The South African Institute of Chartered Accountants

5 December 2008

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 33 – *SIMPLIFYING EARNINGS PER SHARE*

In response to your request for comments on the IASB's exposure draft, Proposed Amendments to IAS 33 **–** *Simplifying Earnings Per Share*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

SAICA SUBMISSION ON EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 33 – *SIMPLIFYING EARNINGS PER SHARE*

GENERAL COMMENTS

We support a long-term view that the Earnings per Share (EPS) standard should be revised once projects such as the conceptual framework, presentation of financial statements and the re-deliberation of the distinction between equity and liabilities have been completed.

We question the need to proceed with a short-term convergence project, because further changes to the EPS standard are likely to arise from the work currently under way in respect of the above projects. We are of the view that until the amendments as to what constitutes equity is finalised, the amendment to the standard may provide further complexity in the understanding of EPS in the market. We agree with the concerns that Stephen Cooper has raised. We believe there cannot be high quality convergence of EPS until US GAAP and IFRS have converged models for liabilities and equity classification and measurement.

Our general view is that the single biggest contributor to complexity in financial reporting is constant change in the accounting requirements. While we agree that a long-term solution is required for simplification and improvement, we are cautious that any intermediate amendments would result in complexity as preparers and users would have difficulty in implementing two or more sets of changes. Because amendments by their very nature result in more, rather than less complexity, we would only support any intermediate amendments that reduce the complexity to such an extent that they justify the additional complexity created by implementing such amendments.

If the Board decides to proceed with this convergence project, we agree with the principle that basic EPS should include only instruments that give their holder the right to share currently in profit or loss of the period. We are concerned that this principle is not applied consistently in the exposure draft, as indicated in the responses to questions 1 and 2.

We are also concerned that certain principles may only be understood by reference to Illustrative Examples and are not adequately explained in the body of the standard. Our view is that the purpose of the Illustrative Examples is to elaborate on the principles contained in the standard and not to create new principles. This is relevant to the application of participating instruments and the two-class-method.

SPECIFIC COMMENTS

The answers to the questions below are provided in the event that the Board proceeds with the project. Again we reiterate that we recommend that short-term changes are not made to the EPS standard.

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 of loss of the period? Why or why not?*

We agree in principle that only instruments that give their holder the right to share currently in profit of loss for the period should be included in the weighted average number of ordinary shares for basic EPS.

We would like further clarity on the application of the principles of 'participating instruments'. Our specific concerns are:

- Paragraph 18 states that the calculation of the weighted average number of ordinary shares outstanding should consider the effect of participating instruments, but does not provide any guidance on how such instruments would affect the number of shares outstanding. While the Illustrative Examples provide clarity, we believe this should be included in the text of the standard.

- Illustrative Examples D.2 and D.3 adjust the numerator in the calculation of basic EPS for the earnings attributable to participating instruments. This is not clear from paragraph 18 which suggests an adjustment to the number of shares outstanding, and not to the numerator. We recommend that the Board clarifies this inconsistency.

- Illustrative Examples D.2 and D.3 include calculations of the basic earnings per participating instrument. We note that neither the calculation nor disclosure of basic earnings per participating instrument is required by the exposure draft and therefore recommend that this calculation be removed.

- Paragraph A8 identifies when to include instruments in the calculation of basic EPS. We recommend that these examples be expanded to include participating instruments and those that are currently issuable for little or no cash or other consideration (as discussed in paragraph 19 of the exposure draft).

(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 mandatorily convertible instruments not converted at year end should not be considered as outstanding in the determination of basic EPS. We agree that a mandatorily convertible instrument should only be included in the determination of EPS for the period if it has the **current** ability to participate in profits for the period.

We agree that ordinary shares which are currently issuable for little or no consideration should be considered as outstanding in the determination of basic EPS. However, we believe that the term 'little or no consideration' is subject to interpretation. One interpretation could be that an option where the market value of the underlying share exceeds the strike price could be considered as being issuable for little consideration. An alternative interpretation could be that the absolute value of the strike price should be considered in making this determination. We therefore believe that further clarity should be provided with regard to the term 'little or no consideration'. For example, it is unclear how this principle is applied to mandatorily convertible instruments. Is the conversion of these instruments considered to be an exchange of the debt instrument for the equity instrument? Does the exchange represent "little or no consideration"?

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 proposed 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 has 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 paragraph A23-28 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?

We disagree with the proposed treatment of gross physically settled contracts to repurchase an entity's own shares and mandatorily redeemable shares for the reasons noted below.

