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5 December 2008

Dear Mr Buschhueter

International Accounting Standards Board Exposure Draft: *Simplifying Earnings per Share (Proposed amendments to IAS 33)*; Financial Accounting Standards Board Exposure Draft: *Earnings per Share, an amendment of FASB Statement No. 128 (File Reference No. 1580-100) (the Exposure Drafts)*

We appreciate the opportunity to respond to the International Accounting Standards Board's (IASB's) and the U.S. Financial Accounting Standards Board's (FASB's) (the Boards') Exposure Drafts about the proposed amendments to Earnings per Share (EPS). This letter represents the views of KPMG International and its member firms, including KPMG LLP (U.S.), and is being submitted to both the IASB and the FASB.

We agree that it is desirable for any guidance on EPS issued by the IASB and FASB to be converged. We note that the Boards assert that the Exposure Drafts aim to converge the denominator of the EPS calculation according to IAS 33 *Earnings per Share* and FASB Statement No. 128, *Earnings per Share*; however, the two documents use different words in many parts of the proposals. One example is the principle for instruments to be included in the basic EPS calculation that is outlined by the Boards in both Exposure Drafts. Paragraph 18 of the IASB Exposure Draft states that:

“[i]n calculating the weighted average number of ordinary shares outstanding an entity shall consider all instruments that give their holder the right to share in profit or loss of the period.”

This is contrasted with paragraph 2 of the FASB Exposure Draft, in which the principle is stated as:

“[a]n entity shall include in the computation of basic EPS all common shares outstanding and 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.”

The Exposure Drafts contain no explanation regarding why the Boards decided to seek convergence in application of the guidance in IAS 33 and Statement 128 without converging the actual wording of those standards. The pervasive differences in wording throughout the two Exposure Drafts raise questions as to whether the Boards' objective of converging the EPS denominator will be achieved in practice as differences in wording raise questions as to whether the Boards reached the same conclusions. We believe that the Boards should use identical wording in both final standards, except when the use of identical wording is precluded because of specific differences in other IASB or FASB standards or when identifying areas where the Boards' decisions are not converged. This approach was applied recently in connection with IFRS 3 *Business Combinations* (as revised in 2008) and FASB Statement No 141R, *Business Combinations* (revised 2007), and we encourage the Boards to use the same approach in connection with the final amendments to IAS 33 and Statement 128 as well. Using the same language would reduce the likelihood of interpretation differences that can arise in practice.

Potential Continuing Differences between IAS 33 and Statement 128 Due to Different Levels of Interpretive Guidance and Differences in Transition Requirements

Paragraph IN1 of the IASB Exposure Draft indicates that the proposals aim to achieve convergence with Statement 128. Additionally, the Summary section of the Notice to Recipients of the FASB Exposure Draft indicates that the limited exceptions to convergence "relate to certain instruments for which the underlying accounting under U.S. generally accounting principles (GAAP) and International Financial Reporting Standards (IFRSs) is different." However, it is not clear how those stated intentions align with the IASB's decision not to consider certain interpretive guidance currently included in U.S. GAAP that "goes beyond the level of detail in IAS 33." Given the Boards' intention of issuing converged standards, we believe that the two standards should address the same range of issues. If the IASB believes that entities applying IAS 33 are not required to apply all of the U.S. GAAP interpretations listed in paragraph BC8, then the final standards should identify those interpretations as areas where convergence was not achieved.

Another item that will cause a lack of convergence is the FASB's proposed exception to retrospective transition for instruments that have been settled for cash, or modified to eliminate any share settlement alternative, on or before the last day of the period of adoption. We expect that the final standards would be effective on January 1, 2010 for calendar year-end entities and would be applied retrospectively to an entity's 2009 and 2008 financial statements. Given that entities have had nearly five years to amend or settle their share-settleable contracts between the FASB's original proposal in 2003 and 2008, the FASB should consider whether that exception to retrospective application is still necessary. We believe that both standards should be consistent in their retrospective transition requirements, and should be applied to all periods presented.

