STAFF PAPER

January 2012

IFRS Interpretations Committee Meeting

Previous meetings: Nov 2011

Project	**IAS 33 – *Earnings per Share***
Paper topic	Calculating earnings per share considering non-cumulative preference dividends

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Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to address an issue related to the calculation of basic earnings per share ('EPS') under IAS 33 *Earnings per Share*.
2. Specifically, the submitter requested that the Committee clarify the period in which a dividend on non-cumulative preference shares, which are classified as equity ('preference dividend'), should result in an adjustment to the EPS calculation.
3. The submitter did not define the type of non-cumulative preference shares referred to in the submission. Following an informal discussion with staff of the submitter, we understand that the non-cumulative preference shares referred to in the submission are assumed to include the following characteristics:

    (a) They are classified as equity within the statement of financial position;

    (b) There is no contractual obligation on the entity to declare a preference dividend in any given period;

    (c) When a dividend is proposed on the ordinary shares, a preference dividend must be declared in the same period and the ratio of the distribution on the preference shares to the ordinary shares is contractually fixed, ie there is an agreement on how distributions of the net profit will be allocated ('participation feature').

(d) The preference dividends are non-cumulative, ie if no preference dividend is declared in the current dividend cycle, there is no accumulation of arrear preference dividends that would need to be paid in a future period.

Decisions taken in the previous meeting

4. At the November 2011 Committee meeting, the Committee noted that, for non-cumulative preference shares with participation features and classified as equity instruments as described in paragraph 3 above, it is not relevant whether the dividends declared on the preference shares have been recognised in the financial statements for the for purposes of calculating EPS.

5. The Committee noted that paragraph A14 of IAS 33 would require the preference dividends, in the fact pattern considered in paragraph 3, to be taken into account in the calculation of EPS, on the notional basis that all of the net profit or loss for the period was distributed to each class of equity instrument.

6. However, the Committee noted that there may be other fact patterns that *would* require an entity to apply the guidance in paragraph 14(a) of IAS 33, and that the application of this guidance may result in diversity, for example:

(a) when no participation feature exists and a preference dividend is declared by the directors; or

(b) when there is a loss recorded for the period but a preference dividend is nevertheless declared

7. The Committee therefore directed the staff to:

(a) perform outreach to determine if any current fact patterns exist where the guidance in paragraph 14(a) applies; and

(b) to perform an analysis of whether the wording in IAS 33 may need to be clarified.

Staff Analysis

Outreach to determine relevance of IAS 33 paragraph 14(a)

8. To address the Committee's first request, we sent out a request for information to the National Standard Setters Group. Specifically, we asked:

   (a) *In your experience, is the first situation identified by the Committee (losses are incurred but a preference dividend is still declared) prevalent in practice? In other words, do entities commonly issue non-cumulative preference shares classified as equity and declare dividends in years when they have made net losses in their statement of comprehensive income?*

   (b) *In your experience, is the second situation identified by the Committee (no participation feature) prevalent in practice? In other words, do entities commonly issue non-cumulative preference shares (classified as equity instruments) without a participation feature? By participation feature, we mean that the shareholders' agreement, preference shareholders' agreement or local legislation explains how the profits would be distributed in the event that all of the profit for the current period was distributed.*

   (c) *If you answered yes to question (a) or (b), is there a clear preference by entities in the way in which they apply paragraph 14(a) of IAS 33 to determine the period in which the preference dividends affect EPS? For example, the period in which preference dividends (in the situations described above) are incorporated into the calculation of EPS might be:*

      (i) *the period in which they are proposed by the directors;*

      (ii) *the period in which they are authorised by the shareholders (and hence recognised in the financial statements);*

      (iii) *the period in which the related profit / loss was earned, irrespective of when the dividends are proposed or recognised in the financial statements; or*

(iv) *something else (please provide details if this is the case in your jurisdiction).*

9. The views expressed below are informal feedback from the National Standard Setters. They do not reflect the formal views of the Boards of those organisations The geographic breakdown for the responses is as follows:

Geographic area	**Number of respondents**
Africa	1
Asia/Oceania	2
Europe	3
North America	2
Total respondents	**8**

10. Almost all of the respondents stated that the two issues described were not prevalent in their jurisdiction.

11. However, for the relatively small number of respondents who stated that the issue did occur in their jurisdiction, the responses indicated that there was diversity in how paragraph 14(a) is being interpreted. There was no clear preference on the current interpretation of paragraph 14(a). In other words, the respondents were split in whether paragraph 14(a) is intended to mean:

(a) the date at which the dividend is proposed,

(b) the date at which the dividend is recognised in the financial statements; or

(c) the date at which the related profits are earned.

