

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

5 December 2008

Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856
United States

Dear Sirs

Invitation to comment - IASB Exposure Draft of Proposed Amendments to IAS 33 *Simplifying Earnings per Share*

Invitation to comment - FASB Exposure Draft of Proposed Amendments to FASB 128 *Earnings per Share* – File Reference No. 1240-100

The global organisation of Ernst & Young is pleased to comment on the International Accounting Standards Board's (IASB) Exposure Draft (ED) and the Financial Accounting Standards Board's (FASB) ED on the proposed amendments to their respective Standards on *Earnings per Share*.

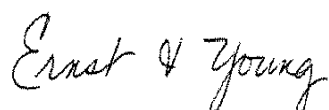
Overall, we agree with the proposals to clarify and simplify the calculation of earnings per share (EPS) and believe that the EDs achieve this in most of the proposed amendments. However, we question whether the EPS standards should be amended at this time when there are other projects currently being undertaken by both the IASB and the FASB, the outcome of which may affect the calculation of EPS - in particular the joint projects on *Financial Instruments with Characteristics of Equity* and *Financial Statement Presentation*. In view of this, the changes proposed in the EDs may be short-term in nature and thus the incremental benefits of revised standards to financial statement preparers and users may not justify the costs and efforts of issuing and adopting revised standards given the likelihood of further amendments subsequent to finalisation of these other standards that could affect the determination of EPS.

These EDs are part of the Short-term Convergence project undertaken by the IASB and the FASB, with the objective to reduce differences between International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP). The EDs also propose other amendments to the calculation of EPS that go beyond convergence, in particular, the treatment of instruments that are measured at fair value through profit and loss. Certain of those changes create inconsistency in terms of how the dilutive effect of different instruments is calculated. For example, the earning-per-share effect of an instrument

remeasured at fair value is different than a similar instrument that is not remeasured at fair value. Similarly, the liability balance relating to a dilutive instrument is included in “proceeds” assumed in the treasury-stock method, but similar “proceeds” are ignored in the if-converted method. Inconsistencies already exist in the earnings-per-share model in the manner in which dilution is calculated under the treasury stock methods, if-converted methods, and the contingently issuable shares model. We do not support making any changes to the Standards that would potentially increase the number of inconsistencies without a comprehensive reconsideration of the earnings-per-share model. Consequently, we urge the Boards to limit the amendments to those that achieve convergence, and we recommend that the Boards do not pursue the proposed changes with respect to instruments that are measured at fair value through profit or loss and the use of the end-of-period stock price when applying the treasury stock method at this time. Once the Boards complete the projects on *Financial Instruments with Characteristics of Equity* and *Financial Statement Presentation*, we recommend undertaking a wholesale review of the calculation of earnings per share and development of an alternative principles-based approach to the calculation of earnings per share that does not contain the unnecessary complexity of the current (and proposed) model.

On the basis that the Boards decide to pursue amendments to the EPS Standards, we have provided answers to the specific questions and additional comments on the more specific details of the exposure drafts as set out in the appendices to this letter. We would be pleased to discuss our comments further with the Boards at your convenience. Please contact either Leo van der Tas (Netherlands – Rotterdam, +31 10 406 1844) or Carlo Pippolo (US – New York +1 212 773 1790).

Yours faithfully

A handwritten signature in cursive script that reads 'Ernst & Young'.

Attachments:

- Appendix A – Responses to specific questions in IASB Exposure Draft
- Appendix B – Responses to specific questions in FASB Exposure Draft

APPENDIX A

RESPONSES TO THE SPECIFIC QUESTIONS RAISED IN THE IASB EXPOSURE DRAFT

Question 1: Mandatorily convertible instruments and instruments issuable for little or no cash or other consideration

- a) *Do you agree that the weighted average number of ordinary shares for basic EPS should include only instruments that give (or are deemed to give) their holder the right to share currently in profit or loss of the period? Why or why not?*

We agree with the proposed principle for determining which instruments are included in the calculation of basic EPS. Essentially basic EPS is a measure of the share of profit or loss attributable to an ordinary shareholder for that period, and therefore only those instruments that can currently share in profit or loss for the period should be included in the weighted average number of ordinary shares. We believe that the proposed clarification of this principle will make the standard easier to apply.