Instruments Measured at Fair Value Through Profit or Loss

We do not support the proposed exclusion of instruments measured at fair value through profit or loss from the denominator of diluted EPS because the change in fair value of the instrument recorded in the numerator will not necessarily reflect the dilutive impact to shareholders in each reporting period. EPS is calculated on a period-by-period basis, and in periods in which the change in fair value of the instrument results in a gain to the entity, that fair value adjustment in profit or loss is anti-dilutive to EPS, even when the instrument is deep in-the-money. We do not believe that the proposed guidance results in the achievement of the objective of diluted EPS as stated in the Exposure Drafts. Our response to Question 3 in Appendix A of this letter provides further discussion behind our position on this issue.

Use of the If-Converted Method

The IASB Exposure Draft proposes to exclude the ordinary shares underlying gross physically settled written put options and forward purchase contracts from the denominator of the basic and diluted EPS calculations. Under IFRSs, those contracts are accounted for as if the repurchase of shares already had occurred by reducing equity and recognising a financial liability equal to the present value of the redemption amount. We support the proposed change to exclude the underlying ordinary shares from the denominator of the basic and diluted EPS calculations because it creates consistency between the accounting and EPS treatment.

Another area in which we believe the accounting and EPS treatment could be made consistent is in respect of the application of the if-converted method in diluted EPS calculations. The if-converted method would apply to convertible instruments that will be settled in shares upon conversion, regardless of whether the convertible instrument is accounted for as a combined instrument (for example, perpetual convertible preference shares) or whether the instrument is separated into a financial liability and a conversion option (for example, all convertible debt under IFRSs and convertible debt with a beneficial conversion feature under U.S. GAAP). To better align the accounting and EPS treatment of convertible instruments, we believe that a conversion option that is accounted for separately should be reflected in diluted EPS using the treasury stock method, consistent with the EPS treatment of a freestanding written call option on an entity's ordinary shares. We believe that the if-converted method should be applied only to convertible instruments in circumstances in which the conversion option is not accounted for separately from the host contract.

Presentation of EPS in General Purpose Financial Statements

We note that EPS is an analytical tool that is a widely-used metric by external users of the financial statements and by management. However, EPS is a key performance indicator rather than an accounting measurement. There are a number of other financial ratios and metrics that are used widely by analysts and other financial statement users that are not presented within an entity's general purpose financial statements. Therefore, we suggest that as part of the IASB project on Management Commentary (MD&A) and the joint FASB/IASB Financial Statement



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Presentation project, the Boards should consider whether EPS should continue to be included as part of the basic financial statements or the notes thereto or whether it represents supplemental information that would be reported more appropriately in MD&A or elsewhere outside the financial statements.

Responses to Specific Questions in the Exposure Drafts

Appendix A to this letter provides our responses to the specific questions raised in the Exposure Drafts. Appendix B provides comments specific to the IASB's Exposure Draft, and Appendix C provides comments specific to the FASB's Exposure Draft.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Mary Tokar with the KPMG International Financial Reporting Group in London at +44 (0)20 7694 8871, or Mark Bielstein or Paul Munter with KPMG LLP in New York at +1 (212) 909 5419 or +1 (212) 909 5567, respectively.

Yours sincerely

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Appendix A: Responses to the questions set out in the Exposure Drafts

This appendix provides responses to the six questions set forth in the Invitation to Comment section of the IASB Exposure Draft, as well as the three issues set forth in the Notice to Recipients section of the FASB Exposure Draft. The question numbers referred to in this appendix are those used in the IASB Exposure Draft.

Q1—Mandatorily convertible instruments and instruments issuable for little or no cash or other consideration

Paragraphs 18 and 19 of the exposure draft propose that the weighted average number of ordinary shares 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. If ordinary shares issuable for little or no cash or other consideration or mandatorily convertible instruments do not meet this condition, they will no longer affect basic EPS.

- (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?*
- (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?*

KPMG Response:

Q1(a)—Generally, we agree with the core principle set forth in paragraphs 18 and 19 of the IASB Exposure Draft (and the related guidance in paragraphs 2 and 3 of the FASB Exposure Draft). As noted in our covering letter, the Exposure Drafts use different wording to express what we understand to be the same core principle. We believe that the Boards should use identical wording in both final standards, except when the use of identical wording is precluded because of specific differences in other IASB or FASB standards.

