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The Chair & Members,
International Accounting Standards Board,
30 Cannon Street, London EC4M 6XH,
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Through email to: commentletters@iasb.org

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Honourable Board Members:

Re: Comments on Exposure Draft of Simplifying Earnings per Share: Proposed amendments to IAS 33

The exposure draft requested for comments on proposed amendments. However, some relevant aspects of IAS 33 also emerged during the course of my review and included here. I hope these will be in line with the Board's objective of continual improvement of the Standards.

Our comments are as follows-

Objective >>

Para 1 We propose the following:

'This Standard prescribes principles for the computation of earnings per share and its disclosure in the financial statements of an entity. There are two elements of earnings per share computation: earnings i.e the profit attributable to the ordinary shareholders (the numerator) and the number of ordinary shares (the denominator), for the reporting period. The individual items which determine profit of an entity for the period are described in other Standards whereas this Standard focuses on the denominator. Consistent computation, presentation and disclosure of earnings per share enables performance comparisons between different entities in the same reporting period and between different reporting period for the same entity. However, 'earnings' depend on the specific accounting policies applied.'

Scope >>

Para 2: We propose the following:

'This Standard shall apply to entities and its controlled subsidiaries whose ordinary shares or potential ordinary shares are publicly traded and by entities and its controlled subsidiaries that are in the process of issuing ordinary shares or potential ordinary shares.'

Alternatively:

'This Standard shall apply to

(a) the separate (or individual) financial statements of an entity;

(b) the consolidated financial statements of an entity as a group,

whose ordinary shares or potential ordinary shares are publicly traded and by entities that are in the process of issuing ordinary shares or potential ordinary shares.'

Definitions >>

Para 6>> Provide numbers or alphabets [(a), (b),...] to the individual definitions. This is handy when a specific definition or its reference is being quoted elsewhere.

Note that the term ‘earnings’ is also refered by other terms such as ‘income’ and ‘profit’. The terms are use interchangably and this fact is not defined or explained anywhere. Also, mention clearly that the ‘earnings’ used in the eps expression is ‘after tax’.

Para 7>> There is no point of having this para when para 6 defines ordinary shares as ‘subordinate to all other classes of equity instruments’. We note that ‘preference shares’ is not defined in para 6.

The point regarding more than one class of ordinary shares is requested to be placed as a part of definition of ordinary shares.

Alternatively, since the definition of ‘ordinary shares’ is central to this Standard, place it in this para. Also, add by way of explanation that ‘ordinary shares’ are also refered as ‘common shares’ in some countries.

Para 8>> This para appears to be a direct extension of definition of ‘potential ordinary shares’. It appears disjointed, out of place and isolated. Place the contents of this para in definition.

Alternatively, cross-reference the definition of ‘potential shares’ with para 6. Add ‘(see para 8)’.

Para 9>> Provide references of paras where the terms used in IAS 32 have been used.

Open ended reference, such as this one gives an impression of essential requisite knowledge of IAS 32 and severely dampens the confidence of users venturing an understanding of this Standard.

Personally, we do not find the need to give so much prominence to IAS 32 or for the rationale of having this para in the first place. Is it not understood that the terms used in the Standard are ones which may be defined in other places?

Measurement >>

Basic earnings per share

Para 10 >> We propose the following wordings:

‘The objective of computing the basic earnings per share is to attribute a portion of earnings after tax for the period to each ordinary share, on weighted average basis.’

In its present form the para is inconsistent with the para 2 but also suffers from two major technical defects.

Para 2 logically lists the applicability of IAS 33 to separate financial statements of an entity *before* mentioning its applicability to consolidated financial statements as a group. Whereas this natural order has been reversed in this para, creating an avoidable conceptual confusion.

The two major defects are about earnings figure before or after tax and attributable earning to ordinary equity holders in case of stand-alone and consolidated financial statements.

We clearly see the need to clarify here if the 'profit or loss attributable to the equity holders of the parent' is before or after tax figure (this has been done in para 14 in a round about fashion). Also, the use of phrase 'of the parent' in this expression brings out an important point which has not been explained: that the numerator in the eps figure changes depending on whether an entity is a parent or not. In case of an entity without subsidiaries, the figure in numerator is profit after tax whereas in case of an entity as a parent it is profit or loss attributable to the equity holders.