We believe that the reference to “currently” in paragraph 19 of the ED¹ is unclear in that it does not specify a point in time reference (eg. end of reporting period). The corresponding wording in the proposed amendments to FAS 128 refers to instruments “for which the holder has (or is deemed to have) the present right as of the end of the period to share in current-period earnings with common shareholders” (paragraph 9A), and we presume that these concepts are intended to be the same. If that presumption is correct, then we recommend that both standards use the same words with the exception of previously defined terms in the standards (eg. Common stockholders vs. ordinary shareholders) otherwise the use of differing language within each of these standards could create confusion. Alternatively, the IASB could include a clear statement in the basis for conclusion that they do not expect a different conclusion from USGAAP.

- b) *Does the exposure draft apply this principle correctly to mandatorily convertible instruments and ordinary shares issuable for little or no cash or other consideration? Why or why not?*

We agree that this principle has been correctly applied to mandatorily convertible instruments and to ordinary shares issuable for little or no cash or other consideration.

We agree that ordinary shares issuable for little or no cash or other consideration should be included in basic EPS, because there is no significant economic event required to

¹ “Ordinary shares that are currently issuable for little or no cash or other consideration are deemed to have the right to share with ordinary equity holders in profit or loss for the period.”

occur in order for the holder of such instruments to share in profit or loss for the period. At the reporting date the holder effectively has an unconditional right to receive ordinary shares and this should be reflected in the determination of the weighted average number of ordinary shares. Although the concept of “little or no cash or other consideration” proposed in paragraph 19 is not new, as it is a part of the definition of contingently issuable ordinary shares in IAS 33, we believe that guidance should be provided as to the reference point for “little cash or other consideration” for use solely within the amended standard. We note that the FASB’s ED (in proposed paragraph 10) clarifies that this is in relation to the end-of-period market price of the entity’s ordinary shares. In the interests of convergence we would suggest that the IASB includes similar guidance in IAS 33.

Another matter related to paragraph 19 is the exact meaning of ‘current ability to become an ordinary equity holder’, particularly when considered with the ‘little or no cash or other consideration’ criteria. In particular, is this the same as exercisable as of the end of the period? For example, consider two options exercisable for CU 0.01 and the value of the underlying stock is CU 100. Option A is an “American” option and is exercisable at any time during its 10-year life. Option B is a “European” option and is only exercisable at the end of its 10-year life. Assume the reporting period is 31 December and that Option B is not exercisable until 1 January. Based on the proposed amendments to IAS 33 and FAS 128, we believe that the shares underlying Option A would be included in basic EPS. However, the guidance in paragraph 19 is not as clear with Option B and thus we believe that the Boards should clarify how the exercisability of an instrument should be considered when considering whether the holder of such an instrument has the “current ability to become an ordinary equity holder” by revising the last sentence in paragraph 19 to say “... has the current ability (eg. an instrument that is currently exercisable) to become an ordinary equity holder”.

Question 2: Gross physically settled contracts to repurchase an entity’s own shares and mandatorily redeemable ordinary shares

Do you agree with the proposed treatment of gross physically settled contracts to repurchase an entity’s own shares and mandatorily redeemable shares? Why or why not?

We agree with the proposed treatment of gross physically settled contracts to repurchase an entity’s own shares and of mandatorily redeemable ordinary shares. The proposed treatment for EPS purposes is consistent with the accounting treatment required by IAS 32 *Financial Instruments: Presentation*, and for participating instruments.