In addition, we believe that the Boards should define the basic principle to ensure clarity in its application and to establish consistency between the two standards. In the Exposure Draft, the IASB articulates a principle that “*the weighted average number of ordinary shares includes only those instruments that give their holder the right to share in profit or loss for the current period.*” FASB articulates a similar but not identically-worded principle. However, the IASB Exposure Draft introduces an additional principle in paragraph A8, which the FASB Exposure Draft does not contain. The additional principle is that ordinary shares are included in EPS when resources from share issuance become available to the entity. While we would support this principle as aligning the EPS impact of new (potential) shares with the availability of resources that contribute to earnings (EPS numerator), we note that this principle may not always align with the principle above of the right to share in profit or loss for the current period.

Currently under both IFRSs and U.S. GAAP, a share issuable solely upon the passage of time is included in the denominator of basic EPS in the same manner as an outstanding ordinary share; it is not considered to be contingently issuable. In the Exposure Drafts, the Boards propose that such arrangements would be reflected as outstanding shares in the basic EPS denominator only if the counterparty currently could obtain those shares on demand. Since there was no explanation given in the Basis for Conclusions for this change, it is difficult to ascertain whether it is an intended or unintended change. We believe that shares that are not yet issued but are issuable solely upon the mere passage of time (i.e., there is no ongoing service or other “vesting” requirement) should be included in basic EPS as this is consistent with the additional principle, i.e., the resources from the share issuance have already been received by the entity and the issuance of the shares is a certainty. We do not believe that it is necessary for the related shares to be issuable *currently* to be included in the basic EPS calculation when the entity already has received consideration for those shares. Additionally, failing to include those shares in basic EPS is inconsistent with the treatment of forward share purchase contracts which are treated as though the shares already were repurchased.

Q1(b)—We agree with the application of the principle to mandatorily convertible instruments because the underlying shares are not issuable for little or no consideration. Rather, the holder is required to forego substantive economic benefits upon conversion of the instrument. For example, upon conversion of a mandatorily convertible instrument into ordinary shares, the holder loses (a) its rights to future interest or dividend payments, (b) its creditor rights or other preferences in the event of a bankruptcy, receivership, or general liquidation of the entity, (c) any rights to impose collateral requirements on the issuer, (d) its rights to enforce debt covenants, and (e) any special voting rights. Mandatorily convertible instruments have significant economic differences from outstanding ordinary shares and we agree with the Boards’ conclusions that such instruments should not be included in the denominator of basic EPS as if they were equivalent to ordinary shares. Additionally, we agree that an appropriate numerator allocation should be reflected in basic EPS calculations under the two-class method for participating securities, regardless of whether or not those participating securities are mandatorily convertible.

Q2—Gross physically settled contracts to repurchase an entity’s own shares and mandatorily redeemable ordinary shares

Paragraphs A31 and A32 of this exposure draft propose clarifying that an entity treats ordinary shares that are subject to a gross physically settled contract to repurchase its own shares as if the entity had already repurchased the shares. Therefore, the entity excludes those shares from the denominator of the EPS calculation. To calculate EPS, an entity allocates dividends to the financial liability relating to the present value of the redemption amount of the contract. Therefore, the liability is a participating instrument and the guidance in paragraphs A23–A28 applies to this instrument. However, such contracts sometimes require the holder to remit back to the entity any dividends paid on the shares to be repurchased. If that is the case, the liability is not a participating instrument. The Board proposes that the principles for contracts to repurchase an entity’s own shares for cash or other financial assets should also apply to

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?

KPMG Response:

We agree with the proposal that, since an entity accounts for ordinary shares subject to contracts to repurchase its own shares as if the shares already had been repurchased, those shares should be excluded from the denominator of basic EPS. In those circumstances when the contract does not require the return of the dividends to the entity, we agree that these instruments should be considered participating instruments and included in the calculation of EPS through a numerator adjustment determined using the two-class method because these instruments have the present ability to share in profit or loss during the period. Additionally, when a contract requires the counterparty to return dividends to the entity, we believe that such remittances should be accounted for as equity transactions (i.e., the payment and subsequent return of dividends should be accounted for as if the dividends were never paid, with no effect on earnings or retained earnings). Consistent with that accounting treatment, we agree that the two-class method should not be applied when the counterparty to the repurchase agreement is required to remit dividends back to the entity. We agree with that conclusion regardless of whether the counterparty is required to hold the underlying shares throughout the entire term of the contract or whether the counterparty can acquire the underlying shares in the market prior to the repurchase transaction. This outcome is appropriate because the remaining holders of ordinary shares are entitled to all of the entity's profit or loss for the period in circumstances in which the counterparty to the repurchase agreement is required to remit dividends back to the entity.