Para 11 >> We propose the following wordings:

'Basic earnings per share shall be calculated by dividing profit and loss attributable to the ordinary share holders for the period* (the numerator) by number of ordinary shares on weighted average basis during the period (the denominator)'.

*The term 'profit attributable to the ordinary share holders' is same as 'profit available for distribution to the shareholders for the period'.

It may be added by way of explanation here that in profit attributable to ordinary share holders of the entity in case of separate or stand-alone financial statement will often be 'profit after tax' whereas in case of consolidated financial statements will be 'profit attributed to the ordinary shareholders of the parent'.

We also recommend replacing the expression 'ordinary equity holders' (used here first time and over 70 times subsequently) in this Standard with 'ordinary share holders'. When the equity of the subject entity we are discussing is expressed in terms of shares, its holders should logically be 'share holders', and not 'equity holders'.

Similarly, the expression 'of the parent entity' (used here first time and 48 times subsequently) is relevant in case of consolidated financial statements only. It is inconsistent with a natural order stated in para 2 and should be deleted.

We also agree with para A31 and A32 of application guidance, as stated in Question 2 of invitation to comment. However, an illustrative example on this topic is recommended.

Earnings

Para 14 >> We propose the following wordings:

‘All items of income and expense recognised in a period, included in the determination of the profit or loss of an entity, are also used for determining earnings attributable to the ordinary share holders.

The term expense includes provisions for tax and dividends to preference shareholders for the period.’

Note that the term ‘attributable to the ordinary equity holders of the parent entity’ has been used twice in this para. Use of expression ‘preference shares *classified as liabilities*’ is unclear.

Shares >>

Para 15 >> We propose the following wordings:

‘For calculating basic earnings per share, the number of ordinary shares outstanding during the year shall be determined on weighted average basis.’

In its present form, the term ‘number of ordinary shares’ has been used twice.

Para 16 >> We propose the following wordings:

‘The application of weighted average basis results in a representative figure of number of shares outstanding throughout the period. This requires that number of shares, bought back or issued during the period but not outstanding throughout the period, are multiplied with a respective time-weighing factor, and added or subtracted from the number of shares outstanding throughout the period. The time-weighing factor is.....in the period.’

In its present form, the last phrase in this para: ‘a reasonable approximation of the weighted average is adequate in many circumstances’ – appears to be inconsistent with the objective of a ‘performance comparisons’ as stated in para 1, specially when the disclosure of time-weighing factor – whether daily, weekly, monthly, quarterly, half-yearly basis - is not required. This should be deleted.

Para 19 >> We propose the following wordings:

‘The number of ordinary shares, determined on weighted average basis, 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 mandatory convertible instruments do not meet this condition, they will not affect basic earnings per share.’

The para in the Standard in its present form assumes by default that such instruments have the right with ordinary share holders to share in the profit and loss, whereas that may be a question of fact (depending on the terms of contract).

The way this issue has been reflected in the text of Question 1 of 'Invitation to comment' is much clearer than the text of the Standard.

Para 22(b) and Para A10 >> Refer to our comments on illustrative example on A.5 below - on the formula stated in A10 - for isolating the bonus element in a right issue, for computing 'adjustment ratio' through a simplified version. In the light of simple formula proposed, effect appropriate amendments.

Diluted earnings per share >>

Para 25 >> We propose the following wordings:

'The objective of computing the dilute earnings per share is to attribute a portion of earnings after tax for the period to each ordinary share and potential ordinary share, on weighted average basis.'

Para 26 & 27 >> We agree with this treatment as mentioned in Question 3 of the invitation to comment. That should have always been the case.

Disclosure >>

Para 64 – 68 >> We agree that no additional disclosures are warranted in the light of the amendments proposed in response to Question 6, Invitation to comment. However, the basis for time weighing factor is an important policy applied in determining number of shares on weighted average basis of information not presently disclosed (see our comment on para 16 above).

Miscellaneous >>

Question 4 & 5 of invitation to comment >> I am unable to comment as the text was not clear.

Contents >> The paras for 'Basic earnings per share' should read 10-24, and not 10-12. Furthermore, state the sub-headings below it i.e of 'Earnings' and 'Shares' in the text of the Standard as 'Basic earnings per share: Earnings' to distinguish it from identical sub-headings that appears below the heading 'Diluted earnings per share', which should also be amended like-wise.