Question 3: Instruments that are measured at fair value through profit or loss

Do you agree that the fair value changes sufficiently reflect the effect on ordinary equity holders of instruments measured at fair value through profit or loss and that recognising those changes in profit or loss eliminates the need for further adjustments to the calculation of EPS? Why or why not?

We do not agree that the fair value changes sufficiently reflect the effect on ordinary equity holders of instruments measured at fair value through profit or loss and that recognising those changes in profit or loss eliminates the need for further adjustments to the calculation of earnings per share under the current model. We acknowledge that these instruments may no longer be dilutive if the liability balance is assumed to be the proceeds under the treasury stock method and that this approach simplifies the calculation of diluted EPS. However, we do not believe the changes in fair value reflect the full dilutive effect of the exercise or conversion of such instruments. For example, fair value gains or losses could be minimal in a given period yet the instruments could be heavily in the money and thus have a considerable dilutive effect. Therefore, if such instruments are not included in the calculation of diluted EPS, it is likely that diluted EPS would be overstated, resulting in an information gap for users of financial statements.

In addition, excluding such instruments from the calculation of diluted EPS appears to be inconsistent with the treatment of equity settled share-based payments for this purpose. The share-based payment expense is included in profit or loss and the potential ordinary shares are included in the diluted EPS calculation because it reflects the two economic events that have occurred (IFRS2.BC56). The Board concluded in paragraph BC 57 of IFRS 2 that the dual effect on diluted EPS is not double-counting the effects of a share or share option grant. Rather, two different effects are each counted once. Similarly for instruments measured at fair value through profit or loss there are two economic events: fair value gains or losses due to changes in market conditions and the exercise or conversion of instruments by the holder. Consequently to be consistent, both economic events should be reflected in the calculation of diluted EPS.

We also have concerns that due to projects being undertaken at present by both Boards that relate to the accounting for underlying instruments (for example, *Financial Instruments with Characteristics of Equity*), this is a short-term amendment that will need to be reconsidered when these projects are finalised and thus, as previously noted, the incremental benefit may not justify the cost and effort of issuing and adopting revised EPS standards.

Question 4: Options, warrants and their equivalents

- a) *Do you agree that to calculate diluted EPS an entity should assume the settlement of forward sale contracts on its own shares in the same way as options, warrants and their equivalents? Why or why not?*

We agree that to calculate diluted EPS an entity should assume the settlement of a forward sale contracts on its own shares consistent with the treatment of options, warrants and their equivalents. This is consistent with the underlying accounting treatment and the proposal provides guidance that was not previously stated.

- b) *Do you agree that ordinary shares arising from the assumed exercise or settlement of options, warrants and their equivalents should be regarded as issued at the end-of-period market price? Why or why not?*

We agree that ordinary shares arising from the assumed exercise or settlement of options, warrants and their equivalents should be regarded as issued at the end-of-period market price on the basis that it simplifies the calculation. However the benefit from this amendment will not be significant as it is not a particularly difficult exercise to calculate the average market price for the period. Also, as stated in BC 17 of the ED, the objective of diluted EPS is to be a measure of performance rather than to act as a warning signal, there is an argument that the average market price for the period should be used rather than a market price at a specific point in time.

Paragraph 46 of the ED refers to the use of the end-of-period market prices for options, etc outstanding at period end. There is no such equivalent discussion of which prices to use for dilutive potential ordinary shares that are cancelled or lapse during the period. Without, a direct reference to these situations, different practices may develop. We recommend that these situations are specifically referred to, and believe that the market price on the date of cancellation or lapse should be used.

Question 5: Participating instruments and two-class ordinary shares

Do you agree with the proposed amendments to the application guidance for participating instruments and two-class ordinary shares? Why or why not?

We agree with the proposed amendments to the application guidance for participating instruments and two-class ordinary shares as it is much clearer than the guidance currently provided in IAS 33. It is also consistent with the current application of US GAAP.