Under both contracts to repurchase its own shares and mandatorily redeemable shares, an entity is required to fulfil an unconditional obligation and is committed to settlement by future transfer of assets at a specified or determinable date or on occurrence of a specified event. Due to the similarities between a gross physically settled contract for an entity to repurchase its own shares and mandatorily redeemable shares, we agree that the same EPS treatment should apply to both types of instruments. However, we believe the IASB Exposure Draft also should specify that shares subject to an embedded put option (i.e., puttable shares) also are excluded from the denominator of EPS calculations when those shares are classified as financial liabilities under IAS 32 *Financial Instruments: Presentation*.

Q3—Instruments that are measured at fair value through profit or loss

For an instrument (or the derivative component of a compound instrument) that is measured at fair value through profit or loss, paragraphs 26 and A28 propose that an entity should not:

(a) adjust the diluted EPS calculation for the assumed exercise or conversion of that instrument; or

(b) apply the guidance for participating instruments and two-class ordinary shares in paragraphs A23–A28.

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?

KPMG Response [Note: This response addresses both Question 3 of the IASB Exposure Draft and Issue 1 of the FASB Exposure Draft.]:

As noted in our covering letter, we do not agree that fair value changes of instruments measured at fair value through profit or loss sufficiently reflect the effects on ordinary shareholders in the determination of diluted EPS, and therefore do not agree with the proposal that would eliminate the need for further adjustments to the calculation of diluted EPS for these instruments. We believe that potential ordinary shares that are measured at fair value through profit and loss should be reflected in EPS calculations in the same manner as other potential ordinary shares. We acknowledge, however, that the proposed guidance does support the Boards' efforts to simplify the EPS calculation.

Both Exposure Drafts state that the objective of diluted EPS is to "measure the performance of an entity over the reporting period while giving effect to all dilutive potential common shares outstanding during the period." We observe that basic and diluted EPS represent period-to-period calculations of per share amounts, not cumulative calculations of per share amounts. For any given reporting period, a share-settleable financial instrument that is measured at fair value with changes in fair value reported in profit or loss could result in either a gain or a loss being reported in the financial statements. In some periods, the fair value of such an instrument may not change significantly such that there is little, if any, effect on reported profit or loss. In periods in which the change in fair value of a share-settleable financial instrument results in the recognition of a gain, it is unclear how that gain would capture appropriately the potential dilution to holders of outstanding ordinary shares. Such an instrument could be significantly in-the-money at the balance sheet date while its fair value may have changed during the period in a manner that resulted in gain recognition for the period. In many cases, the impact of the proposed guidance would increase diluted EPS, as compared to the current requirements of IAS 33 and Statement 128, because the incremental shares from such instruments no longer would be included in the denominator and any gain from changes in fair value no longer would be reversed through an adjustment to the numerator.

Q4—Options, warrants and their equivalents

For the calculation of diluted EPS, an entity assumes the exercise of dilutive options, warrants and their equivalents that are not measured at fair value through profit or loss. Similarly, paragraph 6 of this exposure draft proposes clarifying that to calculate diluted EPS an entity assumes the settlement of forward contracts to sell its own shares, unless the contract is

measured at fair value through profit or loss. In addition, the boards propose that the ordinary shares arising from the assumed exercise or settlement of those potential ordinary shares should be regarded as issued at the end-of-period market price, rather than at their average market price during the period.

(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?

(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?

KPMG Response:

Q4(a)—We agree that the assumed manner of settlement for forward contracts to sell an entity's own shares should be consistent with the assumptions for options and warrants. While this proposed clarification is not explicit in current guidance, we believe that the proposed clarification would be consistent with current practice.

Q4(b)—We support the change to the end-of-period market price when calculating the assumed proceeds because it would simplify one aspect of the EPS calculation. However, we believe that the reasoning behind this change as noted by the Boards should be reconsidered. Both Exposure Drafts indicate that use of the end-of-period market price eliminates an inconsistency in calculating the incremental number of shares included in the diluted EPS denominator under the treasury stock method. That method requires the entity to assume that exercise of the instruments (i.e., options, warrants, or their equivalents) occurs at the beginning of the reporting period (or at the time issued, if later), and the assumed repurchase of treasury shares using the proceeds from exercise occurs at the same time. The use of the entity's end-of-period market price to determine the number of treasury shares assumed to have been repurchased at the beginning of the period does not, in fact, remove the inconsistency cited by the Boards regarding the use of the entity's average stock price for the reporting period. Rather, it simply replaces it with a different inconsistency. It is confusing to suggest that the proposed change is somehow "eliminating" an inconsistency, when it is just changing the nature of the inconsistency. Therefore, we believe that the final standards should clarify that this change was made for purposes of simplifying the diluted EPS calculation, rather than asserting that the change eliminates an inconsistency.

