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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Sir David,

Proposed Amendments to IFRS 2 *Share-based Payment* Vesting Conditions and Cancellations

Deloitte Touche Tohmatsu is pleased to comment on the *Exposure Draft of Proposed Amendments to IFRS 2* Share-based Payment *Vesting Conditions and Cancellations* (referred to as 'the ED' or 'the proposed amendments'). Our responses to the questions raised in the ED are set out in the Appendix to this letter.

We do not believe the Board should issue the proposed amendments at this time. We refer you to our comment letter responding to D11 *Changes in Contributions to Employee Share Purchase Plans* dated 1 March 2005. The proposed amendments would codify in the standard the same requirements as the IFRIC were proposing as an interpretation. We believe that the Board should undertake further research and consider alternative approaches that may be better suited to address the wide range of schemes that exist in practice today. We have included in our comment letter a proposed approach that we believe should be considered by the Board prior to issuing a final amendment (as discussed in the responses below).

We appreciate the opportunity to provide our comments. If you have any questions concerning our comments, we would be pleased to discuss them.

Sincerely,

Ken Wild
IFRS Global Leader

Appendix
Comments of Deloitte Touche Tohmatsu on
Exposure Draft of Proposed Amendments to *IFRS 2*
***Share-based Payment* Vesting Conditions and Cancellations**

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 do not agree with this proposal. We do not believe the proposed amendments address the range of features which exist in share-based payment schemes.

We believe that this amendment would cause some conditions which have previously been treated as non-market vesting conditions no longer to be treated in this manner. It may also result in interpretive issues as to the exact meaning of the term 'performance', and particularly whether that term is intended to be restricted to performance by the entity and/or performance by the employee.. As an example, we are aware that differing views exists as to whether an Initial Public Offering would be considered to be a vesting condition (as a successful IPO is an identifiable performance target) or not (as the success or failure of the IPO is not necessarily directly related to the financial performance of the entity or the specific performance of an individual.) Furthermore, BC 4 of the ED concerns us because it implies that conditions which are no longer treated as non-market vesting conditions should be incorporated into the fair value measurement at grant date. We note that in paragraph BC 197 of IFRS 2 the Board acknowledged the difficulty of incorporating the probability of satisfaction of non-market vesting conditions into the grant date fair value. We believe that there are schemes that involve conditions that are not service or performance conditions which nevertheless will be difficult to measure.

We note that paragraph BC20 of the proposed amendments states that the relevant requirements of US GAAP are the same as the proposed amendments. In accordance with FASB Statement No. 123(R), *Share Based Payment*, a share-based payment award is classified as a liability and the relevant conditions are factored into the grant date fair value when a vesting condition exists that does not meet the definition of a market, performance, or service condition. The fair value of the liability (incorporating these conditions) is then remeasured at every reporting date until the date of settlement. In accordance with the proposed amendments, the definition of vesting conditions would be similarly restricted and the entity would be required to incorporate such conditions into the grant date fair value. However, unlike Statement 123(R), IFRS 2 does not require liability classification and remeasurement for equity-settled share based payment awards. Accordingly divergence would continue to exist in the accounting for awards with vesting conditions other than market, performance, or service conditions.

We therefore recommend the Board undertake further research before proceeding with this amendment.

Question 2 – Cancellations

The Exposure Draft proposes that cancellations by parties other then 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.

We believe in some circumstances the unique nature of certain counter-party cancellations are sufficiently different from an entity cancellation as to warrant a different accounting treatment than that used in the case of entity cancellations. Accordingly, we believe that the IASB should consider the following model for such counter-party cancellations:

> If a counter-party withdraws from a share-based payment arrangement, and that withdrawal is evidenced by the cessation of that counter-party meeting a condition of the scheme that has real economic substance to the counter-party, recognition of compensation expense should cease on the withdrawal date. Previously recognised compensation cost should not be reversed since the employee has already provided services in anticipation of the award vesting. Unrecognised compensation expense should not be recognised since the employee is effectively forfeiting the award by no longer meeting a required condition and will not provide further services in anticipation of an award vesting..

For example, under a typical Employee Stock Purchase Plan (ESPP) employees are required to make contributions through payroll deductions that are used to buy the employer's stock over a specified purchase period. Some ESPPs allow employees to withdraw from the plan before the shares are purchased and to receive a refund for amounts previously withheld. Compensation cost resulting from the ESPP is measured on the date the employee elects to participate in the plan and is based on the expected payroll withholdings (which does not take potential withdrawals from the ESPP into account). If no distinction is made between a withdrawal from an ESPP and a normal cancellation, entities will be required to recognise compensation expense related to shares that were never purchased since the employee elected to withdraw from the plan. Withdrawal from an ESPP is different from a normal cancellation in that it may be motivated by factors other than the stock price of the employer's shares that nevertheless have real economic substance to the employee (such as the employee's personal financial situation).

We believe that this approach recognises the true economics of the transaction even though it will be inconsistent with the approach under FASB Statement No. 123(R), *Share Based Payment*, and FASB Technical Bulletin No. 97-1, *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option*, where any decreases in withholding amounts are disregarded for purposes of recognizing compensation cost

The Board has previously expressed a concern that to treat cancellation by the counter-party differently from other cancellations would create incentives for entities to structure transactions in order to achieve a desired accounting result. The requirement which we propose alleviates this concern because the alternative accounting treatment is triggered only when the cancellation has a real economic impact on the counter-party.. A commonly cited example of a structuring opportunity is where the counter-party writes a letter indicating their intent to no longer participate in the scheme (possibly at the instigation of the entity). Counter-parties could potentially be encouraged to provide such confirmation of intent in response to a request by the entity where they believe that the confirmation will not result in any particular economic impact on themselves. Our proposed accounting treatment would not apply in this situation because the writing of the letter does not have real economic substance to the counter-party.

Although we have provided one alternative approach, we believe that the Board should do further analysis to determine an appropriate accounting treatment for scenarios which are neither a vesting condition (as per the amended definition) nor a cancellation 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.

Are the proposed effective date and transition appropriate? If not, what do you propose and why?

Should the IASB proceed with the proposals we agree with the proposed effective date and transition. We agree with the Board that most entities that have applied IFRS 2 to date should have sufficient information available to them to make the changes with retrospective effect. We therefore do not see the need for any exception from the general principles relating to changes in accounting policy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.