Analysis of wording in IAS 33 paragraph 14(a)

12. Paragraph 14 of IAS 33 states:

> The after-tax amount of preference dividends that is deducted from profit or loss is:

a) the after-tax amount of any preference dividends on non-cumulative preference shares declared in respect of the period; and

b) the after-tax amount of the preference dividends for cumulative preference shares required for the period, whether or not the dividends have been declared. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

13. In analysing paragraph 14(a), we think the following aspects are relevant to the issue of when EPS should be adjusted for preference dividends in the circumstances where IAS 33 paragraph A14 is not applicable:

(a) the meaning of the term ‘in respect of the period’; and

(b) the meaning of the term ‘declared’.

Meaning of the term ‘in respect of the period’

14. We think that there are two potential ways of interpreting ‘in respect of the period’ in the context of paragraph 14(a) of IAS 33:

(a) **View 1: adjust EPS in the period dividends are declared** – The sentence is intended to mean that the preference dividends affect EPS in respect of the period *in which they are declared*. If this view is more appropriate, then the meaning of the word ‘declared’ becomes important and is discussed later in this paper.

(b) **View 2: adjust EPS in the period of the related profits** – The sentence is intended to mean that the preference dividends affect EPS in respect of the period *in which the corresponding profit was earned*. If this view is more appropriate, then the meaning of the word ‘declared’ becomes less relevant because the impact of the preference dividend will be adjusted for the previous accounting period if the dividend relates to the profits earned in that period.

15. Proponents of view 1 believe that the preference dividends only impact the financial position of the entity when they are declared for financial statement purposes because:

    (a) it does not make sense that the preference dividends would be recognised as a distribution in one accounting period but that their impact to the EPS measure might predate the preference dividends recognition in the financial statements;

    (b) trying to determine the period that the profits were earned on which the related dividend is declared may be impracticable in some cases. For example, a company may have earned profits for the past three years without the declaration of a preference dividend and at the end of year three the company declares such a dividend. Does the preference dividend relate to:

        (i) the profits earned for the last three years equally; or

        (ii) the profit earned only for the year preceding the declaration; or

        (iii) the first year that a profit was earned, ie a FIFO basis?

    (c) Although certain jurisdictions have legal requirements regarding the allocation of a dividend to a particular period of profits or retained income, these requirements vary by jurisdiction and the accounting should therefore not be based one particular set of legal requirements.

16. Proponents of view 2 believe that more useful information is provided to users of financial statements where the EPS measure is adjusted for the effects of preference dividends in the period in which the related profits were earned because:

    (a) Adjusting the EPS measure in the period in which the preference dividends are declared in the financial statements could reduce the relevance of the EPS measure if this is not the same period in which the related profits were earned. IAS 33 paragraph 11 explains that the objective of the Standard is to provide a measure, per ordinary share, of the performance of the entity over the reporting period.

(b) Accruing for preference dividends for the purposes of the EPS calculation is analogous to adjusting the EPS measure for cumulative preference dividends on equity instruments, as explained in paragraph 14(b) of IAS 33, which are taken into account whether or not the dividends have been declared.

17. We think that view 1 is the more appropriate view, ie 'declared in respect of the period' means that the preference dividends affect the EPS calculation in the period in which they are declared because:

(a) although we understand that the preference dividends declared in a financial period may relate to profits earned in a previous period, we do not think that paragraph 14(a) is intended to be applied in this manner for the reasons set out in paragraph 15 above.

(b) In addition, we think that paragraph 14(b) of IAS 33 reinforces this rationale, because cumulative dividends and non-cumulative dividends are treated differently for EPS purposes. In other words, paragraph 14 of IAS 33 makes a distinction between cumulative and non-cumulative dividends because cumulative dividends will always be taken into account in the period in which the related profit is earned, whereas non-cumulative dividends will only be taken into account in respect of the period in which they are declared.