However, it is not clear whether paragraphs A23-28 of the application guidance for participating instruments results in the presentation on the face of the statement of comprehensive income not only of the EPS for each class of ordinary shares (as required under paragraph 58 of the ED) but also of an EPS amount for the participating instruments, as if they were a different class of ordinary shares. EITF Issue 03-6, paragraph 6, states that the presentation of basic and diluted EPS for securities other than common stock is not required, and we would suggest that the Board clarify whether such disclosure is required in its standard.

Question 6: Disclosure requirements

Are additional disclosures needed? If so, what additional disclosures should be provided and why?

If a final standard on diluted EPS excludes instruments that are measured at fair value through profit and loss from diluted earnings per share, we recommend that an entity should disclose sufficient information about such instruments to allow users of the financial statements to determine the actual dilutive effect of such securities. Such disclosures would address the information gap that we referred to in comments made in response to Question 3 above. Although disclosure of the income statement effect of

changes in fair value of instruments classified as liabilities, and the number of such instruments issuable based on the end of period market price are required under FASB Statement 129, *Disclosure of Information About Capital Structure*, paragraph 66 of the IASB's ED does not specifically require such disclosures. We suggest that this should be a specific disclosure requirement or that IFRS 7, *Financial Instruments: Disclosure* should be amended.

If the final standard continues to include instruments that are measured at fair value through profit and loss in diluted earnings per share, we agree that no additional disclosures are required.

Additional EPS measures (paragraph 67 of the ED on IAS 33)

We note that the IASB has proposed an amendment to paragraph 67 (current paragraph 73) that prohibits presentation of additional per share amounts in the statement of comprehensive income. Paragraph 68 extends this prohibition to the presentation of additional per share amounts in the income statement. This proposed change converges with FAS 128, paragraph 37, in regards to the prohibition on presentation of such amounts within the statement of comprehensive income. Current paragraph 73 would allow the presentation in the notes to financial statements of per share amounts that are not reported as line items in the statement of comprehensive income as long as they are reconciled to a reported line item within the statement of comprehensive income. Although the use of such per share measures in the notes to financial statements would not be explicitly prohibited by FAS 128, the US Securities and Exchange Commission's (SEC) Regulation S-K, Rule 10(e), would prohibit the use of such "non-[US]GAAP" measures within the financial statements and related notes for all US domestic issuer and foreign private issuer registrants. As a result, while we agree with the proposed change, we do not believe that convergence would be effectively achieved between IFRS and US GAAP as US GAAP is currently applied by SEC registrants.

Furthermore, where current paragraph 73 permits the use of non-IFRS EPS measures, we believe there could be significant diversity in practice in the calculation of the denominator when entities present alternative per share amounts. We therefore recommend that the Board modify paragraph 67 of the ED to clarify the meaning of "using the weighted average number of ordinary shares determined in accordance with this Standard" as this could be interpreted to require the use of the same denominator as that used in the determination of basic and diluted EPS or, alternatively, that a new denominator should be calculated in accordance with Standard taking into account the effect of various alternative numerators. If, for example, the selected numerator excludes the effect of instruments measured at fair value through profit or loss, it is unclear whether a financial statement preparer would include or exclude the dilutive effect of these instruments in the calculation of the denominator for this alternative per share amount. In addition, we suggest that the last sentence to paragraph 67 of the ED be modified to include language regarding the computation of the denominator and, as noted in the previous recommended change to paragraph 67, that this wording be clear in terms of how the denominator would be calculated.

We also recommend that the IASB and FASB consider the potential consequences of the guidance in paragraph 67 in its redeliberations, although we recognise that the (prohibition of)

voluntary disclosure of additional information either on the face of the primary statements or in the notes is a broader issue that goes beyond additional per share disclosures. We believe this wider discussion would be better held as part of the current project on Financial Statement Presentation.

Additional comments to the IASB's Exposure Draft

Paragraph 49

Paragraph 49 the third line is to be amended to “.. the *proceeds* referred to in paragraph 47..”, “proceeds” having replaced “issue price”, but only paragraph 47(b) refers to “proceeds” on the second line. The fifth line of paragraph 47 refers to “issue price” and it appears that this should have been changed to “proceeds”.

