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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting: **23 January 2008, London**

Project: **Earnings per Share**

Subject: **Decision Summary (Agenda Paper 6A)**

INTRODUCTION

1 The purpose of this agenda paper is to provide the IASB with a comprehensive summary of the decisions made in the Earnings per Share (EPS) project and to ask the IASB for permission to begin drafting an exposure draft of amendments to IAS 33 *Earnings per Share*.

2 This agenda paper:

a identifies the project objective;

b summarises the IASB's and FASB's tentative decisions to amend the calculation of basic and diluted EPS and to modify some of the application guidance in IAS 33 and Statement of Financial Accounting Standards (SFAS) No. 128 *Earnings per Share*;

c assesses whether the tentative agenda decisions meet the project objective; and

d asks the Board to permit the staff to begin drafting an exposure document.

PROJECT OBJECTIVE

3 The Earnings per Share project is part of a wider short-term convergence project with the FASB. Its purpose is to reduce differences between IFRSs and US GAAP that can be resolved in a relatively short time and can be addressed outside major projects.

4 The objective of the Earnings per Share project is to simplify and converge the calculation of EPS according to IAS 33 and SFAS No. 128.

TENTATIVE DECISIONS

5 The following paragraphs summarise the boards' tentative decisions to amend:

a the scope of instruments that are included in the calculation of **basic EPS** and to specify the method of calculating EPS for those instruments;

b the calculation of **diluted EPS** for options, warrants and their equivalents as well as for convertible instruments; and

c the **application guidance** of IAS 33 and SFAS No. 128.

Overview

	IAS 33	SFAS No. 128	Proposed Amendment
Basic EPS			
Mandatorily convertible instruments	Included in basic EPS	Excluded from basic EPS	Only participating instruments are included in basic EPS
Contingently issuable shares	Included in basic EPS	Included in basic EPS	Only currently exercisable or participating instruments are included in basic EPS
Diluted EPS			
Options, warrants and their equivalents	Treasury stock method	Treasury stock method	Modified treasury stock method (proceeds include end of period carrying value of liability assumed to be settled. Shares are assumed to be issued at end-of-period market price, not average for the period.)

	IAS 33	SFAS No. 128	Proposed Amendment
Financial instruments measured at fair value through profit or loss	Depends on type of instrument	Depends on type of instrument	Diluted EPS is not adjusted for options, warrants, convertibles that are measured at fair value through profit or loss The two-class method for basic and diluted EPS does not apply to participating instruments that are measured at fair value through profit or loss.[1]
Application guidance (two-class method)			
Basic EPS: Should the if-converted method or two-class method be applied to participating convertible instruments?	No explicit guidance	Two-class method	Two-class method
Diluted EPS: How is the two-class method applied to the calculation of diluted EPS?	Assume conversion for those instruments that are convertible into ordinary shares, if the effect is dilutive (if-converted method). For those instruments that cannot be converted into ordinary shares apply the two-class method.	No explicit guidance	Test whether the convertible instrument would be more dilutive under the if-converted method or the two-class method. Apply the more dilutive method for the calculation of diluted EPS.

[1] The FASB refers to the proposed amendments described in paragraph 12 of this agenda paper as the 'fair value method'.

Basic EPS

6 IAS 33.11 states that the objective of basic EPS is to provide a measure of the interest of each ordinary share of a parent entity in the performance of the entity of the reporting period. To comply with this objective the boards tentatively decided that, unless the holder of a financial instrument has a right, similar to an ordinary shareholder, to participate in current profit or loss, the financial instrument should not be included in the calculation of basic EPS. The boards observed that, as a consequence, the calculation of basic EPS should include only (a) ordinary shares, (b) instruments that are currently exercisable or convertible into ordinary shares for little or no cost to the holder of the instrument and (c) instruments that can presently participate in profit or loss with ordinary shareholders. As a consequence, the boards tentatively decided to amend the treatment in basic EPS of mandatorily convertible instruments and contingently issuable shares.

