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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

### **INFORMATION FOR OBSERVERS**

**Board Meeting:** 17 July 2007, London

**Project:** Short-term convergence – Earnings per Share

**Subject:** Earnings per share: Outstanding issues (Agenda paper 3)

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### **PURPOSE OF THIS MEMORANDUM**

1. This memo is intended to address the issues that have arisen in drafting the proposed Statements on the amendments to FASB Statement No. 128, "Earnings per Share", and IAS 33, "Earnings per Share". The staff of both the FASB and the IASB has identified the following issues that need to be resolved.
  - a. Physically settled forward purchase contracts
  - b. Physically settled written put options over own shares
  - c. Instruments in which the embedded option is fair valued
  - d. Allocation of actual dividends in the computation of diluted EPS under the two-class method
  - e. Effective date

f. Comment period

**PHYSICALLY SETTLED FORWARD PURCHASE CONTRACTS**

2. The first issue was initially raised by a FASB Board member at the FASB's March 21, 2007 education session on earnings per share. The staff has analyzed the Board member's question and believes a conclusion has been reached for Board consideration. The question surrounds the EPS treatment of forward contracts that require physical settlement by repurchase of a fixed number of the issuer's equity shares for cash (referred to herein as "physically settled forward purchase contracts") and that treatment's consistency with the staff's recommendation regarding mandatorily convertible securities in FASB Board Memo #11 and IASB March 2007 Board Paper 11A.
3. Having reviewed both FASB Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", and IAS 32, "Financial Instruments: Presentation" the staff believes that physically settled forward purchase contracts under both standards require the contract to be recorded as a liability with an offset to equity at contract inception. Effectively, both standards require the issuance of a physically settled forward purchase contract to be accounted for in a manner akin to a treasury stock purchase using borrowed funds (that is, as if the future repurchase of shares had already occurred). The staff has confirmed their conclusions regarding the accounting for a physically settled forward purchase contract with the joint liabilities and equity team.

**Earnings Per Share Treatment of a Physically Settled Forward Purchase Contract**

**U.S. GAAP - Basic EPS**

4. Since the accounting representation of a physically settled forward purchase contract is to account for the shares as though they have been repurchased at the inception of the forward contract, the EPS requirements in paragraph 25 of Statement 150 require that the shares (subject to repurchase) are removed from the denominator of the basic and diluted EPS calculations. However, paragraph 25 of

Statement 150 goes on to say there is a numerator adjustment in the computation of EPS. That numerator adjustment includes:

“Any amounts, including contractual (accumulated) dividends and **participation rights in undistributed earnings**, attributable to shares that are to be redeemed or repurchased that have not been recognized as interest costs in accordance with paragraph 22 shall be deducted in computing income available to common shareholders (the numerator of the earnings per share calculation), consistently with the ‘two-class’ method set forth in paragraph 61 of FASB Statement No. 128, Earnings per Share.” [Emphasis added]

The staff has interpreted the phrase “participation rights in undistributed earnings” as the rights of the common shareholders (subject to repurchase) to current period earnings. The staff believes the numerator adjustment in paragraph 25 of Statement 150 is intended to capture the claim that current shareholders (whose stock is subject to repurchase) have on current period earnings prior to actually being repurchased. Note: the staff confirmed their interpretation of paragraph 25 of Statement 150 with the project manager on the Statement 150 project. The staff believes their interpretation of the phrase “participation rights in undistributed earnings” is consistent with the staff’s recommendation for mandatorily convertible instruments discussed at the March 2007 Board meetings. That is, the staff observed that instruments that presently participate in earnings with common shareholders are required to be included in basic EPS using the two-class method.

5. Additionally, the staff believes (a) the exclusion of the common shares subject to repurchase and (b) their interpretation of the numerator adjustment required under the two-class method would generally result in the same basic EPS amount as if the entity had not excluded the shares and not made the numerator adjustment. The staff also observes that the resulting basic EPS amount **would** differ in circumstances where the forward contract counterparty (if the legal owner of the common shares) agrees to remit dividend payments back to the issuer for the number of shares underlying the forward contract, because there would be no dividend participation feature in that circumstance. However, the staff does not know how common such arrangements are in practice.