Paragraph 54

Paragraph 54 contains a typographical error: "An entity treats as outstanding and includes them when calculating diluted earnings per share ..."

Illustrative examples

We welcome the inclusion of narratives relating to the principle that each example demonstrates.

We note that there are no illustrative examples for new concepts such as gross physically settled contracts to repurchase an entity's own shares and mandatorily redeemable ordinary shares that have been introduced into the ED. We believe illustrative examples for these items would benefit financial statement preparers.

We believe that it would be useful for the revised standard to show the new text underlined and deleted text struck through as in the rest of the standard and application guidance.

A. Basic earnings per share and A.1 Preference shares

Illustrative example A. *Basic earnings per share* uses the term "Profit attributable to ordinary equity holders" whereas Illustrative example A.1 *Preference shares* uses the term "Profit for 20X1" yet they would appear to refer to the same line item in the statement of comprehensive income. We believe that terms should be used consistently in the illustrative examples.

B.2 Employee share options

It would be beneficial if this example also illustrated the proposed requirements of paragraph 49(b), that is the tax benefit on exercise, as this is a proposed amendment.

B.3 Convertible instruments and B.4 Determining the order in which to include dilutive instruments

Illustrative examples B.3 *Convertible instruments* and B.4 *Determining the order in which to include dilutive instruments* use the term "ordinary equity holders" whereas A.1 *Preference shares* uses the term "ordinary share holders". We believe that terms should be used consistently in the illustrative examples.

D.1 Ordinary shares issuable for little or no cash or other consideration

Paragraph 19 of the ED provides guidance on ordinary shares that are currently issuable for little or no cash or other consideration. Within paragraph 19, ordinary shares are currently issuable if the holder of an instrument has the current ability to become an ordinary equity holder. Illustrative example D.1 *Ordinary shares issuable for little or no other consideration* of the ED is intended to provide an illustration of when such instruments are considered in the calculation of basic and diluted EPS. This example carries forward, with minor modifications, example 7 of the current IAS 33 for contingently issuable shares. One of the key messages of example D.1 is that "currently issuable" in this case means "once a contingency that triggers the issuance of shares has occurred". To illustrate this we believe that the Boards should include further examples, such as an example based on (vested) deep-in-the money American style options granted to employees or other third parties.

D.2 Participating instruments and two-class ordinary shares (basic EPS)

The example does not follow the method specified in paragraph A24 to calculate basic EPS because step paragraph A24(c) is not performed. The example illustrates the steps in paragraphs A24(a) and A24(b) on a per share basis and then sums them for the step in paragraph A24(d). However, paragraph A24 does not require per share amounts to be calculated in steps required by paragraphs A24(a) and A24(b). We recommend that the example on page 93 illustrate the correct application of paragraph A24.

D.3 Participating instruments and two-class ordinary shares (basic and diluted EPS)

The same point as above regarding the method of calculation.

In addition on page 96 a “CU” is missing.

APPENDIX B

Note that our views on other potential changes described in the proposed Statement that previously were exposed by the FASB are included in our letters of 10 March 2004 and 21 November 2005. In addition, please refer to our response to the Question 1a in the IASB's ED above. We believe that matter is also relevant to the FASB's proposed amendments.

RESPONSES TO SPECIFIC QUESTIONS IN FASB EXPOSURE DRAFT

Instruments That Are Measured at Fair Value Each Period with Changes in Fair Value Recognized in Earnings

Issue 1: In this proposed Statement, an entity would not include in the denominator of diluted earnings per share the number of additional common shares that would arise from the assumed exercise or conversion of certain freestanding instruments (or a component of certain compound instruments that is accounted for as if it were freestanding) that are measured at fair value each period with changes in fair value recognized in earnings. Similarly, an entity would not include in the computation of basic and diluted earnings per share under the two-class method certain participating securities that are measured at fair value each period with changes in fair value recognized in earnings. The Board concluded that the effect of those instruments on current shareholders during the period has been reflected in the numerator of basic and diluted earnings per share through the changes in fair value recognized in earnings. Do you agree that the fair value changes sufficiently reflect the effect of those instruments on current shareholders and that recognizing those changes in earnings eliminates the need to include those instruments in determining the denominator of diluted earnings per share or in computing earnings per share under the two-class method? If not, why not?

