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International Accounting Standards Board
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Response of the Accounting Committee of the Institute of Chartered Accountants in Ireland Exposure draft: ***Simplifying Earnings per Share – Proposed amendments to IAS 33***

Dear Sir/Madam,

The Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland welcomes the opportunity to comment on the proposals contained in the above document. The appendix to this letter provides answers to the detailed questions asked in the document.

Should you wish to contact us about any of our comments please feel free to do so.

Yours faithfully,

Mark Kenny

Secretary, Accounting Committee

Appendix

Question 1—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?***

Question 1 (a): The AC agrees with the proposed principle for determining which instruments are included in the calculation of basic EPS. Essentially basic EPS is a measure of the maximum distribution that an equity holder could receive for a year and therefore only those instruments that can currently share in profit or loss for the period should be included in the weighted average number of ordinary shares. This principle will clarify which instruments should be included in the denominator of the EPS calculation.

Question 1 (b): The AC agrees that this principle has been correctly applied to mandatorily convertible instruments and to ordinary shares issuable for little or no cash or other consideration. Currently IAS33 does not explicitly state how these instruments should be treated. No guidance is given on the determination of “little cash”, this would require judgement. We assume it is relative to “no cash” rather than to the nominal value of the instrument. However, if mandatorily redeemable shares are in issue where conversion is unavoidable and will take place after a certain period of time, then AC considers that it may be appropriate to include such shares into the calculation.

The reference to ‘currently’ in paragraph 19 of the ED is open to interpretation as it could be interpreted as being the period up until the financial statements are authorised for issue. Therefore we suggest that ‘currently’ should be removed from this paragraph.

Question 2—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?

AC agrees with the proposed clarification in the exposure draft for ordinary shares that are subject to a gross physically settled contract to repurchase an entity’s own shares as if the entity had already repurchased the shares. AC supports BC14, that the contract to repurchase an entity’s own shares is economically similar to the acquisition of treasury shares using borrowed funds and accordingly the denominator of the basic and diluted EPS calculation should not include the number of ordinary shares that will be acquired upon physical settlement of the contract.

AC agrees with Board proposal that principles for contracts to repurchase an entity's own shares for cash or other financial assets should also apply to mandatorily redeemable ordinary shares, as mandatorily redeemable ordinary shares are similar to contracts to repurchase an entity's own share for cash or other financial assets. Therefore, the principles for those contracts (A31 and A32) should also apply to mandatorily redeemable ordinary shares.

Question 3—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?

On the basis that it simplifies the calculation of diluted EPS, AC agrees that there should be no adjustments for instruments measured at fair value through profit or loss. The rationale given for this is that the fair value changes recognised in the statement of comprehensive income sufficiently reflect the effect on ordinary equity holders of such instruments. The result is that not all dilutive potential ordinary shares outstanding are included in the calculation of diluted EPS. AC considers that the dilutive effect is already included in the basic EPS. Consider, for example, cash settled share based payment. In this case, where one has accounted for the difference between market value and exercise price over the vesting period, then one has reduced earnings by this change in fair value. In our view, to include the dilutive effect in the calculated of diluted EPS would amount to double counting.

Excluding such instruments from the calculation of diluted EPS appears to be inconsistent with the treatment of equity settled share-based payments for EPS. The share-based payment expense is included in profit or loss and the potential ordinary shares are included in the diluted EPS calculation because it reflects the two economic events that have occurred (IFRS2.BC56). Similarly for instruments measured at FVTPL there are two economic events: fair value gains / losses due to market conditions and the exercise or conversion of instruments by the holder.

Also we have concerns that, due to projects being undertaken at present, which are dealing with the underlying instruments (e.g. Financial Instruments with the Characteristics of Equity), this is a short-term amendment that will need to be reconsidered when such projects are finalised

Question 4—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?***

Question 4(a): AC agrees that, to calculate diluted EPS, an entity should assume the settlement of forward sale contracts on its own shares treating them in the same way as options, warrants and their equivalents. This is consistent with the underlying accounting treatment and provides guidance which was not given previously.

Question 4(b): On the basis that it simplifies the calculation, AC agrees 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. The dilutive effect is a warning of predictive future earnings and, therefore, the year end price is probably the best estimate of the future price at that point in time.

The benefit from this amendment will not be significant as it is not a particularly difficult exercise to calculate an average for the period. Also, if the intention of EPS is to be a measure of performance rather than a warning, there is an argument to use the average price for the period rather than a price at a specific point in time.

This requirement will result in the use of the end of period market price for dilutive potential ordinary shares that are cancelled or allowed to lapse during the period even though the instruments were no longer in issue on this date.

Question 5—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?

AC agrees with the proposed amendments to the application guidance for participating instruments and two-class ordinary shares as it is much clearer than the guidance in IAS 33.

AC agrees with BC28 that, if the test causes an entity to assume the conversion of dilutive convertible instruments, it is necessary to consider what dividends to attribute to the resulting shares. If the instruments had been converted at the beginning of the period, dividends might have been payable on the resulting ordinary shares. However, the entity might have made a different decision on the per-share amount of authorised dividend or actual dividends from the beginning of the period. Accordingly, diluted EPS should reflect actual dividends for the period, not the dividend that might have been payable assuming conversion at the beginning of that period.

Question 6—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?

On the basis that it simplifies the application of the Standard, AC agrees that no additional disclosures are required.

However, the introduction of other disclosure might be beneficial to users of financial statements - for example, additional disclosure about the shares that would be issued upon exercise or conversion of the instruments that are measured at FVTPL and the number of instruments to which they relate. In addition, AC considers that users may find useful a reconciliation of shares issued at the beginning of the year to the weighted average used in the calculation of EPS including an explanation that the full year impact of these shares will take effect in the following year.

Regarding the clarification that entities are prohibited from disclosing additional EPS figures on the face of the statement of comprehensive income, AC believes that this should have been specifically included in the invitation to comment. AC believes that such adjusted EPS numbers should be disclosed in the notes to the financial statements and not on the face of the primary statements. In addition, we note an increased use of ‘non GAAP’ per share numbers being disclosed. Whilst it may not be appropriate to prohibit such measures, AC believes that such adjusted figures should be reconciled back to the EPS based on GAAP.