6. The staff has prepared the following example to illustrate, for a physically settled forward purchase contract, the interaction of (a) the guidance in paragraph 25 of Statement 150, which requires an adjustment to the denominator, and (b) the application of the two-class method, which requires an adjustment to the numerator.

Assume a company had net income of \$1,000 for the year and had 1,000 shares of common stock outstanding for the entire year. As of the beginning of the year, the company enters into a physically-settled forward contract to purchase 200 of its outstanding common shares in two years at the then market price. If the company had not entered into the forward contract, it would have reported basic EPS of \$1.00 ( $\$1,000/1,000$  common shares). Pursuant to paragraph 25 of Statement 150, the entity reduces the denominator of the basic EPS calculation by the 200 shares that it will purchase under the forward contract. However, if the entity had paid a dividend during the year, the shares underlying the forward contract would receive their share of the dividend. Accordingly, the two-class method must be used to calculate earnings per share. The two-class method requires a hypothetical allocation of earnings for the period as if all earnings had been distributed. If the company had distributed all \$1,000, \$200 of that income would have been distributed to the shares underlying the forward contract (and removed from the denominator in the EPS calculation). Accordingly, net income would be reduced by \$200 to compute net income available to common shareholders of \$800. Dividing that \$800 by the 800 shares (as adjusted pursuant to paragraph 25 of Statement 150) results in basic EPS of \$1. Accordingly, excluding the shares underlying the forward contract from the denominator of the EPS calculation had no ultimate effect on basic EPS in this example.

The staff observed that this result would also arise if the entity issued mandatorily redeemable common stock, rather than a physically settled forward purchase contract.

### **IFRS – Basic EPS**

7. The staff notes that IAS 32 does not have any specific EPS guidance on physically settled forward purchase contracts. The staff also notes that IAS 33 does not have any specific guidance on the calculation of basic EPS with respect to forward purchase contracts. This fact has been confirmed with the IASB’s liabilities and equity staff. That is, IAS 32 (unlike paragraph 25 of Statement 150) and IAS 33 do not require adjustments to the numerator and denominator of the basic EPS calculation for physically settled forward purchase contracts.

### **Staff Discussion of Difference in Basic EPS**

8. The staff has analyzed the potential convergence differences the EPS guidance in paragraph 25 of Statement 150 poses for the computation of basic EPS. The staff believes there should be no difference in the basic EPS amounts between IFRS and U.S GAAP with respect to physically settled forward purchase contracts. This is because no adjustment is required by IFRS and while Statement 150 requires a numerator and denominator adjustment, these adjustments would result in the same basic EPS amount as if no adjustments were made as highlighted in the example above.

### **U.S. GAAP - Diluted EPS**

9. The staff notes that the guidance in paragraph 25 of Statement 150 applies to both the computation of basic and diluted EPS. Accordingly, no further adjustments are required in the calculation of diluted EPS compared with the calculation of basic EPS for physically settled forward purchase contracts.

### **IFRS – Diluted EPS**

10. Paragraph 63 of IAS 33 requires the use of the “reverse treasury stock” method in the calculation of diluted EPS for forward purchase contracts. The Boards tentatively decided at the March 2007 Board meetings that the treasury stock method should be modified to:

- a. Include the end-of-period carrying value of the liability as an assumed proceed

- b. Use the end-of-period market price in the computation of the treasury stock method.

The staff believes the above changes would apply equally to the reverse treasury stock method. Therefore, applying the above tentative decisions to the reverse treasury stock method in the calculation of diluted EPS for physically settled forward purchase contracts the staff believes would always return an antidilutive result. That is, the carrying value of the liability would reduce the required proceeds to satisfy the forward contract by such an amount that the reverse treasury stock method would always return an antidilutive result.