We do not agree that the fair value changes sufficiently reflect the effect on ordinary equity holders of instruments measured at fair value through profit or loss and that recognizing those changes in profit or loss eliminates the need for further adjustments to the calculation of earnings per share under the current model. We acknowledge that these instruments may no longer be dilutive if the liability balance is assumed to be the proceeds under the treasury stock method and that this approach simplifies the calculation of diluted EPS. However, we do not believe the changes in fair value reflect the full dilutive effect of the exercise or conversion of such instruments. For example, fair value gains or losses could be minimal in a given period yet the instruments could be heavily in the money and thus have a considerable dilutive effect. Therefore, if such instruments are not included in the calculation of diluted earnings per share, it is likely that diluted earnings per share would be overstated, resulting in an information gap for users of financial statements.

In addition, excluding such instruments from the calculation of diluted earnings per share appears to be inconsistent with the treatment of equity settled share-based payments in the calculation of earnings per share. The Basis for Conclusions to Statement 123(R), *Share-Based Payment*, states that "[a] transaction that results in an expense and that also increases the number of common shares outstanding properly affects both the numerator and the

denominator of earnings per share” (Statement 123(R), paragraph B28. Similarly, for instruments measured at fair value through profit or loss, there are two economic events: fair value gains or losses due to changes in market conditions and the potential dilution from the exercise or conversion of instruments by the holder. Consequently to be consistent, both economic events should be reflected in the calculation of diluted earnings per share.

We also have concerns that due to projects being undertaken at present by both Boards that relate to the accounting for underlying instruments (for example, *Financial Instruments with Characteristics of Equity*), this is a short-term amendment that will need to be reconsidered when these projects are finalized and thus, as previously noted, the incremental benefit may not justify the cost and effort of issuing and adopting revised EPS standards.

Diluted earnings per share under the Two-Class Method

Issue 2: In computing diluted earnings per share, dilutive potential common shares and potential participating securities are assumed to be outstanding. This proposed Statement would clarify that an entity would not reduce income from continuing operations (or net income) by the amount of additional dividends that would be assumed to be declared for potential common shares or potential participating securities that are assumed to be outstanding. The Board reasoned that an entity may make a different decision on the per-share amount of dividends declared if that per-share amount was distributed to all potential common shares or participating securities. Do you agree? If not, why not?

We agree that an entity would not reduce income from continuing operations (or net income) by the amount of additional dividends that would be assumed to be declared for potential common shares or potential participating securities that are assumed to be outstanding. We would not recommend introducing any additional assumptions into the earnings per share calculation. Actual dividends have been paid and cannot be reallocated, whereas hypothetical dividends have not and could be reallocated at will by the entity, so they should not be considered in the calculation.

Disclosures

Issue 3: The Board decided that the amendments in this proposed Statement would not warrant additional disclosures beyond those already required by U.S. GAAP (for example, Statement 128, FASB Statement No. 129, *Disclosure of Information about Capital Structure*, and EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock”). Do you agree that additional disclosures are not warranted? If not, what additional disclosures should be required and why?

We agree that no additional disclosures are required. If a final Statement excludes instruments that are measured at fair value through profit and loss from diluted earnings per share, we believe that Statement 129, *Disclosure of Information about Capital Structure*, requires disclosure of sufficient information about such instruments to allow users of the financial

statements to determine the actual dilutive effect of such securities. Such disclosures would address the information gap that we referred to in comments made in response to Question 1 above.