7 ***Mandatorily convertible instruments***: IAS 33.23 requires an entity to include ordinary shares that will be issued upon conversion of a mandatorily convertible instrument in the calculation of basic EPS from the date the contract is entered into. SFAS No. 128 does not require an entity to include those shares in the calculation of basic EPS. To comply with the principle stated in paragraph 6 the boards tentatively decided to include in the calculation of basic EPS only those ordinary shares that will be issued upon conversion of a **participating** mandatorily convertible instrument. In contrast, the calculation of basic EPS will exclude ordinary shares that will be issued upon conversion of a **non-participating** mandatorily convertible instrument. Participating instruments are instruments that participate in dividends with ordinary shares according to a predetermined formula (for example, two for one).

8 IAS 33 and SFAS No. 128 provide a similar allocation mechanism to determine the profit or loss attributable to ordinary shareholders when participating instruments exist. According to this mechanism, profit or loss for the period is allocated to the different classes of ordinary shares and participating instruments. The allocation is made in accordance with the rights of each class to participate in distributions if the entire profit or loss was distributed. US GAAP refers to this allocation mechanism as the ‘two-class method’. The boards decided to require the two-class method for participating mandatorily convertible instruments. See also example 1 in Appendix A.

Staff observation: The scope of the two-class method is currently not aligned between IAS 33 and SFAS No. 128. The two-class method in SFAS No. 128 applies to all participating securities, regardless of whether they are classified as liabilities or equity. In contrast, the scope of the two-class method in IAS 33 is limited to participating equity instruments and two-class ordinary shares. However, the staff believes that the tentative decisions described in this agenda paper imply that the IASB intended the two-class method to apply to all participating instruments, regardless of whether they are classified as liabilities or as equity.[2]

Does the Board agree with the staff observation?

9 ***Contingently issuable shares***: IAS 33.5 defines contingently issuable ordinary shares as ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions. IAS 33.24 treats contingently issuable shares as outstanding from the date when all necessary conditions have been satisfied and includes them in the calculation of basic EPS. Paragraph 10 of SFAS No. 128 contains a similar requirement for US GAAP. The boards tentatively decided to include contingently issuable shares in the calculation of basic EPS only if the financial instrument is (a) currently exercisable or convertible or (b) can currently participate in earnings with ordinary shareholders.

Staff observation: According to IAS 33.24, shares that are issuable solely after the passage of time are not contingently issuable shares, because the passage of time is a certainty. The staff believes that the wording is not clear on whether to include shares that are issuable solely after the passage of time in the calculation of basic EPS as soon as the contract providing the right in the future shares has been transferred.[3] We believe that, for consistency with the Board's tentative decision on contingently issuable shares, the calculation of basic EPS should only include those shares that are either currently

[2] The staff refers also to the IASB's July and September 2007 meetings when the Board discussed the application of the two-class method to forward purchase contracts. Those contracts are classified as liabilities. See Agenda Paper 3 of the IASB's July 2007 meeting and Agenda Paper 9 of the IASB's September 2007 meeting.

[3] To illustrate, assume that an entity agrees on 1 January to issue shares on 1 July. The staff believes that the standard is not clear on whether the standard requires inclusion of the shares in the calculation of basic EPS from 1 January or 1 July.

exercisable or convertible for little or no cost or can currently participate in earnings with ordinary shareholders.

<u>Does the Board agree with the staff observation</u>?

DILUTED EPS

10 IAS 33.32 states that the objective of diluted EPS is consistent with that of basic EPS. The objective is to provide a measure of the interest of each ordinary share in the performance of an entity while giving effect to all dilutive potential ordinary shares outstanding during the period. Therefore, diluted EPS includes in addition to basic EPS dilutive potential ordinary shares from options, warrants and their equivalents, convertible instruments as well as other contingently issuable shares.[4]