(c) We think that applying view 2 may in some cases not be practicable. For example, if an entity incurs losses from 2010 to 2012 but declares a dividend in 2013 out of profits earned in 2009, would the entity be required to restate the financial statements of 2009 because the dividend in 2013 is being declared out of profits earned in 2009?

Question for the committee
1. Does the Committee agree that, for the purposes of determining EPS when paragraph 14(a) of IAS 33 applies, 'declared in respect of the period' means

> that the preference dividends affect the EPS calculation in the period in which they are declared?

Meaning of the term 'declared'

18. IAS 33 does not provide a definition of the word 'declared' in the context of dividend declaration and paragraph 14(a) of IAS 33.

19. We think that there are two potential ways of interpreting 'declared' in the context of paragraph 14(a) of IAS 33:

    (a) **View (a) 'declared = proposed'** – This sentence is intended to mean that the preference dividends affect the EPS calculation in respect of the period in which they are *proposed* by the directors.

    (b) **View (b) 'declared = recognised'** – This sentence is intended to mean that the preference dividends affect the EPS calculation in respect of the period in which they are *recognised* in the financial statements.

20. Proponents of view (a) look to paragraph 10 of IFRIC 17 *Distributions of non-cash assets to owners* which states that:

    > The liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity, which is the date:
    >
    > a) when declaration of the dividend, eg by management or the board of directors, is approved by the relevant authority, eg the shareholders, if the jurisdiction requires such approval, or
    >
    > b) when the dividend is declared, eg by management or the board 2of directors, if the jurisdiction does not require further approval.

21. Proponents of view (a) argue that paragraph 10(a) of IFRIC 17 indicates that there is a distinction between the declaration of a dividend and its authorisation (and hence recognition) in jurisdictions where shareholder approval is required. Consequently, although the recognition of the dividend may be dependent on

shareholder approval, the declaration of the dividend can occur prior to the dividend being recognised in the financial statements.

22. Proponents of view (a) also argue that in some jurisdictions, there is a legal requirement for the shareholders to approve the preference dividends before they are recognised in the financial statements while in others there is not. Therefore comparability of the EPS calculation suffers as a result of the differing legal frameworks around the world.

> For example, consider two entities (Entity A and Entity B) that earn the same net profit for the year ending 31 December 2011 and whose directors propose an identical preference dividend at 31 December 2011. However, Entity A is in a jurisdiction that requires shareholder approval before the dividend is recognised in the financial statements whereas Entity B is in a jurisdiction where shareholder approval is not required before the dividend is paid. Although both entities have in substance identical performance for the period, Entity B will recognise a lower EPS measure than Entity A.

23. Proponents of view (b) believe that the term 'declared' is intended to mean the date that the preference dividends are recognised in the financial statements. As part of the development of IFRIC 17, paragraph 13 of IAS 10 *Events after the Reporting Period* was amended (Refer to IFRIC 17 paragraphs BC18 – BC20 reproduced in Appendix A to this paper). Prior to the amendment, IAS 10 provided the following meaning for the term 'declared':

> …the dividends are appropriately authorised and no longer at the discretion of the entity.

24. Consequently, proponents of view (b) think that 'declared' is intended to mean recognised as a liability in the financial statements for the purposes of IAS 33. Proponents of view (b) think that the amendment to IAS 10 was not intended to change the meaning of 'declared'. IFRIC 17 no longer refers to the term 'declared'. Proponents of view (b) think that the reason for removing the reference to the word 'declared' was because 'declared' might have a different meaning depending on the relevant legal jurisdiction and was not relevant in determining when the dividend should be recognised.

25. We think that view (b) is the more appropriate view. We acknowledge that the amendment to IAS 10 and introduction of paragraph 10(a) of IFRIC 17 might make the meaning of 'declared' in IAS 33 more difficult to interpret. However, we think that view (b) is the more appropriate interpretation because:

(a) Before the amendment to IAS 10, there was sufficient guidance in paragraph 13 of IAS 10 to conclude that 'declared' was intended to mean 'the dividends are appropriately authorised and no longer at the discretion of the entity', ie recognised in the financial statements.