#### **Staff Discussion of Difference in Diluted EPS**

11. The staff has analyzed the potential convergence differences the EPS guidance in paragraph 25 of Statement 150 and the proposed paragraph 63 of IAS 33 pose for the computation of diluted EPS. The staff notes that as a result of the conclusions on (a) the adjustments required by paragraph 25 of Statement 150 (that is, the adjustments would generally result in the same diluted EPS amount as if the entity had not excluded the shares and not made the numerator adjustment) and (b) the application of paragraph 63 of IAS 33 (modified for the Boards tentative decisions on the treasury stock method), U.S. GAAP and IFRS will result in the same diluted EPS amounts.

#### **U.S. GAAP - Diluted EPS for Other Forward Purchase Contracts**

12. The issue being addressed in this section is that of physically settled forward purchase contracts. However, for the sake of completeness, the staff has considered the calculation of diluted EPS for other forward purchase contracts (that is, other than physically settled forward purchase contracts). These other contracts are currently included in diluted EPS using the reverse treasury stock method (paragraph 24 of Statement 128). The staff observes that these other forward purchase contracts (that is, net settled forward purchase contracts or contracts that can be net or gross settled) are carried at fair value on an entity's balance sheet pursuant to Statement 150. Therefore, as a result of the Boards' tentative decisions on the use of the fair value method, these other forward

purchase contracts would be excluded from the diluted EPS computation in their entirety.

#### **IFRS - Diluted EPS for Other Forward Purchase Contracts**

13. Net settled forward purchase contracts accounted for in accordance with IAS 32 and IAS 39, “Financial Instruments: Recognition and Measurement,” are also carried at fair value on the entity’s balance sheet with changes in fair value recognized in profit or loss for the reporting period. As a result, they also would be excluded from the diluted EPS computation in their entirety pursuant to the Boards’ tentative decisions on the use of the fair value method. However, forward purchase contracts that have a settlement option where one of the options is gross physical settlement are accounted for in accordance with IAS 32 in the same way as a physically settled forward purchase contract. Accordingly, that type of forward purchase contract would apply the reverse treasury stock method pursuant to paragraph 63 of IAS 33.

#### **Staff Discussion of Difference in Diluted EPS**

14. Since net settled forward purchase contracts are measured at fair value with changes in fair value recognized in profit or loss for the reporting period under both U.S. GAAP and IFRS there will be no convergence difference in EPS as the contracts would apply the proposed fair value method under either standard. However, because of the difference in accounting for forward purchase contracts that allow for a choice of settlement between net settlement and gross physical settlement an EPS convergence difference may exist. Because the difference in accounting between U.S. GAAP and IFRS is the same for a forward purchase contract that allows for a choice of settlement (between net settlement and gross physical settlement) and a physically settled written put option the staff has deferred discussion of that potential convergence difference in EPS until the next section that discusses physically settled written put options in greater detail.

#### **Staff Recommendation**

15. As the staff has noted there does not appear to be a difference in the basic or diluted EPS amounts of a physically settled forward purchase contract. However,

there is a difference in the manner in which U.S. GAAP and IFRS arrive at those same EPS amounts. Therefore, the question for the Boards to consider is whether it is important from a convergence perspective to arrive at the same basic and diluted EPS amounts using the same means or is it simply enough to arrive at the same basic and diluted EPS amounts. The staff's believe the objective of the convergence project is to achieve, for the same instrument, either the same EPS amount or the same denominator used in the computation of EPS. Therefore, the staff believes convergence has been achieved for physically settled forward purchase contracts since both standards arrive at the same basic and diluted EPS amounts and recommend no additional changes be made to either Statement 128 or IAS 33.

**Issue 1: Do the Boards believe it is important from a convergence perspective that the amount of basic and diluted EPS be the same as well as the manner in which both U.S. GAAP and IFRS compute basic and diluted EPS for physically settled forward purchase contracts?**

#### **PHYSICALLY SETTLED WRITTEN PUT OPTIONS OVER OWN SHARES**

16. The second issue that the staff would like to raise with the Boards is how a physically-settled written put option and a written put option that can be net or gross physically settled over own shares should be reflected in the EPS calculation. An example is a written put option that gives the holder the right to require an entity to repurchase a fixed number of its own shares for a fixed amount of cash. This instrument has different accounting under IFRS compared with U.S. GAAP.