Q5—Participating instruments and two-class ordinary shares

Paragraph A23 proposes to extend the scope of the application guidance for participating instruments to include participating instruments that are classified as liabilities. In addition, the Board proposes to amend the application guidance for participating instruments and two-class ordinary shares. The proposed application guidance would introduce a test to determine

whether a convertible financial instrument would have a more dilutive effect if the application guidance in paragraph A26 and A27 for participating instruments and two-class ordinary shares is applied or if conversion is assumed. The entity would assume the more dilutive treatment for diluted EPS. Also, the amended application guidance would require that, if the test causes an entity to assume conversion of dilutive convertible instruments, diluted EPS should reflect actual dividends for the period. In contrast, diluted EPS would not include dividends that might have been payable had conversion occurred at the beginning of the period. Do you agree with the proposed amendments to the application guidance for participating instruments and two-class ordinary shares? Why or why not?

KPMG Response [Note: This response addresses both Question 5 of the IASB Exposure Draft and Issue 2 of the FASB Exposure Draft.]:

When a participating instrument is also a potential ordinary share, we agree that an entity should reflect the more dilutive effect of the assumed exercise or conversion of the participating instrument and assuming that the participating instrument is not exercised or converted (i.e., the two-class method). We believe that this guidance will provide a measure of the interest of each ordinary share in the performance of an entity while giving effect to the dilutive potential ordinary shares outstanding during the period that is consistent with the objective for diluted EPS.

For purposes of applying the two-class method in calculations of diluted EPS, we agree that the amount allocated to *distributed earnings* should be based on actual (declared) dividends for the period. That amount should not be adjusted for the hypothetical increase in dividends that would have occurred upon exercise or conversion of potential ordinary shares. Using actual declared dividends also is consistent with the objective of simplifying the EPS calculation. However, we believe that the language used in the Exposure Drafts should be clarified regarding this requirement. For example, paragraph A25 of the IASB Exposure Draft states that the *attribution* of undistributed profit or loss to all potential ordinary shares does not reflect additional dividends that might have been paid if the instruments had been outstanding. We believe that this guidance would be clearer if it states that the *amount of undistributed profit or loss to be attributed* is not adjusted for the dividends that would have been declared on the incremental ordinary shares issuable upon exercise or conversion of potential ordinary shares.

Additionally, we believe that both Boards should consider whether to include consistent guidance regarding participating securities. In this regard, we believe that the IASB should consider whether to incorporate the principles currently found in EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128" and FSP EITF 03-6-1, "Determining whether Instruments Granted in Share-Based Payment Transactions are Participating Securities." If the IASB discusses that guidance and determines it should not be incorporated into its final standard, then the standard should identify this as an area where convergence was not achieved.

We also believe that the IASB and FASB Exposure Drafts would be improved if the guidance on participating instruments were located within the sections of the documents that address preference share dividends and other adjustments to the *numerator* of EPS calculations (e.g., paragraphs 13 – 14 of the IASB Exposure Draft and paragraph 9 of the proposed amendment to Statement 128). The two-class method is an earnings allocation formula that determines earnings per share for each class of ordinary shares and participating instruments by adjusting the numerator of EPS calculations according to dividends declared (or accumulated) and participation rights in undistributed earnings. Presently, the discussion of participating instruments is contained within sections of those documents that generally address the weighted-average number of shares included in the denominator of EPS calculations (e.g., paragraph 18 of the IASB Exposure Draft and paragraph 9A of the proposed amendment to Statement 128), which may cause confusion as to the treatment of participating instruments.

Q6—Disclosure requirements

The Board does not propose additional disclosures beyond those disclosures already required in IAS 33. Are additional disclosures needed? If so, what additional disclosures should be provided and why?

