The Institute of
Chartered Accountants
of Pakistan

HEAD OFFICE

International Accounting Standards Board,
30 Cannon Street, London EC4M6XH,
United Kingdom

December 05, 2008

Subject: **COMMENTS ON EXPOSURE DRAFT OF 'SIMPLIFYING EARNINGS PER SHARE'**

Sir,

The Institute of Chartered Accountants of Pakistan welcomes the opportunity to offer comments on the above mentioned exposure draft. Overall, we agree with the proposals outlined in the exposure draft.

Please find enclosed the comments of the relevant Committee of the Institute for your perusal.

If you require any further clarification, please do not hesitate to contact us.

Yours faithfully,

Shahid Hussain
Director Technical Services
The Institute of Chartered Accountants of Pakistan
Shahid.hussain@icap.org.pk

SUMMARY OF EXPOSURE DRAFT "SIMPLIFYING EARNINGS PER SHARE"

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?

Agree to both (a) and (b) as discussed below.

- **(a) The basic purpose of the EPS is to provide a measure of the interest of each ordinary share in the performance of an entity. As such it is correct to include, in the weighted average number of ordinary shares for basic EPS, only those instruments that give (or are deemed to give) their holder the right to share currently in profit or loss of the period.**

- **(b) Yes it does. For inclusion in the weighted average number of ordinary shares, instruments must entitle the holder to a share in current profits. Mandatorily convertible instruments and ordinary shares issuable for little or no cash or other consideration (such as shares issued under employee share option schemes) do entitle the holder to a share in current profits and thus have to be included.**

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?

Agree.

Gross physically settled forward purchase contracts for own shares are accounted for in accordance with paragraph 23 of IAS 32 as if the shares have already been purchased. A

financial liability is recognised for the present value of the redemption amount with a reclassification from equity.

The effect of the forward purchase contract is to cause the ordinary shares to be accounted for as a participating debt instrument rather than an equity instrument. IAS 32 requires an entity to recognise a liability for the present value of the redemption amount of the contract to repurchase the entity's own shares. To calculate earnings per share, an entity allocates dividends to that financial liability. As a consequence, the liability participates in profit or loss of the entity and meets the definition of a participating instrument.

Forward purchase contracts for own shares will sometimes include an additional condition that requires the holder of the forward purchase contract to remit back to the entity any dividends paid on the shares to be repurchased. Such a requirement results in the ordinary shares being accounted for as a non-participating debt instrument and thus excluded from the denominator for calculating EPS.

Mandatorily redeemable shares have the same characteristics as a participating debt instrument and hence merit the same treatment in the computation of EPS.

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?

Agree.

When an entity measures an instrument at fair value through profit or loss, the change in the fair value of the instrument is recognized in the profit or loss for the period. Therefore earnings used in the EPS calculation already reflect the effect of those instruments on ordinary equity holders and thus there is no need for further adjustments to the calculation of EPS.

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?

Agree to both (a) and (b)

(a) The objective of diluted EPS is to provide a measure of the interest of each ordinary share in the performance of an entity while giving effect to all dilutive potential ordinary shares outstanding during the period. Therefore, diluted EPS includes in addition to basic EPS dilutive potential ordinary shares from options, warrants and their equivalents, convertible instruments as well as other contingently issuable shares.

The settlement of forward sale contracts on an entity's own shares has the same dilutive effect as that arising on exchange of options, warrants and their equivalents with ordinary shares. As such 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

(b) If an instrument classified as a liability is settled in shares, the liability for the instrument is extinguished without sacrifice of assets and the amount of the liability is credited to equity. Therefore, proceeds from the exercise of dilutive options, warrants and their equivalents include the end-of-period carrying value of the liability that is assumed to be settled. Furthermore in order to maintain consistency, ordinary shares should be regarded as issued at the end-of-period market price, rather than at their average market price during the period

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?

Agree

Paragraph A14 of current IAS 33 explains how participating equity instruments and two-class ordinary shares affect diluted EPS.

a) **If those instruments are convertible into ordinary shares, conversion is assumed if the effect is dilutive but**
b) **If those instruments are not convertible into a class of ordinary shares, profit or loss for the period is allocated to the different classes of instruments in accordance with their dividend rights or other rights to participate in undistributed earnings.**

The proposal introduces a test to determine how a participating instrument and a second class of ordinary shares should be included in the diluted EPS. The instruments are to be taken into account as the more dilutive of:

a) **assuming exercise or conversion; and**

b) **assuming no exercise or conversion.**

Although paragraph A14 of current IAS 33 is clear on how to calculate diluted EPS under the two-class method for participating instruments, it might in certain cases not maximise the dilution of EPS. Therefore, more detailed application guidance helps in determining whether a convertible financial instrument would have a diluted effect.

Shares that are exercised or converted do participate in dividends and that those shares should be assumed to have received dividends which affects the allocation of undistributed profits or losses to the different classes of participating instruments. We agree that actual rather than hypothetical dividends should be used for this allocation.

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?

No additional disclosures are needed