#### **U.S. GAAP – Physically Settled Written Put Options**

17. The U.S. GAAP accounting for **all** written put options over own shares is to account for the contract as a liability and to recognize the contract at its fair value with changes in fair value recognized in profit or loss.

### **IFRS – Physically Settled Written Put Options**

18. The IFRS accounting for physically settled written put options and written put options that can be net or gross physically settled over own shares is to record a liability for the present value of the redemption amount with a corresponding debit recorded in equity in accordance with IAS 32. That is, the written put option is accounted for in a manner akin to a treasury stock purchase using borrowed funds. The liability is measured at amortized cost and the accretion of the discount is recognized in profit or loss. This is the same accounting as a physically settled forward purchase contract (or a forward purchase contract that has a settlement option where one of the options is gross physical settlement) accounted for pursuant to IAS 32.

### **U.S. GAAP – Diluted EPS for Physically Settled Written Put Options**

19. Since *ALL* written put options are carried at fair value with changes in fair value recognized in profit or loss for the reporting period, all written put options will be excluded from the computation of diluted EPS pursuant to the proposed fair value method under U.S. GAAP. Accordingly, the reverse treasury stock method currently prescribed by paragraph 24 of Statement 128 would not apply to any written put options under the proposed changes to Statement 128.

### **IFRS – Diluted EPS for Physically Settled Written Put Options**

20. Since physically settled written put options and written put options that can be net or gross physically settled are accounted for in the same way as a physically settled forward purchase contract (or a forward purchase contract that has a settlement option where one of the options is gross physical settlement), the computation of diluted EPS is also the same. That is, a physically settled written put option would also apply paragraph 63 of IAS 33 (that is, the reverse treasury stock method) in computing diluted EPS. As noted above (in the diluted EPS discussion of physically settled forward purchase contracts) the application of paragraph 63 of IAS 33 will always return an antidilutive result due to the proposed changes to the treasury stock method that the staff believes would apply equally to the reverse treasury stock method.

## **Staff Discussion of Difference in Diluted EPS**

21. The staff has analyzed the potential convergence differences the proposed fair value method applied under U.S. GAAP and the proposed paragraph 63 of IAS 33 poses for the computation of diluted EPS. The staff notes that as a result of (a) the use of the fair value method and (b) the application of paragraph 63 of IAS 33 (modified for the Boards tentative decisions on the treasury stock method) neither U.S. GAAP nor IFRS will require physically settled written put options, written put options that can be net or gross physically settled, or forward purchase contracts that have a settlement option where one of the options is gross physical settlement to be included in the computation of diluted EPS. However, the staff also notes that the fair value method will require fair value adjustments to be included in net income under U.S. GAAP that may be different than the accretion of the discount required under IFRS. This difference in net income will result in a difference in basic and diluted EPS simply because the numerator control number (net income) is different. This difference in the numerator control number (net income) will arise anytime there is a measurement difference between U.S. GAAP and IFRS. As a result, the staff believes that because the denominator in both EPS computations are the same, the standards could be viewed as converged.

## **Diluted EPS for Other Written Put Options**

22. While the issue being addressed in this section is that of physically settled written put options and written put options that can be net or gross physically settled, for completeness the staff has considered the calculation of EPS for other written put options over own shares (that is, net settled written put options). These other contracts are currently included in diluted EPS using the reverse treasury stock method (paragraph 24 of Statement 128 and paragraph 63 of IAS 33) under both standards. The staff observed that these other written put options (that is, net settled written put options) are carried at fair value on an entity's balance sheet with changes in fair value recognized in profit or loss under U.S. GAAP and IFRS. Therefore, as a result of the Boards' tentative decisions on the use of the fair value method, these other written put options would be excluded from the diluted EPS computation in their entirety under either standard. No convergence difference will exist.