11 ***Options, warrants and their equivalents***: IAS 33.45 states that, for the purpose of calculating diluted EPS, an entity shall assume the exercise of dilutive options and warrants of the entity. The assumed proceeds from exercise of diluted options, warrants and their equivalents shall be regarded as having been received from the issue of ordinary shares at the average market price of ordinary shares during the period. Paragraph 17 of SFAS No. 128 contains a similar requirement and refers to this as the 'treasury stock method'. The boards observed that if an instrument classified as a liability is settled in shares, the liability for the instrument is extinguished without sacrifice of assets and the amount of the liability is credited to equity. Therefore, the boards tentatively decided to require that proceeds from the exercise of dilutive options, warrants and their equivalents include the end-of-period carrying value of the liability that is assumed to be settled. For consistency, the boards decided further to require that the ordinary shares be regarded as issued at the end-of-period market price, rather than at their average market price during the period. This amendment would apply to all options, warrants and their equivalents, regardless of whether the instrument is classified as equity or liability. See also example 2 in Appendix A.

[4] However, paragraph 12 of the agenda paper discusses an exception to this principle for those financial instruments that are classified as liabilities and are measured at fair value through profit or loss. As a consequence, diluted EPS adjusts the basic EPS number only for those dilutive potential ordinary shares whose underlying instrument are not measured at fair value through profit or loss.

Staff observation: IAS 33.63 states that contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive. Paragraph 24 of SFAS No. 128 contains a similar requirement. US GAAP refers to the treatment of those contracts in the calculation of diluted EPS as the 'reverse treasury stock method'. The staff believes that to be consistent with the boards' decision on options, warrants and their equivalents the same amendments should also apply to written put options.

Does the Board agree with the staff observation?

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

12 The boards observed that changes in fair value recognised in profit or loss already sufficiently reflect the economic effect of financial instruments on current owners and a further adjustment to the calculation of EPS for those instruments is unnecessary (see also Agenda Paper 6B). In addition, the boards' objective of simplifying the calculation of basic and diluted EPS would be satisfied if the EPS calculation is not adjusted for those financial instruments. Therefore, the boards tentatively decided that:

a neither basic nor diluted EPS should be adjusted for participating financial instruments that are measured at fair value through profit or loss.

b profits or losses from changes in the fair value of options, warrants and their equivalents should remain in the numerator of diluted EPS. In addition, the denominator of diluted EPS should not include incremental shares resulting from the assumed exercise of options, warrants and their equivalents or the conversion of convertible instruments that are measured at fair value through profit or loss. This requirement applies to both freestanding instruments and embedded derivatives.

Staff observation: As indicated in paragraph 11 of the agenda paper, an entity applies the reverse-treasury method to determine the dilutive effect of written put options. The reverse-treasury stock method mirrors the treasury stock method that applies to warrants, options and their equivalents. We believe that the Board intended to include profits or losses from changes in the fair value of written put options in the numerator of diluted EPS. Furthermore, the Board intended that incremental shares from the exercise of written put options that are measured at fair value through profit or loss should not be included in the denominator for diluted EPS.

Does the Board agree with the staff observation?

13 Agenda Paper 6B presents to the boards a disclosure related to financial instruments measured at fair value through profit or loss. The boards did not discuss any further disclosures as part of this project.

APPLICATION GUIDANCE: TWO-CLASS METHOD

14 ***Calculation of basic EPS under the two-class method***: IAS 33.A14 does not explicitly state whether, in order to calculate basic EPS, conversion of convertible participating financial instruments should be assumed or whether the two-class method should apply. Paragraph 61 of SFAS No. 128 assumes conversion of those securities that are convertible into common stock. US GAAP refers to the assumed conversion of convertible instruments as the 'if-converted method'. In contrast, the two-class method of calculating EPS applies to those securities that are not convertible into a class of common stock.[5] Issue No. 7 of EITF Issue No. 03-6 *Participating Securities and the Two-Class Method under FASB Statement No. 128* interprets paragraph 61 to require application of the two-class method for participating securities in calculating basic EPS. Consistent with the EITF consensus,

[5] Subsequent to the issuance of SFAS No. 128 the FASB staff issued Topic No. D-95 *Effect of Participating Convertible Securities on the Computation of Basic Earnings per Share*. Topic No. D-95 stated that the determination of how participating convertible securities are included in the calculation of basic EPS (that is, using either the if-converted method or the two-class method) is an accounting policy decision. Issue No. 7 of EITF Issue No. 03-6 nullified Topic No. D-95.

the IASB tentatively decided to amend IAS 33.A14 to clarify that participating convertible instruments are included in basic EPS using the two-class method.