KPMG Response [Note: This response addresses both Question 6 of the IASB Exposure Draft and Issue 3 of the FASB Exposure Draft.]:

We believe that additional disclosure is not required beyond the disclosures currently required unless the Boards decide to affirm the proposal in the Exposure Drafts in respect of instruments measured at fair value through profit or loss. If the Boards proceed with that guidance, then we believe entities should be required to disclose (a) the number of incremental shares that would have been included in diluted EPS for those instruments under the treasury stock method and (b) the change in the fair value of those instruments for the period. Equity investors, and potential investors, could use the information provided by those disclosures to determine the potential dilution to their investments (and potential investments) resulting from share-settleable instruments measured at fair value through profit or loss. Additionally, that information already is required for purposes of computing diluted EPS under both IFRSs and U.S. GAAP, so it would not impose significant incremental costs for entities to continue to obtain.

Appendix B: Other comments specific to the IASB Exposure Draft

- A) In paragraph 6, a participating instrument is defined as “an instrument that gives its holder the right to participate in *dividends* with ordinary shares according to a predetermined formula” (emphasis added). This is contrasted with paragraph 18 which identifies instruments “that give their holder the right to share in *profit and loss* of the period...Examples of those instruments are...participating instruments” (emphasis added). We believe that the standard should be consistent in its description of a participating instrument.
- B) In paragraph 6, in respect of the definitions of Antidilution and Dilution which both have the inserted phrase, “*and forward contracts are settled*” (emphasis added), we believe this would be phrased more appropriately as “*or forward contracts are settled*” (emphasis added).
- C) In paragraph 6, the definition of options, warrants and their equivalents indicates that “Equivalents to options and warrants include forward contracts to sell an entity’s own shares.” While we agree with the treatment proposed by the standard for these instruments, we do not believe that the conclusion regarding the treatment should be presented within the definitions to the standard. Rather, this conclusion should be stated affirmatively in the body of the Standard. Furthermore, we believe that the Standard should be phrased to indicate that forward contracts are treated in the EPS calculation similar to options and warrants, rather than concluding the forward contracts are *equivalents* to options and warrants.
- D) In paragraph 17, we propose the phrase “as a holder of that instrument” be inserted after “profit or loss of the period” to clarify that participation has to result from holding the instrument, versus participation in profits or loss as a result of rights stemming from another instrument not within the scope of paragraph 17.
- E) The language in paragraph 18 appears to indicate that all instruments that give their holder the right to share in profit or loss for the period be included in calculating the weighted average number of ordinary shares outstanding for basic EPS. However, instruments other than ordinary shares that give the holder the right to share in profit or loss of the period through participation features are reflected in basic EPS through a numerator adjustment using the method described in paragraphs A23-A28 (i.e., two-class method) and are not included in calculating the weighted average number of ordinary shares outstanding (i.e., the denominator of basic EPS). We believe that application of the two-class method without including shares in the calculation of shares outstanding for basic EPS is appropriate for instruments such as options with current dividend rights. We believe that it is more consistent with the principles of EPS to deduct dividends from the basic EPS numerator than to assume exercise for the basic EPS denominator.

- F) In paragraph 24, the Board should clarify what is meant by the reference to “overall effect.”
- G) In paragraph 35, the reference to paragraphs “15 and 21” should be 15 *through* 21.
- H) Paragraph 49(a) of the Exposure Draft proposes to delete the words *in the future* from the discussion regarding the requirement to include unrecognised compensation expense for equity-classified share-based payment awards as assumed proceeds in applying the treasury stock method. While we acknowledge that there have been interpretive questions in practice in respect of the application of that guidance, we believe the basic principle is sound and the proposed deletion may create confusion. To clarify that guidance, we recommend that paragraph 49(a) be revised to state “the portion of grant date fair value that is unrecognised is calculated using the proportion of the vesting period unexpired as at the end of the reporting period.” The discussion in Illustrative Example (IE) B.2 also should be revised to reflect this clarification. These changes would improve the consistency between the guidance in the Exposure Draft and the related guidance in paragraph 21(b) of the proposed amendment to Statement 128.
- I) In paragraph 49(b), the Board should clarify the *basis* of the tax benefit calculation i.e., whether at grant date or at the end of the reporting period as the current proposed wording is unclear. IE B.2 also should be revised to reflect this proposed requirement.
- J) The Exposure Draft introduces principles through the Application Guidance (AG), the Introduction (IN), the Basis for Conclusion (BC) or IE, rather than only through the main document of the standard. Specifically, the treatment of ordinary shares subject to a repurchase contract is introduced in paragraphs A31 and A32; the application of the guidance for contracts to repurchase an entity’s own shares to mandatorily redeemable shares is introduced in IN2 and discussed in BC16; the calculation of EPS when a subsidiary has potential ordinary shares is addressed by IE D.4, and the treatment of Treasury shares is only addressed by IE A.3. We believe that the basic concepts in respect of these examples should be articulated in the standard itself. In addition, the Board also should consider incorporating the treatment of share-based payment expense currently set out in BC 54-57 of IFRS 2 into the EPS standard.
- K) We believe that deleted paragraph A6 should not be removed from the standard, as it is still applicable; however, we note that the reference to the average share price should be changed to the end-of-period market price.
- L) Paragraph A16 should be revised to replicate the language used in proposed paragraph 54 for consistency.