## **Staff Recommendation**

23. As the staff has noted, both U.S. GAAP and IFRS would exclude written put options from the computation of diluted EPS, but for different reasons. In addition, because of the measurement differences in the accounting for written put options, the numerator control number (net income) will not be the same. However, the denominator (the weighted average number of shares) will be the same for both U.S. GAAP and IFRS. Therefore, the question for the Boards to consider is whether it is important from a convergence perspective to arrive at the same denominator (that is, weighted average number of shares) or to compute basic and diluted EPS in the same manner for a physically settled written put option under both U.S. GAAP and IFRS. The staff believes the objective of the convergence project is to achieve, for the same instrument, either the same EPS amount or the same denominator used in the computation of EPS. Therefore, the staff believes convergence has been achieved for physically settled written put options since both standards arrive at the same denominator and recommend no additional changes be made to either Statement 128 or IAS 33.

**Issue 2: Do the Boards believe it is more important from a convergence perspective to arrive at the same denominator (that is, weighted average number of shares) or to compute basic and diluted EPS in the same manner for a physically settled written put option under both U.S. GAAP and IFRS?**

## **INSTRUMENTS IN WHICH EMBEDDED OPTION IS FAIR VALUED**

24. A question has arisen on the use of the fair value method to an instrument that has an embedded derivative (in which the embedded derivative is accounted for separately as a liability and measured at fair value through earnings for the reporting period) with a share settlement alternative. For example, a convertible debt instrument in which the conversion option is accounted for as a derivative liability measured at fair value for the reporting period. In the creation of the fair value method, the staff considered whether instruments that are, in part, measured at fair value should be subject to the fair value method exclusion. At least initially, the staff concluded that answer should be “no” and that the fair value method should only apply if the compound instrument was measured at fair value

in its entirety for the reporting period. The staff reasoned that because U.S. GAAP and IFRS had different requirements on whether an embedded derivative should be separately accounted for and measured at fair value that the fair value method should only apply to instruments (including compound instruments) that are classified as a liability and measured at fair value in their entirety. That said, the staff now acknowledges the lack of comparability that will occur for instruments that are measured at fair value in their entirety among and between U.S. GAAP and IFRS due to an entity's ability to elect the fair value option on an instrument by instrument basis. As a result, the staff has reconsidered their prior conclusion.

### **Staff Recommendation**

25. The staff noted in the development of the fair value method for instruments that are classified as liabilities and measured at fair value in their entirety for the reporting period that the mark-to-market adjustments required by fair value accounting better reflect the dilution of earnings attributable to common shares than the treasury stock method, the reverse treasury stock method, the if-converted method, and the two-class method. The staff recommends, for that same reason, that the fair value method should be expanded to include embedded derivative instruments that contain a share settlement alternative that is separately classified as a liability and measured at fair value through earnings for the reporting period. The staff notes that this conclusion will further expand the use of the fair value method, which is believed will simplify the computation of diluted EPS.

**Issue 3: Does the Board agree with the staff's recommendation to expand the fair value method to compound instruments for which the embedded derivative is accounted for separately as a liability and measured at fair value through earnings for the reporting period?**

### **ALLOCATION OF ACTUAL DIVIDENDS IN THE COMPUTATION OF DILUTED EPS UNDER THE TWO-CLASS METHOD**

26. In drafting the amendments to Statement 128 and IAS 33 a question arose on the computation of diluted EPS under the two-class method. Specifically, does the

computation require a distribution of hypothetical dividends (or interest on participating income bonds) to all outstanding common stock and potential common stock (for example, shares issued from exercise of options) or does it require only distribution of actual dividends (or interest on participating income bonds) to all outstanding common stock at the date of distribution. Paragraph 61 of Statement 128 and paragraph A14 of IAS 33 require “an allocation of current period earnings to each class of common stock and participating security.” Further, paragraph 61(a) of Statement 128 and paragraph A14(a) of IAS 33 state that “income from continuing operations shall be reduced by the amount of dividends declared in the current period for each class of common stock and by the contractual amount of dividends (or interest on participating income bonds) that must be paid for the current period.”