Appendix A: Application guidance >> State para references in front of the 'Application guidance', as it forms an integral part of the Standard. Also, state sub-headings of three main headings at its begining to aid navigation.

Application guide: Decision tree >> The situations described in the Standard may also be explained by way of a diagram or decision diagram to aid understanding. For example, for a stand-alone entity having a single class of ordinary shares, with no change in the number of shares during the year, the basic (and diluted) earnings per share would be simply profit after tax divided by the number of shares. Let us now take another situation where a stand-alone entity issues bonus shares during the year with no change in number of shares during the year, requiring the eps for the previous year(s) to be restated. However, number of shares on weighted average basis will come into play where treasury shares are bought back or further issued for a right. Whereas dilute eps (p. 16) will only come into play in case of presence of potential shares. Situations like these can be meaningfully conveyed through diagram than text. Consider to include decision trees and diagrams in the application guide.

Illustrative examples >> Include illustrations for para 11 (application guidance paras A31 and A32) on forward purchase contracts, para 22 (c) share split, and paras 22 (d) and 24 a reverse share split (consolidation of shares) special dividend.

Reference text of the Standard with illustrative examples >> Provide users with handy indication that the contents of a para in the Standard have been illustrated by referencing it with 'illustrative examples'. This will enable the user to leap at the relevant illustration instantly.

Keywords for each para >> Provide a title to each para based on its key word.

Illustrative examples: Specific comments >>

A. Basic earnings per share >> Mention clearly if the 'profit or loss attributable to the equity holders of the parent' is before or after tax figure. Also, the use of phrase 'of the parent' in this expression brings out an important point which has not been illustrated: that the numerator in the eps figure changes whether an entity is a parent or not. In case of an entity without subsidiaries, the figure in numerator is profit after tax whereas in case of an entity as a parent it is profit or loss attributable to the equity holders.

The Board needs to see that not all listed entities internationally have subsidiaries. Hence, a critical piece of information, an elementary one about computing eps for entities not having subsidiaries is missing from this section.

Furthermore, the IAS also calls for the disclosure of eps in case of loss. Again this important aspect has not been illustrated anywhere.

An elementary question for the users of financial information is: why do you call it eps and not ‘profit per share’, when clearly its the term ‘profit’ which is mostly often used in the financial statements? This should be clarified, as mentioned earlier.

We recommend to the Board to enhance the contents of this section by including carefully sequenced elementary illustrations. Let us start with basic eps for A Limited having a positive profit after tax figure for the year and no change in number of shares during the year followed by another one about what happens to eps in case of a reported loss after tax figure with no change in number of shares during the year. The next one may be about a A Limited as a parent company to contrast the difference in terms used for numerator. The text may include the explanation that in case the number of ordinary shares were not outstanding throughout the year, the apportioned period, in terms of number of days or months may be included. The principle that basic and diluted eps are the same (identical) where there is no change in the number of shares during the year (and no other potential ordinary shares) can also be stated (or preferably illustrated through a flow-chart).

A.1 Preference Shares >> The illustration is confusing because it says that ‘an equity adjusts profit or loss for the after-tax effects of equity instruments other than ordinary shares’ and one expects that the illustration below would relate to the assertion. However, in the illustration there is no mention of tax, and again it is not clear if the ‘profit for 20X1’ stated is before or after tax.

Also, compare the expression used ‘profit for 20X1’ with ‘profit or loss attributable to the equity holders of the parent’ in section A. Clearly, the former relates to non-parent entity whereas later relates to an entity as parent, and is inconsistent with the expression used in section A, as mentioned in our comments above.

To the best of our knowledge, preference share is an equity instrument other than an ordinary share having no after-tax effect. If so, the opening para of this section should be deleted because it is not relevant and related to the illustration that follows.

The Board may also consider to include an illustration about what happens in case of dividend of cumulative preference shares and there is a loss.

A.2 Increasing rate preference shares >> We do not understand how this would lead to the eps. I think this illustration is not complete as it conveniently ignores the calculation of eps.

A.3 Weighted average number of ordinary shares outstanding >> Listed entities report financial results on quarterly basis. This is reflected by an all-in-one illustration. However, we suggest that this concept exclusively is illustrated by a stand-alone entity with single class of ordinary shares.