15 ***Calculation of diluted EPS under the two-class method***: IAS 33.A14 states that, for the purpose of calculating diluted EPS, conversion is assumed for participating equity instruments and two-class ordinary shares that are convertible into ordinary shares if the effect is dilutive. For those instruments that are not convertible into a class of ordinary shares, profit or loss for the period is allocated to the different classes of shares and participating equity instruments in accordance with their dividend rights or other rights to participate in undistributed earnings. SFAS No. 128 does not provide explicit application guidance on the use of the two-class method in calculating diluted EPS.

16 In 2007, the FASB exposed FASB Staff Position No. FAS 128-a *Computational Guidance for Computing diluted EPS under the Two-Class Method* (FSP 128-a). FSP 128-a introduces a test that considers whether a convertible financial instrument would have a more dilutive effect if the two-class method is applied or if conversion is assumed. The more dilutive method would be included in the calculation of diluted EPS.[6] Appendix B contains an extract of FSP 128-a. The boards tentatively decided to incorporate the proposed application guidance and examples of FSP 128-a into the amended standards. The proposed application guidance would amend the calculation of diluted EPS in IAS 33.A14. See example 3 in Appendix A.

17 ***Additional FASB Guidance on the two-class method***: In accordance with the boards' commitment to set principle-based accounting standards, they tentatively decided not to incorporate into the amended standards the following FASB guidance on detailed application issues of the two-class method into :

a Issues 2-6 of EITF Issue No. 03-6 *Participating Securities and the Two-Class Method under FASB Statement No. 128* which address the definition of a participating security and some application questions for the two-class method;

[6] Diluted EPS assumes the exercise or conversion of dilutive potential ordinary shares. If exercised or converted, those shares would participate in dividends. A question arises on whether the two-class method for diluted EPS should assume that those shares have received dividends (hypothetical dividend). A hypothetical dividend would affect the allocation of undistributed profits or losses to the different classes of participating instruments. The boards tentatively decided that actual dividends rather than hypothetical dividends should be used for this allocation. The staff provided a comprehensive analysis of the issue in Agenda Paper 3 of the IASB's July 2007 meeting.

b EITF Issue No. 04-8 *The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*;

c EITF Issue No. 07-4 *Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships*; and

d proposed FASB Staff Position No. EITF 03-6a *Determining whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*.

ADDITIONAL FASB DECISIONS TO CONVERGE SFAS NO. 128 WITH IAS 33

18 ***Instruments that may be settled in cash or shares***: Paragraph 29 of SFAS No. 128 requires an entity to assume that an instrument that could be settled in cash or shares would be settled in shares if the effect is more dilutive. However, this assumption could be rebutted if past experience or a stated policy provides a reasonable basis to believe that the contract would be paid partially or wholly in cash. IAS 33 assumes share settlement for all dilutive instruments. The FASB decided to converge SFAS No. 128 with IAS 33 on this issue by removing the ability to rebut the assumption that the instrument will be settled in shares, if dilutive.

19 ***Year-to-date calculation***: Paragraph 46 of SFAS No. 128 requires that year-to-date diluted EPS be based on a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS calculation. In contrast, IAS 33.37 requires a cumulative computation for the entire year to date. The FASB tentatively decided to amend SFAS No. 128 to converge with IAS 33 in this area.

20 Similarly, a footnote to paragraph 30 of SFAS No. 128 requires that for year-to-date calculations, contingent shares be weighted for the interim periods in which they were included in the calculation of diluted EPS. The FASB tentatively decided to amend paragraph 30 to be consistent with the amended calculation of year-to-date diluted EPS described above. That is, contingent shares are weighted on a year-to-date basis.