- M) If it is the intention of the Boards to converge the treatment of convertible instruments with market price contingencies in the diluted EPS calculation, then paragraphs A17 and A18 would require modification to reflect that convertible instruments should be included in diluted earnings per share (if dilutive) regardless of whether the market price trigger has been met. We refer you to item H in Appendix C of this letter.
- N) In (a) of paragraph A24, the phrase “attributable to ordinary equity holders” was removed. We believe that this phrase is necessary to be consistent with the definition of profit or loss as prescribed in paragraph 11 which includes this phrase. Further, in (b) of this paragraph, “the remaining profit or loss” should be replaced with “the amount calculated in (a) above” as the amount discussed in this paragraph is not referring to the remaining amount.
- O) Paragraph A25 refers to an undefined term of “undistributed profit or loss.” We believe that the standard should either define this term, or reference paragraph 14 as undistributed profits or loss are described in this paragraph.
- P) We believe that there is an inconsistency between the principles currently set out in paragraphs A29 and A30. Paragraph A29 requires inclusion of partly paid shares on a *pro rata* basis, based on the right to participate in the dividends during the period for the basic EPS calculation. Conversely, paragraph A30 requires inclusion of partly paid shares that are not entitled to participate in dividends during the period based on the proportion of subscription amount paid. We recommend that the IASB consider a drafting change to achieve a consistent principle between those two paragraphs.

Appendix C: Other comments specific to the FASB Exposure Draft

- A) Paragraph 2 of the Exposure Draft states that “[a]n entity shall include in the computation of basic EPS all common shares outstanding and 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” (emphasis added). We do not believe that it was the Board’s intention to suggest that only those instruments outstanding as of the end of the period should be included in the basic EPS calculation, thereby excluding participating instruments outstanding for a portion of the reporting period but not as of the end of the period. However, the phrase “as of the end of the period” implies that only those instruments outstanding as of the balance sheet date would be reflected in basic EPS. This paragraph, along with paragraphs 9A and C4 of the proposed amendment to Statement 128 should be clarified to be consistent with the language used in paragraph 18 of the IASB Exposure Draft which does not include the phrase “as of the end of the period.”
- B) Paragraph 3 of the Exposure Draft states “An entity should apply the little-or-no-cost criterion or other-assets criterion by considering the amount required to be paid by the holder relative to the end-of-period market price of the entity’s common stock. For example, an entity would include in the denominator of basic EPS a warrant with an exercise price of \$0.01 when the end-of-period market price is \$100 because the holder is deemed to have the present ability to become a common shareholder.” When a warrant or similar instrument can be net-share-settled, application of that guidance would result in the net shares issuable upon exercise of the instrument being included in the denominator of basic EPS whenever the warrant is “in-the-money” at the balance sheet date. We do not believe that this was the FASB’s intent and recommend deleting the discussion that the exercise price should be compared to the end-of-period market price for purposes of applying the little-or-no-cost criterion. Given the FASB’s objective of providing more principles-based guidance, we do not believe it is necessary to provide interpretive guidance on what is meant by “little or no cost” and we observe that such guidance is not contained in the IASB Exposure Draft.
- C) Paragraph 3 of the Exposure Draft also addresses the interaction between share-based payment awards and the consideration of the little-or-no-service criterion. As currently written, this paragraph suggests that all vested share-based payment options would be included in basic EPS regardless of strike price, which we do not believe is consistent with the basic EPS principle. We believe that this statement should be modified to require a nominal strike price (i.e., little or no consideration) in addition to the no further service requirement when assessing whether the little-or-no-service criterion is met.
- D) Paragraph 10 of the Exposure Draft states that “exercise of an outstanding instrument and purchase of shares are assumed to occur *on the last day* of the reporting period (or at the time of actual exercise, if earlier)” (emphasis added). This is inconsistent with

