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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: **23 January 2008, London**

Project: **Earnings per Share**

Subject: **Supplemental Document (Agenda Paper 6Bi)**

PURPOSE OF THIS MEMORANDUM

1. [Some Board members] requested the staff develop a disclosure that would enable a user to compute diluted EPS in accordance with the methods required by IAS 33 and Statement 128 for instruments that are not measured at fair value (that is, the treasury stock method, reverse treasury stock method and the if-converted method). Separately, [one Board member] requested the staff develop a disclosure that would enable users to compute diluted EPS in a manner different from what is currently required by IAS 33 and Statement 128. The purpose of this memorandum is to provide the Boards with the information requested by [those Board members].

2. At the January 23, 2008 FASB and IASB Board meetings, the staff intends to ask the Boards whether additional disclosures should be required for instruments that are measured at fair value through profit or loss.

3. The staff continues to believe that no disclosures should be required as part of the Boards' short-term convergence project. The Boards have decided that the changes in fair value of those instruments reflect the economic effect of those instruments on current shareholders for the period and, therefore, no further adjustment to the denominator of diluted EPS is necessary. The staff believes that those Board members who suggest additional disclosures effectively disagree with this rationale. However, if a disclosure is intended to compensate for a weakness in the proposed approach to calculating diluted EPS, the staff believes that it is a more appropriate measure to change the proposed accounting requirement.

4. At the FASB Education Session, some FASB members requested the staff to provide the excerpt from the preballot draft of the exposure document (such a preballot draft has not been distributed to the Boards), which provides the FASB's basis for excluding these instruments from the denominator of diluted EPS. That excerpt is included as Appendix A. [Appendix A is not reproduced in this observer note.]

Alternative 1: Disclose Information Necessary to Compute Diluted EPS under Previous Methods

5. [Some Board members] believe that the objective of diluted EPS is to enable users to project future share issuances. Because the denominator of the diluted EPS computation would no longer be adjusted for the incremental shares issuable upon exercise or conversion of instruments that are measured at fair value through profit or loss, the objective of the disclosure proposed by [those Board members] is to provide enough information to enable users to compute diluted EPS using the treasury stock, reverse treasury stock and if-converted methods for these instruments[1]. That objective could be satisfied in one of the following ways:

   a Disclose the following information to enable users to compute diluted EPS: the number of shares potentially issuable upon exercise or conversion, the exercise

[1] [One Board member] believes that users should be able to compute diluted EPS using the modified treasury stock, modified reverse treasury stock and if-converted method for instruments measured at fair value through profit or loss. In contrast, [another Board member] believes that a disclosure should enable users to compute diluted EPS under the treasury stock, reverse treasury stock and if-converted method as currently required by IAS 33 and Statement 128.

or conversion price, the beginning and ending carrying value, and the after-tax amount of interest expense recognized for the period.

b Disclose the number of incremental shares that would have been added to the denominator of diluted EPS. This alternative would require the preparer, not the user, to perform the computation of the denominator of diluted EPS under the previous methods.

Alternative 2: Disclose the Fair Value of All Instruments

6. [One Board member] has suggested that many financial analysts would prefer to compute diluted EPS differently from the method required in IAS 33 and Statement 128. He observes that because of the assumed exercise of all options or warrants under the treasury stock and reverse treasury stock methods, diluted EPS reflects only the intrinsic value of those instruments. He believes that there is an approach to computing diluted EPS that would be simpler and provide more decision-useful information to users of financial statements. An article describing this approach is included as Appendix B [Appendix B is not reproduced in this observer note]. [The Board member] acknowledges that a fundamental review of the computation of diluted EPS is beyond the scope of the short-term convergence project. However, he believes that an improved disclosure could assist those users who would prefer to apply this approach.

7. Therefore, the objective of the disclosure proposed by [this Board member] is to provide information to enable users to compute diluted EPS in a manner different from those prescribed by IAS 33 and Statement 128. That objective could be satisfied by requiring an entity to disclose the fair value of all options, warrants and conversion options embedded in convertible instruments.

Staff Recommendation and Question for the Boards

8. As indicated previously, the staff does not recommend that additional disclosures be provided as part of the Boards' convergence project. The staff is concerned that the disclosures to satisfy [the first request] would neutralize the simplification of the computation of diluted EPS that is intended by the fair value method. The disclosures would require the preparer to perform a computation of diluted EPS as if the standards had not been simplified. In effect, an entity will be reporting diluted EPS on the face of the

financial statements in one manner and reporting it (or information for a user to compute incremental shares) differently in the disclosures. In addition, the disclosures may provide misleading information if incremental shares (or information for a user to compute incremental shares) are disclosed because those shares could have been antidilutive under the previous methods.

9. Additionally, the staff has not had the opportunity to evaluate the benefits and costs of requiring the disclosure suggested [in the second request]. In making that evaluation, the staff believes that the following, at a minimum, would need to be considered:

    a The staff should discuss this approach with a broader group of users to better understand whether this approach is commonly used and what other information would be needed.

    b The disclosure suggested in paragraphs 6 and 7 could bear additional valuation costs for preparers, as it requires a fair value measurement of options, warrants or convertible instruments that are classified as equity.. It also would require fair value for certain share-based payment awards that Statement 123(R) noted as not sufficiently reliable in measuring compensation cost (for example, performance based awards).

    c To provide this disclosure, an entity would need to determine the fair value of an embedded option. This may be difficult for preparers.

    d If this approach is indeed preferable to users, then shouldn't the Boards explore it as an alternative to the current methods of computing diluted EPS as opposed to just disclosing the information?

10. To move this project closer to completion, the staff recommends asking constituents in the Exposure Draft whether (a) they agree with the basis for excluding instruments that are measured at fair value through profit or loss from the denominator of an EPS computation and (b) additional information should be provided in a disclosure for these instruments and why.

Do the Boards agree with the staff recommendation?