DO THE PROPOSED AMENDMENTS ACHIEVE THE PROJECT OBJECTIVE?

21 The staff believes that the proposed amendments resolve the majority of the differences between IAS 33 and SFAS No. 128. The tentative decisions summarised in this agenda paper will result in most cases in the same EPS denominator under both standards. In addition, the proposed amendments clarify and, in some cases, simplify the calculation of basic and diluted EPS. The staff believes therefore that the boards' tentative decisions achieve the project objective.

22 However, the staff notes that there will be financial instruments that will not result in the same EPS denominator under both standards, because of differences in the underlying accounting for those instruments,. Those instruments include forward purchase contracts that provide for the option of gross physical or net-share or net-cash settlement and written put options (see agenda paper 9 of the IASB's September 2007 meeting). At their September meetings, the boards acknowledged those remaining differences, but observed that addressing the underlying accounting differences would be outside of the project scope of the short-term convergence project.

STAFF RECOMMENDATION AND QUESTION FOR THE BOARD

23 The staff believes that the boards' tentative decisions achieve the project objective and asks the Board for permission to begin drafting an exposure draft of amendments to IAS 33. The boards have already decided tentatively that the exposure draft for the revised IAS 33 should have a 120-day comment period. The staff will assess as part of the drafting process whether there is a need for transition guidance and bring this issue back to the IASB as a sweep issue, if necessary.

Does the Board agree with this decision summary and permit the staff to begin drafting of an exposure document?

APPENDIX A – ILLUSTRATIVE EXAMPLES

Example 1: Participating mandatorily convertible equity instruments

Profit attributable to equity holders:	1,000
Ordinary shares outstanding:	400
Participating mandatorily convertibles outstanding:	100

Each mandatorily convertible instrument is convertible into one ordinary share. The mandatorily convertible instrument is classified as equity. For each CU 0.75 distributed to ordinary shareholders, the holders of the convertibles receive CU 0.25. It is assumed that no interest or dividends have been paid on the mandatorily convertible instrument.

Basic EPS is calculated as follows:

Current guidance: if-converted method

$$\frac{\text{Profit}}{\text{Ordinary shares + incremental shares}} = \frac{1000}{400 + 100} = 2.0$$

Proposed guidance: two-class method

$$\text{Ordinary shares:} \quad 1{,}000 \times \frac{0.75 \times 400}{0.25 \times 100 + 0.75 \times 400} = 923$$

$$\text{Mandatorily convertibles:} \quad 1{,}000 \times \frac{0.25 \times 100}{0.25 \times 100 + 0.75 \times 400} = 77$$

Basic EPS amounts:

Ordinary shares:	923 / 400 = 2.31
Mandatorily convertibles:	77 / 100 = 0.77

Example 3 illustrates the calculation of diluted EPS under the two-class method.

Example 2: Options, warrants and their equivalents

Profit attributable to equity holders:	CU 8,000,000
Ordinary shares outstanding:	2,000,000
Average market price:	CU 48
End-of-period market price:	CU 50
Options outstanding:	125,000
Exercise price:	CU 40

The options are assumed to be classified as equity.

Calculation of basic EPS: $\frac{8,000,000}{2,000,000} = 4.00$

Current guidance: treasury stock method

Assumed proceeds:	125,000 x 40 = 5,000,000
Repurchase shares at average market price:	5,000,000 / 48 = 104,167
Incremental shares:	125,000 – 104,167 = 20,833

Diluted EPS: $\frac{8,000,000}{2,000,000 + 20,833} = 3.96$

Proposed guidance: modified treasury stock method

Assumed proceeds: 125,000 x 40 = 5,000,000

[The option is classified as equity; thus the carrying amount of the option is not included in the assumed proceeds.]

