

5 December 2008

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Re: Exposure Draft, *Simplifying Earnings per Share* - proposed amendments to IAS 33

Dear Sir David,

Deloitte Touche Tohmatsu is pleased to respond to the exposure draft, *Simplifying Earnings per Share*, proposed amendment to IAS 33 (the “proposed amendment” or the “Exposure Draft”).

As indicated in previous comment letters, we support global convergence around high-quality accounting standards. Therefore, we continue to support the efforts of the IASB to work closely with the Financial Accounting Standards Board (FASB) and national standard setters to develop high quality standards that will be applied globally. We encourage the FASB and the IASB to work together to develop converged accounting standards that use the same words when describing the same accounting principles or guidance and organise those principles or guidance in the same or similar manner. By doing so, we believe the risk the accounting standards will be interpreted differently will be reduced, if not eliminated. We appreciate the efforts made to converge the two earnings per share (EPS) standards, but note that the look of the standards and words differ in instances when the intended accounting treatment is the same. Before finalisation, both Boards should take the opportunity to align the two standards as best they can.

We believe the proposals in the ED are an improvement to existing standards, and we support the issuance of the proposed Statement as a final standard. However, we do have concerns related to some of the proposed changes to EPS which we believe need to be addressed. In particular:

- (1) Although we support the proposal to make the EPS treatment consistent with the statement of financial position with respect to forward purchases and written puts over own equity we believe the EPS result highlights a wider flaw in the underlying treatment of these arrangements which we commented on in our responses to *Reducing Complexity in Reporting Financial Instruments* and *Financial Instruments with the Characteristics of Equity*.
- (2) We support the proposed simplification in which EPS for instruments that are measured at FVTPL is not adjusted. However, we believe due consideration should be given to the disclosure needs of users as to whether the lack of disclosure of these instruments will prove problematic. We note that IFRS does not currently require separate disclosure of the fair value of these instruments, nor the fair value changes of such instruments.
- (3) We recommend the inclusion of an explicit statement in the final standard that arrangements that result in the issue or acquisition of shares at fair value should not result in any dilutive effect. The current drafting of the ED infers that such arrangements, for example, issuing shares to the value of a fixed amount, are potentially dilutive.

Our detailed responses to the invitation to comment questions are included in Appendix A.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907, Andrew Spooner in London at +44 (0) 207 007 0204, or John Sarno in Wilton, the United States, at +1 (203) 761 3433.

Sincerely,

A handwritten signature in black ink, appearing to read "Ken Wild", written over a horizontal line.

Ken Wild
Global IFRS Leader

Appendix A: Invitation to Comment

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?

We agree with the principle that only those instruments that share in profit or loss in the period should be included in basic EPS. Those not sharing in profit or loss in the period but may do so in the future are potential ordinary shares and therefore it is appropriate that they should only be included in diluted EPS if they dilute earnings per share.

We have concerns surrounding the inclusion of instruments that are **deemed to have** the present right at the end of the period to share in current-period earnings with common shareholders. That is, we question whether instruments that are currently exercisable and shares that are currently issuable for little or no cost to the holder should be included in basic EPS. If these instruments (1) do not share in current period earnings with ordinary shareholders, (2) truly have no further restrictions on their exercise or issuance, and (3) have not been exercised or received by the holder; then we question whether there was some benefit (e.g., tax benefits) that the holder did not want to forego (i.e., an additional cost) that caused them not to exercise or receive the instruments or shares and become a common shareholder. In addition, the proposal may result in diversity in how entities interpret the little or no cost criteria. That is, diversity may develop around which costs to include in the analysis. Therefore, to further simplify the computation of EPS and alleviate any potential implementation issues that may arise, we would suggest excluding these instruments and shares from the computation of basic EPS and include them in the computation of diluted EPS.

We also note that an entity could structure an instrument depending on whether its intent is to include the instrument in basic EPS. For example, consider an entity that issues a certain number of instruments (e.g., penny warrants) that are exercisable into common shares for little or no cost to the holder of the instruments. Alternatively, the entity could issue a greater number of instruments with a higher exercise price (one that is not considered to be little or no cost to the holder) that has the same economic value at the inception of the instrument to the holder. In the latter situation, the shares that would be issued upon exercise of the instruments would be excluded from the computation of basic EPS, however, the instruments have the same economic value at inception of the instrument to the holder as in the original situation.

We do not understand the inclusion of the term “non-participating” in paragraph A8(c) and (d) and believe it should be removed or clarified. Whether a debt or other financial instrument is non-participating or is not relevant in determining when ordinary shares have been issued. Ordinary shares are included in the weighted average number of shares from the point when

the holder has the right to share in profit or loss of the period. By including the term “non-participating” it implies that ordinary shares issued as a result of conversion of a participating instrument are *not* included in the weighted average of ordinary shares which is not the case.

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?