(b) There was no consequential amendment made to IAS 33 at the time of the IAS 10 amendment and issuance of IFRIC 17;

(c) There is nothing in the basis of conclusion to IFRIC 17 that suggests the Board's intention was to change the meaning of the word declared in the context of the calculation methodology of EPS in IAS 33;

(d) we think conceptually, it does not make sense that the EPS figure in the financial statements would be impacted before the related dividend is recognised in the same financial statements; and

(e) we think practically, applying view (a) may result in possible restatement issues. For example, if an entity's directors propose a preference dividend, but after the financial statements are issued, the shareholders vote to reduce or cancel the preference dividend, how would the entity present the comparative period in its next set of financial statements?

Question for the Committee
2. Does the Committee agree that, for the purposes of determining EPS when paragraph 14(a) of IAS 33 applies, interpreting 'declared' as 'recognised in the financial statements' is the more appropriate interpretation?

Assessment against annual improvement criteria

26. Because we think that the wording in IAS 33 paragraph 14 could be clarified, we assessed the possibility of making an amendment to this paragraph against the Annual Improvement's criteria (refer to Appendix B).
27. We think that the issue meets the Annual Improvement criteria. Although the outreach indicated that the issue is not widespread, we note that this is not a requirement to propose an annual improvement.

Staff recommendation

28. We think that the Committee should propose an annual improvement to the Board to clarify the wording in paragraph 14 of IAS 33 because:
    (a) we think that the wording in paragraph 14 of IAS 33 can be clarified;
    (b) although the outreach indicated that the issue is not widespread, we think that the Annual Improvement criteria are still met.
29. Because the amendment may result in a restatement to the EPS measure, we propose fully retrospective application so that EPS comparability is not impaired. This maintains the principle in EPS relating to restatement of comparative periods for shares issued for no consideration.
30. We have included proposed wording for the annual improvement in Appendix C.

Question for the Committee
3. Does the Committee agree that the issue should be addressed through an annual improvement? 4. If the Committee agrees that the issue should be addressed through an annual improvement, does the Committee agree with the proposed wording for the annual improvement (refer to Appendix C)?

Appendix A – Extract from IFRIC 17

When to recognise a dividend payable (paragraph 10) and amendment to IAS 10

BC18 D23 did not address when an entity should recognise a liability for a dividend payable and some respondents asked the IFRIC to clarify this issue. The IFRIC noted that in IAS 10 *Events after the Reporting Period* paragraph 13 states that 'If dividends are declared (ie the dividends are appropriately authorised and no longer at the discretion of the entity) after the reporting period but before the financial statements are authorised for issue, the dividends are not recognised as a liability at the end of the reporting period because no obligation exists at that time.'

BC19 Some commentators stated that in many jurisdictions a commonly held view is that the entity has discretion until the shareholders approve the dividend. Therefore, constituents holding this view believe a conflict exists between 'declared' and the explanatory phrase in the brackets in IAS 10 paragraph 13. This is especially true when the sentence is interpreted as 'declared by management but before the shareholders' approval'. The IFRIC concluded that the point at which a dividend is appropriately authorised and no longer at the discretion of the entity will vary by jurisdiction.

BC20 Therefore, as a consequence of this Interpretation the IFRIC decided to recommend that the Board amend IAS 10 to remove the perceived conflict in paragraph 13. The IFRIC also noted that the principle on when to recognise a dividend was in the wrong place within the IASB's authoritative documents. The Board agreed with the IFRIC's conclusions and amended IAS 10 as part of its approval of the Interpretation. The Board confirmed that this Interpretation had not changed the principle on when to recognise a dividend payable; however, the principle was moved from IAS 10 into the Interpretation and clarified but without changing the principle.

Appendix B – Assessment of Annual Improvement's criteria

In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All criteria (a)–(d) must be met to qualify for inclusion in annual improvements.

(a) The proposed amendment has one or both of the following characteristics:

(i) clarifying–the proposed amendment would improve IFRSs by:

- clarifying unclear wording in existing IFRSs, or providing guidance where an absence of guidance is causing concern.
- A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

(ii) correcting–the proposed amendment would improve IFRSs by:

- resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or.
- addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.

A correcting amendment does not propose a new principle or a change to an existing principle.

[Staff analysis—this criterion is satisfied. The proposed amendment clarifies the meaning of the term 'declared in respect of the period' in paragraph 14 of IAS 33.

(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.