Repurchase shares at end-of-period market price:	5,000,000 / 50 = 100,000
Incremental shares:	125,000 – 100,000 = 25,000

Diluted EPS: $\frac{8,000,000}{2,000,000 + 25,000} = 3.95$

Example 3: Calculation of diluted EPS under the two-class method

Profit attributable to equity holders:	CU 65,000
Class A shares outstanding:	10,000
Class B shares outstanding:	10,000

Each share of Class B common stock is convertible into one share of Class A common stock. Class A shareholders receive 105% of any dividends on Class B shares.

Dividends paid to Class A shareholders:	CU 10,500
Dividends paid to Class B shareholders:	CU 10,000
Options on Class A shares	2,000
Exercise Price	CU 50
End-of-year market price for Class A shares	CU 60

The options are assumed to be classified as equity.

Step 1: Calculation of basic EPS under the two-class method

Net Income:	65,000
Less dividends paid to Class A shareholders:	(10,500)
Less dividends paid to Class B shareholders:	(10,000)
Undistributed profit:	44,500

Allocation to Class A shareholders:

$$44{,}500 \times \frac{1.05 \times 10{,}000}{1.05 \times 10{,}000 + 1.0 \times 10{,}000} = 22{,}793 \qquad 22{,}793 / 10{,}000 = 2.28 \text{ per share}$$

Allocation to Class B shareholders:

$$44{,}500 \times \frac{1.0 \times 10{,}000}{1.05 \times 10{,}000 + 1.0 \times 10{,}000} = 21{,}707 \qquad 21{,}707 / 10{,}000 = 2.17 \text{ per share}$$

Basic EPS	Class A	Class B
Distributed	1.05	1.00
Undistributed	2.28	2.17
Total	3.33	3.17

Step 2a: Calculation of diluted EPS for Class A shares assuming conversion of Class B shares

Calculation of the dilutive effect of options

Assumed proceeds	2,000 x 50 = 100,000

[The option is classified as equity; thus the carrying amount of the option is not included in the assumed proceeds.]

Repurchase shares at end-of-period market price	100,000 / 60 = 1,667
Incremental shares	2,000 – 1,667 = 333

	Allocated profits to Class A shares	Number of Class A shares	EPS
Distributed	10,500		
Undistributed	22,793		
Basic	33,293	10,000	3.33
Options		333	
Class B conversion	31,707	10,000	
Diluted	65,000	20,333	3.20

Step 2b: Calculation of diluted EPS for Class A shares under the two-class method

	Allocated profits to Class A shares	Number of Class A shares	EPS
Distributed	10,500		
Undistributed	22,793		
Basic	33,293	10,000	3.33
Add-back undistributed profits allocated to Class B shares	21,707		
Options		333	
	55,000	10,333	
Less undistributed profits reallocated to Class B shares	(21,343)		
Diluted	33,657	10,333	3.26

Calculation of undistributed profits reallocated to Class B shares:

$$44{,}500 \text{ (total undistributed profits) x } \frac{1.0 \times 10{,}000}{1.05 \times 10{,}333 + 1.0 \times 10{,}000} = 21{,}343$$

In this scenario the reporting entity assumes conversion of the Class B shares into Class A shares because the outcome is more dilutive. The reporting entity presents diluted EPS of 3.20 for Class A shares.

Step 3: Calculation of diluted EPS for Class B shares

	Allocated profits to Class B shares	Number of Class B shares	EPS
Distributed	10,000		
Undistributed	21,707		
Basic	31,707	10,000	3.17
Less undistributed profits allocated to Class B shares	(21,707)		
Add-back undistributed profits reallocated to Class B Shares	21,343		
Diluted	31,343	10,000	3.13

APPENDIX B – EXTRACT FROM FSP 128-A

The proposed FSP 128-a, required the entity to calculate diluted EPS under the two-class method as follows:

Step 1: Compute basic EPS using the two-class method

Step 2: Using total earnings allocated to the common stock under Step 1, compute diluted EPS (with earnings available/allocated to common shareholders as the numerator).

