity-settled payment plan at its starting point corresponds to the accounting of future liabilities due to probable losses from undelivered contracts. Except that the liabilities will have to be remeasured during the course of transaction. On the other hand equity transactions are not measured at the date of authorization but at the date of issue of capital which allows for a definite measure. The consistent solution would be either to measure at grant date on a preliminary basis or to measure on vesting date at a definite basis-

Second: If the fair value of the services received cannot be measured reliably how could be argued that the services of the employees are not affected by changes of the fair value of the equity instruments during the vesting period ?

Third: The often used expression “services received” has not been explored properly. Although various examples of share-based equity-settled employee payment plans have been described in the draft the ruling gives the impression that the service of the employees is related to their time spent in the entity, not considering the quality factors as competence, creativity, innovation, and last not least success. The ruling also ignores the fact that many of these plans are based on performance criteria where

the employees can only contribute to a smaller part heavily depending on outside influences i.e. in case of a defined share-price performance.

Conclusion: Again there remain the two above mentioned options for an appropriate accounting solution. Either to start accounting at grant date with a preliminary fair value and remeasure it annually until vesting date or to account for the definite fair value at vesting date.

The first option would require an actualisation of the rather traditional definition of equity in the Framework which seems to be necessary anyhow as it is too simple (difference between total assets and liabilities) to serve present requirements.

### **Question 8**

The question reduces the different situations and consequences of par. 13 and 14 to a simple point which does not reflect their complexity. Of course, it is self-evident that between granting date and vesting date all conditions of the share-options agreement have to be satisfied or the agreement does not vest. If there are no conditions in the agreement it is obvious that granting and vesting date fall together. In consequence the full increase in equity and the corresponding expense will have to be recognised on grant date. However that the expense should always be the consequence of a service rendered by the employees who are part of the agreement seems to be a very questionable and sometimes unrealistic presumption as it does not consider any success-factors(see above).

### **Question 9**

I do not agree with the surrogate measure at grant date as outlined above. There you also find my proposal. In case of a preliminary measurement at grant date the annual remeasurement should consider the probability of all factors to satisfy the conditions of the plan and not merely the portion of services rendered by the employees.

### **Question 10**

I do not agree with the proposed requirement and propose subsequent adjustments as outlined above.

**Questions 11 and 12**

An option pricing model could be accepted as a preliminary estimate of options granted but not as a definite measure (see above). It should be reapplied annually until vesting date.

**Questions 13 and 14**

I agree with both proposals.

**Question 15**

I have no further indications.

**Question 16**

I agree with the approach to give prescriptive guidance on the estimation of the fair value of options..

**Question 17**

The incremental value granted should be taken into account.

**Question 18**

I completely disagree with the proposed procedure as until vesting anything is of preliminary character and thus any change has to be considered (see also above).

**Questions 19 and 20**

The proposed requirements for cash-settled share-based payment transactions and for share-based payment transactions with the choice of cash settlement are appropriate.

**Questions 21 to 23**

The proposed disclosure and application requirements appear to be appropriate as is the proposed amendment of IAS 12.

**Question 24**

- (a) (a) IFRS is right not to propose any exemption from applying the draft and measuring at fair value.

- (b) (b) SFAS 123 is right to measure the transaction at the fair value of the equity instruments issued. Thus it is of minor importance that the preliminary estimate at grant date is not reduced for the possibility of forfeiture although its consideration in the estimate would be welcomed.
- (c) (c) The immediate recognition of a grant of equity instruments settled in cash by the entity under SFAS 123 is more appropriate than the approach in the draft IFRS.
- (d) (d) The definition of the measurement date for transactions with parties other than employees appears to be more appropriate to reality under SFAS 123 plus EITF 96-18 than in the draft IFRS.
- (e) (e) The draft IFRS is right to stick to fair value measurement.
- (f) (f) The requirement of SFAS 123 to credit realised tax benefits from share-based payment transactions directly to equity is consistent with the concept and right.

## **Question 25**

No further comments.

Sincerely, Yours,

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