paragraph 11 of the Exposure Draft which states that “the incremental number of shares shall be included in the computation of diluted EPS *from the beginning of the period* (or at the time the options or warrants are issued, if later)” (emphasis added). We believe that paragraph 10 of the Exposure Draft should be clarified to be consistent with paragraph 11 of the Exposure Draft.

- E) Paragraph 14 of the Exposure Draft and paragraph 61A of the proposed amendment to Statement 128 indicate that “[t]he difference between basic EPS and diluted EPS using the two-class method relates largely to the potential common shares or potential participating securities that are assumed to be outstanding.” The wording of that sentence suggests that application of the two-class method affects the denominator of diluted EPS. However, differences between the number of ordinary shares assumed to be outstanding in the denominator of basic and diluted EPS calculations is not caused by application of the two-class method; that method is an earnings allocation formula that adjusts the numerator of EPS calculations. Both paragraphs go on to reference paragraphs 11-35 for purposes of determining the number of shares to be included in the denominator. We believe that paragraph 14 of the Exposure Draft and paragraph 61A of the proposed amendment to Statement 128 are unnecessary and should be deleted to avoid the inference that the two-class method impacts the denominator of the EPS calculation.
- F) The references in paragraphs 16 of the Exposure Draft and 61C of the proposed amendment to Statement 128 state that a second class of common stock is a “potential common share” should be corrected to refer to a “class of common stock that can be converted into a different class of common stock.” A second class of common stock is not a potential common share; it already is an outstanding common share.
- G) As noted in the covering letter, we believe that the FASB should eliminate the exception to retrospective application described in paragraph 21 of the Exposure Draft. However, if the Board continues with the exclusion of certain instruments from the retrospective application, then paragraph 21 of the Exposure Draft should be modified to clarify that the assumption of share settlement (in paragraph 12 of the Exposure Draft) should not be retrospectively applied for the instruments described in that paragraph. As the paragraph is currently written, it implies that retrospective application of the remaining amendments to Statement 128 (for example, the requirement to use the end-of-period price in treasury stock method calculations) would also be prohibited for those instruments. Additionally, if the Board proceeds as proposed, we believe that the prohibition should be for those instruments modified or settled for cash on or before the *effective date of the standard*, and not for those instruments modified or settled for cash “on or before the last day of the period of adoption.”
- H) Paragraphs 31 and 32 of the proposed amendment to Statement 128 should be modified to incorporate the consensus in EITF Issue 04-8, “The Effect of Contingently

Convertible Instruments on Diluted Earnings per Share.” That consensus specifies that contingently convertible instruments should be included in diluted EPS (if dilutive) regardless of whether the market price trigger has been met.

- I) We believe that paragraph 50 of the proposed amendment to Statement 128 should be modified to read (additions are underscoring and deleted text is ~~stricken~~) “...unless (a) the effect is dilutive ~~or~~ and (b) those instruments...”
- J) Paragraph 11B of the proposed amendment to Statement 128 states that “[s]imilar adjustments also may be necessary for certain contracts that provide the issuer or holder with a choice between settlement methods.” This statement is inconsistent with paragraph 29 of the proposed amendment to Statement 128, which would delete that same guidance.
- K) As noted in our covering letter, we disagree with the Board’s proposal in respect of instruments measured at fair value through profit or loss. However, if the Board does finalise the standard as proposed in this regard, we believe that the document should contain a single overall statement that instruments measured at fair value through profit or loss should be excluded from both basic and diluted EPS, instead of repeating that statement in various places throughout the document, because there are instances (for example, in paragraphs 3 of the Exposure Draft, and 51, 52 and 53 of the proposed amendment to Statement 128) where this phrase should have been included but was not.
- L) The proposed amendment to Statement 128 continues to refer to the reverse treasury stock method. If the Board affirms its proposal to exclude instruments measured at fair value through profit or loss from the calculation of EPS, it would be helpful for the final standard to provide examples of instruments that would be subject to the reverse treasury stock method.