If the participating security is also a potential common share, then determine the dilutive effect under both of the following approaches:

a. Assume the instrument has been exercised, converted, or issued (that is, apply the treasury stock method, the if-converted method, or the contingently issuable share method). In addition, assume all other dilutive potential common shares have been exercised, converted, or issued, giving specific consideration to the antidilution sequencing provisions in Statement 128.

b. Add back the undistributed earnings allocated to the participating security (or securities) in arriving at basic EPS and assume all other dilutive potential common shares have been exercised, converted, or issued, giving specific consideration to the antidilution sequencing provisions of Statement 128. Then reallocate undistributed earnings to the common shares and the participating security (or securities) giving effect to any additional common shares (denominator) and any additional income (numerator) that would result from exercise, conversion or issuance of potential common shares (that is, the two-class method).

Determine the more dilutive effect of Step 2(a) and 2(b).

If the participating security is not a potential common share, then determine the dilutive effect using Step 2(b).

Step 3: Determine whether diluted EPS is required to be presented, in accordance with paragraph 61(d) of Statement 128, for a second class of common stock.1 If so, compute diluted EPS for the second class of common stock using the two-class method assuming additional common shares of the first class of common stock are outstanding resulting from the conversion of all potential common shares outstanding. That is, determine the incremental effect of reallocating undistributed earnings to the second class of common stock. For a second class of common stock convertible into the first class of

> common stock, disclose the fact that (a) diluted EPS for the second class of common stock does not assume conversion into the first class of common stock and (b) diluted EPS for the first class of common stock assumes conversion of the second class of common stock into the first class of common stock, if dilutive.

The staff notes that many US-constituents who commented on the FSP 128-a exposure draft considered this wording to be overly complex and confusing. The staff has been working since then on an improved, more principle-based wording that will be included in the IAS 33 and SFAS No. 128 exposure drafts.

APPENDIX C – GLOSSARY

Contingently issuable shares

Both IAS 33 and SFAS No. 128 define contingently issuable shares as shares issuable for little or no cash consideration upon the satisfaction of certain conditions pursuant to a contingent stock agreement.

If-converted method

SFAS No. 128 defines the if-converted method as a method of computing EPS data that assumes conversion of convertible securities at the beginning of the reporting period. IFRSs do not use the term 'if-converted method', but IAS 33.49 contains essentially the same calculation of diluted EPS for convertible instruments.

Participating securities

SFAS No. 128 describes participating securities as securities that may participate in dividends with ordinary shares according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share). IAS 33.A13 contains a comparable description of a participating equity instrument. However, participating debt instruments are outside of the scope of the application guidance in IAS 33.A13 and A14.

Treasury stock method

SFAS No. 128 defines the treasury stock method as a method of recognising the use of proceeds that could be obtained upon exercise of options and warrants in calculating diluted EPS. It assumes that any proceeds would be used to purchase ordinary shares at the average market price during the period (proposed amendment: end-of-period market price). IFRSs do not use the term 'treasury stock method', but IAS 33.45 contains essentially the same treatment of options, warrants and their equivalents.

Reverse treasury stock method

SFAS No. 128 defines the reverse treasury stock method as a method of recognising the dilutive effect on EPS of satisfying a put obligation. It assumes that the proceeds used to buy back ordinary shares (pursuant to the terms of a put option) will be raised from issuing shares at the average market price during the period (proposed amendment: end-of-period market price). Therefore, the reverse treasury stock method mirrors the treasury stock method. IFRSs do not use the term 'reverse treasury stock method'. However, IAS 33.63 contains essentially the same treatment of contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts.

Two-class method

SFAS No. 128 describes the two-class method as an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. IFRSs do not use the term 'two-class method'. IAS 33.A13 and A14 provide application guidance on the calculation of EPS when the entity has participating equity instruments or two-class ordinary shares. Even though the application guidance is comparable to the two-class method, the treatment of participating securities under US GAAP and participating equity instruments and two class ordinary shares under IFRSs is not fully aligned.