The exposure draft proposes that basic EPS should include instruments that give the holder the right to share currently in profit or loss for the period. Gross physically settled contracts to repurchase its own shares permit an entity to repurchase its ordinary shares. However, if unexercised at the reporting date, the holders of the shares have the right to share in profit or loss for the period. Therefore, we believe this requirement is inconsistent with the principles contained in paragraphs 18 and 19 of the exposure draft. For example, an entity that entered into both a forward purchase and a forward sale contract over its shares would exclude the shares subject to the forward purchase from the weighted average number of shares outstanding for basic EPS, but would include the shares subject to the forward sale contract as they have a current right to share in profit or loss for the period. This creates inconsistency.

With regard to written put options, we note that the treatment proposed by paragraph A31 may provide opportunity for the manipulation of the weighted average number of shares used in basic EPS, as an entity could write a 'deep out of the money put option' during the reporting period in order to reduce the weighted average number of shares outstanding for basic 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 of loss eliminates the need for further adjustments to the calculation of EPS? Why or why not?

We disagree with the proposal that an entity's own equity instruments (or derivatives thereon) recognised at fair value through profit and loss (FVTPL) should not be adjusted for the purposes of calculating diluted EPS. We believe that this does not appropriately measure the dilutive effect, in comparison to the current standard. We believe that the treatment for calculating the dilutive impact in terms of the current IAS 33 should continue to be applied.

The example below illustrates that FVTPL instruments could have a significant dilutive effect:

Fact pattern

Share price at beginning of period	CU 1 600
Year end share price	CU 650
Strike price of options	CU 389
Average share price for the year	CU 1 200
Number of shares in issue	10 000 000
Number of share options	200 000
Profit after tax, before instruments at FVTPL	CU 160 000 000
Adjustment for instruments at FVTPL[1]	
	CU 190 000 000
Profit after tax, after adjustment for FVTPL instruments	CU 350 000 000

Determination of Earnings per Share

Diluted EPS (proposed by the exposure draft)[2]	CU 35.00

[1] This amount is calculated as CU 1 600 less CU 650 multiplied by number of options outstanding of 200 000

Diluted EPS (proposal)[3]	CU 15.79
Diluted EPS (year end price)[4]	CU 15.87

The calculation represents a simple calculation of the fair value movements on equity instruments recognised at FVTPL.

However, if the Board decides to adopt the approach in the exposure draft, being the exclusion of items carried at FVTPL, we agree with Mr Cooper's dissenting view in paragraph AV5 that additional disclosure is required of adjustments that would have been required had the FVTPL been excluded in the determination of diluted 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?

We agree with the proposed amendments to the standard, because it is reflective of the dilution that could occur to ordinary shareholders.

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

We believe that EPS is a figure that is determined on the performance of the entity for the period (income statement) rather than at a point in time (balance sheet). We therefore believe that the use of the average share price to determine whether instruments are dilutive or anti-dilutive provides a more appropriate measure of performance. We believe that the change from weighted average share price to year end price does not represent a major simplification of the standard. We believe the principle of using the weighted average share price is consistent with

[2] This is calculated as CU 350 000 000 divided by number of shares in issue (10 000 000)
[3] This is calculated as CY 160 00 000 divided by 10 136 167. The number of dilutive instruments has been determined using the average share price for the year. (200 000 options less (200 000 options multiplied by the strike price (CU 389) divided by the average price for the year (CU 1200))
[4] This is calculated as CY 160 00 000 divided by 10 080 308. The number of dilutive instruments has been determined using the year-end share price for the year. (200 000 options less (200 000 options multiplied by strike price (CU 389) divided by the year end share price (CU 650))

the principle of weighting shares for the period for which they are in issue. We are also of the opinion that the year-end share prices may be inflated and not reflective of the movement in the share price for 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?

We do not agree with the proposed amendments. We believe that the proposed amendments do not simplify the calculation of EPS and suggest that the current treatment in IAS 33 is maintained. In particular, we believe that ranking multiple classes of ordinary shares and participating instruments using both the two class method and the treasury stock method is unnecessarily complex, particularly where there are more than two classes of participating instruments.

Although the proposed amendments to the application guidance for participating instruments and two-class ordinary shares provide some guidance, the exposure draft does not provide adequate principles for the application of these amendments.

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?

We agree with the amendment to paragraph 67 and request the Board to make a consequential amendment to IAS 34 – *Interim Financial Reporting,* to provide consistency between the disclosure in the annual and interim financial statements.

Should the Board confirm its proposal to exclude instruments measured at FVTPL from the determination of diluted EPS, we believe additional disclosures are necessary as noted by Mr Cooper in paragraph AV5.

OTHER COMMENTS

Although not amended by this exposure draft, we would recommend that the reference to retained earnings should be eliminated in example A2, as the statement is discussing EPS, and not the presentation of equity. We believe that reference should only be made to include the determination of earnings for the period.

We believe that Illustrative Example B.2 should be expanded to include an example of the tax effect on share-based payments in the determination of EPS, as required by paragraph 49(b).

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