Memo

FirstRand Banking Group

Group Finance : Technical Accounting

To: International Accounting Standards Board ("IASB")
From: Technical Accounting
Date: December 2008

COMMENT LETTER: EXPOSURE DRAFT SIMPLIFYING EARNINGS PER SHARE

1 Introduction

We are pleased to present our responses to your invitation to comment on the *Exposure Draft – Simplifying Earnings per Share: Proposed Amendments to IAS 33* ("ED").

We thank you for the opportunity to comment on this document. Please don't hesitate to contact us should you wish to discuss any of our comments further.

2 General comments on the exposure draft

We understand that the main focus of this project is to achieve short term convergence with US GAAP on the denominator used on the earnings per share ("EPS") calculation. While we support all convergence efforts made by the IASB we are concerned that only a very limited level of convergence will be achieved by the proposals in the exposure draft, for the reasons set out below. We therefore believe that it is misleading for the IASB to describe these amendments as having achieved convergence between IFRS and US GAAP in respect of the calculation of EPS.

We believe the Board should consider the technical merit of each of the proposed amendments and only those amendments which the Board believes result in a significant improvement to calculating EPS, in the short term, should be made.

Based on our review of the proposed amendments we don't believe that any of the proposed amendments result in such a significant improvement to accounting that those changes are warranted at this time. We believe that no amendments should be made to IAS 33 at the current time but rather that wholesale changes are made to the standard at a later stage when progress is made on other projects.

We believe that a limited level of convergence will be achieved through the application of the ED for the following reasons:

1. The IASB has acknowledged that the project focuses on the denominator and that amendments will not result in convergence of the numerator. Therefore, even if the ED were adopted as currently proposed the EPS of a US preparer would not be comparable to the EPS of an IFRS preparer as a result of the extent of differences which remain the numerator.
2. While the ED proposes convergence of the calculation of the denominator only, differences continue to exist between US GAAP and IFRS in respect of the definition of equity and liabilities. The denominator will therefore still not be comparable between US GAAP and IFRS preparers after the adoption of the proposed amendments.
3. We understand that differences will remain between US GAAP and IFRS for contracts which have a choice of gross physical or net settlement.

We propose that once significant convergence is achieved in some of the other areas, most specifically the projects focusing on the conceptual framework and liabilities with characteristics of equity, that the possibility of convergence of EPS be reconsidered. We would like to stress that it is our opinion that many small changes increase complexity in accounting rather than simplify accounting. Therefore, if this standard is going to be amended again in the medium term then it is our preference that no changes are made to the existing standard until the wholesale changes are made at a later date.

3 Responses to specific questions

Although we are not in support of short term changes that may be amended again in the medium to long term once other projects that the IASB is working on have made progress, we have answered the specific questions included in the invitation to comment.

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

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

We agree with the principle that only instruments which can currently share in the profit should be included in EPS.

(b) Does the Exposure Draft apply this principle correctly to mandatorily convertible instruments and ordinary shares issuable for little or no cash or other consideration? Why or why not?

We agree that the ED does correctly apply this principle to mandatorily convertible instruments and ordinary shares issuable for little or no cash or other consideration.

However, we believe that the term “little or no consideration” is open to interpretation and additional guidance would be welcomed on the interpretation of this term and the application thereof. For example, if an option were deeply in the money at the reporting date would it be treated as an option and excluded from EPS and included in diluted EPS to the extent that it is not measured at fair value or would it be treated as an ordinary share issuable for little consideration because the strike price is significantly less than the fair value at the reporting date.

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

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

We agree with principles for gross physically settled contracts and mandatorily redeemable shares described in the ED. We do however recommend that the IASB clarifies that this is only applicable when the rights in terms of the contract are currently exercisable. Therefore if a contract to acquire and entity’s own shares is subject to a number of contingencies then the shares will not be excluded from the denominator unless those contingencies are probable. We believe that without such a proviso this requirement could lead to manipulation by decreasing the number of shares with option contracts with a number of contingencies in place.

We are concerned over the application of paragraph A32. It is our interpretation of *IAS 32 Financial Instruments: Presentation* (“IAS 32”) that an obligation on an entity to buy back equity instruments is reclassified from equity to liabilities. The proposal in paragraph A32 is to treat the liability as a participating equity instrument. Application of this therefore results in inconsistent classification of a single instrument for purposes of recognition and measurement and for purposes of EPS. In addition, these instruments are common in business combinations as an option for the parent to buy back the minority interest, A32 is not specific as to whether each of these instruments is classified as a different participating instrument or whether all of these type of instruments are a single class of participating instruments.

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

(a) Do you agree that the fair value changes sufficiently reflect the effect on ordinary equity holders of instruments measured at fair value through profit or loss and that recognising those changes

in profit or loss eliminates the need for further adjustments to the calculation of EPS? Why or why not?

We agree that the fair value changes do reflect the effect on ordinary equity holders of instruments measured at fair value through profit or loss. However because of the resulting inconsistencies we don’t support the proposal that no further adjustments should be made to EPS for these types of instruments. We believe that in a “perfect world”, ignoring the time value of money, the amount of the fair value and the amount of the dilution would be the same, that the fair value would be converted into capital on exercise date and that both methods would produce the same diluted EPS amounts.

However, very often these calculations are performed in an imperfect world and time value of money can not be ignored. In addition, because certain of these instruments will be measured at fair value through profit or loss and others not the proposed amendments will result in the diluted earnings per share number being calculated differently for very similar instruments because there is a difference in the way in which these instruments are accounted for. We don’t believe that the difference in accounting treatment of similar instruments should result in such different treatment in the diluted earnings per share number. While we agree that the use of fair value where available is probably a more true reflection of the dilution effect we believe that in the interests of achieving consistent treatment for similar instruments that it is preferable for the existing treatment to be applied consistently to all instruments with a potentially dilutive effect.

Question 4 Options, warrants and their equivalents

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

We agree with the proposal to assume the settlement of forward sale contracts on its own shares when calculating diluted EPS.

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

We disagree with the proposal to use the end of period market price to calculate the ordinary shares issued for no consideration arising from the assumed exercise or settlement of options, warrants and their equivalents for the following reasons:

- Paragraph 46 requires an entity to use the end of period market price to determine the theoretical number of shares issued for no consideration. The theoretical number of shares issued for no consideration are treated as shares issued at the beginning of the period for purposes of calculating EPS and diluted EPS. We do not agree with the principle of using a period end market price to calculate the theoretical number of shares issued at the beginning of the period.

- We believe that the use of an average market price is consistent with the principle of weighting shares for the period in which they are in issue.
- We believe that the purpose of EPS is to present the earnings over the reporting period, the EPS is therefore not a year end snapshot. We believe that the use of an average price is more closely aligned with this purpose than the use of a year end price.

We also believe that the simplification achieved does not justify the changes as the average share price for listed equities is very easily obtainable information.

Question 5 Participating instruments and two-class ordinary shares

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

We have no comments in this regard.

Question 6 Disclosure requirements

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

We don't have any recommendations for additional disclosures.

4 Editorial comments

We have noted that in paragraph 7 of the ED the second sentence should begin with a capital letter.