27. The staff has interpreted the words in the current standards to require that the computation of diluted EPS under the two-class method only reduce income from continuing operations for actual dividends (or interest on participating income bonds) distributed to outstanding common stock. The staff believes the requirement to reduce income from continuing operations by the amount of actual dividends is consistent with the FASB’s pre-existing guidance on EPS (APB 15 and its interpretations) that appears to have been unchanged by Statement 128 and IAS 33. As a result, the staff has drafted the proposed amendments to Statement 128 and IAS 33 (including the proposed examples) requiring that the computation of diluted EPS under the two-class method only reduce income from continuing operations by the actual amount of dividends distributed (\$2,500 in the example below). However, the staff has drafted an issue to be included in the notice to recipients of the proposed Statements to solicit feedback on the issue.
28. If the Boards agree with the staff’s interpretation of the two standards, the staff would like to highlight for the two Boards that diluted EPS for the common shares will actually be lower using actual distributions (\$0.728 in the example below) as opposed to hypothetical distributions (\$0.732 in the example below). To illustrate the staff has prepared the following example.

Assume an entity with \$10,000 of net income for the year ended 20X7. The entity has outstanding for the same period 10,000 common shares and 1,000

participating securities that share in current period earnings with common shareholders 1:1. Further assume the entity would include 3,000 incremental shares in the computation of diluted EPS for stock options applying the treasury stock method. The entity declares and distributes dividends of \$0.25 per common share. In computing diluted EPS under the two-class method would the entity reduce net income by the actual distributions paid to outstanding common shares (that is,  $10,000 \times \$0.25 = \$2,500$ ) or would the entity reduce net income by the hypothetical distributions to outstanding common shares and potential common shares (that is,  $[10,000 + 3,000] \times \$0.25 = \$3,250$ )?

Basic EPS for 20X7 would be computed as follows:

|                             |                |
|-----------------------------|----------------|
| Net income                  | \$10,000       |
| Less dividends paid:        |                |
| Common                      | <u>2,500</u>   |
| Undistributed 20X7 earnings | <u>\$7,500</u> |

Allocation of undistributed earnings:

*To participating security:*

$$1,000 \div (1,000 + 10,000) \times \$7,500 = \$682$$

$$\$682 \div 1,000 \text{ shares} = \$0.68 \text{ per share}$$

*To common:*

$$10,000 \div (1,000 + 10,000) \times \$7,500 = \$6,818$$

$$\$6,818 \div 10,000 \text{ shares} = \$0.68 \text{ per share}$$

**Basic per-share amounts:**

|                        | <u>Participating Security</u> | <u>Common Stock</u> |
|------------------------|-------------------------------|---------------------|
| Distributed earnings   | \$0.00                        | \$0.25              |
| Undistributed earnings | <u>0.68</u>                   | <u>0.68</u>         |
| Totals                 | <u>\$0.68</u>                 | <u>\$0.93</u>       |

*Calculation of Diluted EPS Under the Two-Class Method Assuming the Use of Actual Distributions*

|  | Undistributed<br>& Distributed<br>Earnings to<br><u>Common</u> | Common<br><u>Shares</u> | Earnings<br><u>per Share</u> |
|--|--|-------------------------|------------------------------|
| As reported—Basic  | \$9,318  | 10,000                  | \$0.93                       |
| Add-back: Undistributed earnings allocated to participating security | 682  | —                       |                              |
| Options  | —  | 3,000                   |                              |
| Less: Undistributed earnings reallocated to participating security   | <u>(536)(a)</u>  | <u>—</u>                |                              |
| <b>Diluted EPS for common stock</b>                                  | <b><u>\$9,464</u></b>  | <b><u>13,000</u></b>    | <b><u>\$0.728</u></b>        |

(a)  $1,000 \div (1,000 + 10,000 + 3,000) \times \$7,500$  actual undistributed earnings = \$536

*Calculation of Diluted EPS Under the Two-Class Method Assuming the Use of Hypothetical Distributions*

|  | Undistributed<br>& Distributed<br>Earnings to<br><u>Common</u> | Common<br><u>Shares</u> | Earnings<br><u>per Share</u> |
|--|--|-------------------------|------------------------------|
| Hypothetical Basic   | \$9,386(b)   | 10,000                  | \$0.93                       |
| Add-back: Undistributed earnings allocated to participating security | 614(c)   | —                       |                              |
| Options  | —  | 3,000                   |                              |
| Less: Undistributed earnings reallocated to participating security   | <u>(482)(d)</u>  | <u>—</u>                |                              |
| <b>Diluted EPS for common stock</b>                                  | <b><u>\$9,518</u></b>  | <b><u>13,000</u></b>    | <b><u>\$0.732</u></b>        |