[Staff analysis— this criterion is satisfied. The issue is sufficiently narrow in scope to ensure that the proposed change has been considered sufficiently and identified.]

(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.

[Staff analysis—this criterion is satisfied. We think that the Committee will be able to address this issue on a timely basis and we think that the Board should be in a position to also reach a conclusion on a timely basis.]

(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.

[Staff analysis—this criterion is satisfied. There is no current IASB project on IAS 33.]

Appendix C – Proposed wording for annual improvement

A1. The proposed amendment to IAS 33 is presented below.

Amendment to IAS 33 *Earnings per Share*

Paragraph 14 and 50 are amended as follows (new text is underlined and deleted text is struck through):

14 The after-tax amount of preference dividends that is deducted from profit or loss is:

(a) the after-tax amount of any preference dividends on non-cumulative preference shares recognised in the period (assuming the requirements of paragraph A14 in Appendix A do not apply) ~~declared in respect of the period~~; and

(b) the after-tax amount of the preference dividends for cumulative preference shares required for the period, whether or not the dividends have been recognised ~~declared~~. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or recognised ~~declared~~ during the current period in respect of previous periods.

50 Convertible preference shares are antidilutive whenever the amount of the dividend on such shares recognised ~~declared~~ in or accumulated for the current period per ordinary share obtainable on conversion exceeds basic earnings per share. Similarly, convertible debt is antidilutive whenever its interest (net of tax and other changes in income or expense) per ordinary share obtainable on conversion exceeds basic earnings per share.

Effective date and transition

Improvements to IFRSs issued in [date] amended paragraphs 14 and 50. An entity shall apply those amendments for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Basis for Conclusions on proposed amendments to IAS 33 *Earnings per Share*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Calculation of basic earnings per share considering non-cumulative preference shares classified as equity

BC1 The Board received a request to clarify how an entity should apply the requirements of paragraph 14 of IAS 33 to dividends on non-cumulative preference shares that are classified as equity. Specifically, some constituents think that the wording in paragraph 14(a) of IAS 33 is unclear as to what the term 'declared in respect of the period' is intended to mean. Some constituents think that this wording could be interpreted in one of three ways:

a) the adjustment to earnings per share ('EPS') should be made in the period that the related profit was earned, irrespective of when the dividend is declared;

b) the adjustment to EPS should be made when the dividends are proposed by the directors; or

c) the adjustment to EPS should be made when the dividends are recognised in the financial statements.

BC2 The Board noted that paragraph A14 of IAS 33 requires the preference dividends to be taken into account in the calculation of EPS, on the notional basis that all of the net profit or loss for the period was distributed to each class of equity instrument when:

a) the preference shares are classified as equity within the statement of financial position; and

b) the preference shares include a participation feature. In other words, the entity can determine how the net profit would be distributed to all the holders of equity instruments if the entity hypothetically declared all of the net profit for the year.

BC3 However, the Board noted that there may be circumstances when paragraph 14(a) of IAS 33 would be required to determine the adjustment to EPS for a preference dividend, for example:

a) where the preference shares do not include a participation feature; or

b) when losses are incurred during the year but a preference dividend is still declared.

The Board further noted that the wording in paragraph 14(a) of IAS 33 could be clarified.

BC4 The Board noted that IAS 10 *Events after the reporting period*, was amended when the Board issued IFRIC 17 *Distributions of Non-cash Assets to Owners.* Prior to IAS 10 being amended, paragraph 13 of IAS 10 included an explanation of the meaning of the word 'declared'. The Board did not intend, at the time of issuing IFRIC 17, to amend the definition of declared for the purposes of IAS 33. Consequently, the Board is proposing to amend IAS 33 to:

a) clarify that when a dividend is declared on a non-cumulative preference share, classified as equity that includes a participation feature, paragraph A14 of IAS 33 should be used to determine EPS by explicitly referring to paragraph A14 of IAS 33; and

b) clarify that when paragraph 14(a) of IAS is applicable (for example when there is no participation feature), the meaning of the words ‘declared in respect of the period’ is intended to mean ‘recognised in the period’.

BC5 The Board thinks that the amendment will clarify when paragraph 14(a) should be used to determine EPS. The Board also thinks that the amendment will clarify the original intention of the words ‘declared in respect of the period’ and will promote consistency between the requirements of IAS 33 and those of IFRIC 17.