Furthermore, the computations here are based on the month basis, whereas for entities routinely involved in acquiring treasury shares, the electronic means enable its impact on weighted average number of shares to be computed on a day to day basis and the fact must be added by way of explanation. This illustration does not reflect the spirit of the para 16 of IAS 33.

A.4 Bonus issue >> Restating the eps of the previous corresponding period in response to bonus shares issued at the begining of the current period is a confusing assertion for most. How can there be two eps figures for the same period?

Furthermore, most listed entities provide annual eps figures for the last five years or more in its annual report. Obviously, the eps for all these years will be restated for bonus issue; and this important fact also needs to be reflected in the illustration.

We recommend Board to illustrate the concept for A Ltd. (non-parent) by stating its profit after tax figures for past five years, and assuming that its capital structure comprises ordinary shares only, which changed in past five years in response to annual bonus announcements of, say, 10% bonus issue at the end of every year. This will allow the user to trace the impact of issue of bonus shares for upto previous five years. The eps with and without impact of bonus shares should be stated by way of explanation for all years.

A.5 Right issue >> The impact of right issue on the number of ordinary shares in the eps computation is a difficult concept to comprehend, primarily because of the way ‘adjustment factor’ is calculated.

The traditional formula for computing the ‘adjustment factor’ is stated without any word on its rationale anywhere.

My attempt to simplify this formula indicates that the bonus element in the right issue is worked out with reference to the market price per share i.e (market value per share less exercise price per share) multiply by incremental shares.

First, we determine the bonus element.

Using the figure as in A.5, the bonus element is = CU (11 - 5)*100 = 6*100 = 600.

Next, determine market cap after right issue = 11*600 = 6,600.

Now, divide the 'bonus premium element' with 'market cap' i.e. 600 divided by 6,600 = 0.10.

Add to this factor, the market cap as 1 (unity) since it is assumed that this remains constant all the time and we get adjustment ratio = 1 + 0.10 = 1.10.

In other words, if somehow the market price equals exercise price, the so-called adjustment ratio will equal zero; but what happens in case the market price goes below the exercise price, because of company-related or market-related events? A rather plum subject for looking for an illustration.

It should be clear from above that adjusting ratio (or 'right premium ratio' as I call it) hinges on price per share on a single date. In other words, we take the market price prevailing on a single day to be its fair representative value, whereas given the volatility of capital markets, and the time lag involved in announcing and bringing the right issue to conclusion, it is more likely to be false than true.

Shareholders not wishing to avail their rights have the option to sell off their entitlement, and for this purpose, the rights are quoted separately at the stock exchange and are trade alongwith the ready shares of the entity, right upto the exercise date. Thereafter, the situation reverts to the one before rights were traded and one can only trade in the ready shares.

It is logical to assume that the difference between the ready and right trades at the stock exchange would be the exercise price. This is generally but not exactly true. For example, if ready shares of A Ltd. are trading at CU 100 per share today and the exercise price of rights is CU 60 per share-entitlement, the rights can rightly be expected to be trading within an approximate range, say CU37-43, with an element of discount or premium on it, rather than at CU 40 exactly.

If this is how it happens internationally, I am most interested in relatively authentic guidance in illustrative example about how to work this out.

To sum up, not only we have strongest reservation about dependency of adjustment ratio on price prevailing on a specific day, but also about the cryptive formula that refuses to make sense for most accounting professionals. Guess its time to replace terms like 'adjustment ratio', 'fair value per share before exercise of rights' and 'theoretical ex-rights value per share'.

Lastly, entities have been noted to have declared bonus issue and rights issue at the sametime as well. We believe that adjusting figures for the past five years where entities have been making bonus as well as right issue is ripe for an illustration.

We recommend that the Board replace the formula stated in the para 22(b) with a simplified version on the lines mentioned above and suitably modifies the rationale provided in A10. Also, the market price per share may be computed on average basis.

Conclusion>>

The amendments proposed in IAS 33 are relevant. I also made the most of this learning opportunity by commenting on some aspect of the Standard. The essence of my comments is to highlight the the use of a clear syntax and simplifying concepts through illustrations. Changes on these lines can further enhance the understanding of this Standard.
Finally, we support the objectives of IASB and will be pleased to be of any further assistance.

Sincerely,

//sgd//
Altaf Noor Ali,
Chartered Accountant.

CC: The President, Institute of Chartered Accountants of Pakistan.