(b)  $10,000 \div (1,000 + 10,000) \times \{ \$10,000 - [(10,000 \text{ common shares} + 3,000 \text{ options}) \times \$0.25] \}$  hypothetical undistributed earnings = \$6,136 hypothetical undistributed earnings to common shares

\$6,136 hypothetical undistributed earnings to common shares +  
\$3,250 hypothetical distributed earnings to common shares =  
\$9,386

- (c)  $1,000 \div (1,000 + 10,000) \times \{ \$10,000 - [(10,000 \text{ common shares} + 3,000 \text{ options}) \times \$0.25] \}$  hypothetical undistributed earnings = \$614 hypothetical undistributed earnings to participating security
- (d)  $1,000 \div (1,000 + 10,000 + 3,000) \times \{ \$10,000 - [(10,000 \text{ common shares} + 3,000 \text{ options}) \times \$0.25] \}$  hypothetical undistributed earnings = \$482

### **Staff Recommendation**

29. The staff recommends that the computation of diluted EPS under the two-class method should continue to use the actual distributions to outstanding common stock, as that is consistent with the interpretations of both Statement 128 and IAS 33 and the FASB's pre-existing guidance on EPS (APB 15 and its interpretations). Depending on the feedback that the staff receives on the notice to recipients, the staff may readdress this issue with the Boards as part of the redeliberation process.

**Issue 4: Does the Board agree with the staff's recommendation that the computation of diluted EPS under the two-class method should continue to use the actual distributions to outstanding common stock?**

### **EFFECTIVE DATE**

30. During redeliberations of the prior exposure drafts, the FASB decided the effective date should be set very soon after the anticipated issuance date of the proposed Statement. The FASB wanted to avoid a situation in which an entity might present EPS on the face of the financial statements in accordance with the unamended standard and then disclose pro forma EPS in accordance with the proposed Statement to comply with SEC Staff Accounting Bulletin No. 74, "Disclosure of the Impact that Recently Issued Accounting Standards will have on the Financial Statements of the Registrant when Adopted in a Future Period." The IASB has publicly stated a moratorium on the effective dates of any new standards until annual periods beginning on or after January 1, 2009.

## **Staff Recommendation**

31. Acknowledging the different requirements of the two Boards the staff felt it was more important to align the effective dates of the two standards. Aligning the effective dates to coincide with the IASB's moratorium would also allow for flexibility in the event there are further delays in the project. As a result, the staff recommends the amendments to Statement 128 be effective for annual periods beginning after December 15, 2008 and the amendments to IAS 33 be effective for annual periods beginning on or after January 1, 2009.
32. The staff also recommends that early adoption be permitted. The staff believes this would allow an entity that has to comply with the disclosure requirements of SAB 74 to early adopt the standard and only disclose EPS as required by the proposed Statement.

### **Issue 5: Does the Board agree with the staff's recommendation?**

#### **COMMENT PERIOD**

33. The staff recommends a 90-day comment period for the proposed Statements. The following factors were considered in arriving at that recommendation:
- a. *The time of year.* The staff anticipates posting the proposed Statements to the respective website in September 2007, which would result in a comment deadline ending in December 2007. The comment period would fall neatly between the summer vacation season and the beginning of the busy season for many of our constituents.
  - b. *The complexity of the proposal.* Some of the provisions of the proposed Statements are relatively complex because they pertain to the EPS treatment of complex structured transactions. However, the entities that tend to enter into those types of transactions are typically the Boards' most sophisticated constituents. In addition, the fact that this project had previous Exposure Drafts has elevated the awareness of this project among the Boards' constituents that the staff believes will be affected.

**Issue 6: Does the Board agree with the staff's recommendation?**