We believe it is appropriate for forward purchases and written puts over an entity’s own equity for EPS purposes to be treated consistently with the presentation of those arrangements in the statement of financial position. Accordingly, where the entity recognises a gross obligation under IAS 32 (measured in accordance with IAS 39) to acquire its own shares in the future and recognises at inception a debit in equity, we agree that for EPS purposes the debit in equity should be considered a deemed acquisition of ordinary shares on entering into the arrangement.

The Board should note that as a consequence of aligning balance sheet presentation with the EPS treatment in the case of written puts over own equity this will result in volatility in EPS on entering into the arrangement and at expiration of the arrangement if the put is not exercised. If a written put is not exercised then at expiration there will be an increase in the number of ordinary shares even though no new shares have been issued and no new resources have been received. The Board should recognise the potential for manipulation of EPS by an entity writing deeply out of the money written puts on own equity that, upon entering into them will reduce the number of ordinary shares outstanding and thereby immediately impact EPS and at expiry, if not exercised, the impact to EPS will be reversed. We note this problem will only arise in IFRS, not US GAAP, as for the latter written puts over own equity are measured as at FVTPL.

As detailed in our responses to you in September 2008 on *Reducing Complexity in Reporting Financial Instruments* and *Financial Instruments with the Characteristics of Equity* we do not support the recognition of a gross obligation for forward purchases or written puts. The gross obligation inflates financial liabilities as if the instrument was a non-derivative liability, i.e. borrowed funds, and reduces equity as if shares have been acquired when they have yet to be acquired. Although we accept the EPS consequences of this accounting treatment as proposed in these amendments we believe the sooner the underlying accounting treatment for forward purchases and written puts is addressed the better.

The proposed amendment should be clear on the EPS treatment if dividends are remitted back to the entity from the counterparty to the forward purchase and written put. Paragraph A32

states some forward contracts require dividends paid under shares that are subject to a forward contract to be remitted back to the entity and then, in that case, the instrument is not a participating instrument. In practice, the dividends are paid to whoever is the shareholder, and the 'dividend' remitted back is a synthetic dividend by whoever is the counterparty to the forward contract. These two parties are often different parties as the counterparty to the forward is generally not obligated to hold the shares. The amendment should be clearer that a remittance of a synthetic dividend where the counterparty is not necessarily the holder of the ordinary shares is still acceptable in determining the forward contract or written put as a non-participating instrument. Whether the counterparty to the forward purchase or written put holds the shares and therefore happens to be the recipient of the dividend is not critical to the issuer's treatment for EPS, as long as the net cash from dividends paid and received from synthetic dividend remittance is nil with respect to the number of ordinary shares subject to repurchase under the arrangement.

The definition of *Dilution* in paragraph 6 includes the words "forward contracts are settled". We presume this only relates to forward *sale* contracts as it is only these forward contracts that are potentially dilutive. If the instrument was a forward purchase contract, according to the proposed amendments, this may or may not be a participating instrument but it would not be dilutive anyway. The definition, therefore, could be clearer in this respect.

Paragraph 20 on ordinary shares that are "subject to recall" could be made clearer. This term is also used in the current standard but it is not clear whether this relates to equity instruments where there is a right for the issuer to repurchase them by exercising an embedded call option, or whether the standard is referring to shares where the holder has the right to put them to the issuer. We presume it is only the former but this should be confirmed and made clearer.

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?

We agree that standalone or embedded derivatives that are measured as at FVTPL that may result in the delivery or receipt of ordinary shares should be excluded from diluted EPS. We accept that not adjusting EPS for movements in the fair value of derivative instruments that may result in the issue or acquisition of ordinary shares is easier. We believe that the earnings attributable to current shareholders includes the gains/losses on items that are measured as at FVTPL and therefore it is not appropriate to add back or deduct these amounts in determining earnings attributable to ordinary shareholders.

By simplifying the calculation of EPS for those instrument measured as at FVTPL and not providing additional disclosure with respect to those instruments users will not appreciate the number of shares that may be issued in the future. Due consideration should be given to the comments of those users to determine whether additional disclosure is needed. See our response to Question 6.

The ED refers to the “derivative components of *compound* instruments” (paragraph 26) that are measured as at FVTPL which is not the correct term as a compound instrument has a separate liability and equity component. The instruments that the ED is referring to are instruments where the equity definition has failed and therefore the instrument is a *hybrid* financial instrument, not a *compound* one. We believe therefore “compound” should be replaced with “hybrid”.

The ED does not make clear whether ordinary shares that are issued as ‘currency’ for settlement of a financial liability, for example, a variable number of shares equal to a fixed amount, are potentially dilutive. We believe IAS 33 as currently drafted would imply these arrangements are dilutive and the entity would apply the ‘if-converted’ method, i.e. add back any interest to the numerator, and add the *total* number of shares to be issued based on the period end share price to the denominator. This treatment makes no sense when the entity is merely issuing shares at their fair value (alternatively the entity could have issued a variable number of shares for cash, and used the cash to repay a financial liability and EPS would not have been dilutive). We believe there should be a statement upfront in the standard that contracts that require the issue of shares at future fair value should not be considered dilutive (e.g. a variable number of shares to be issued as settlement of a financial liability). Equally, there should be a statement that contracts that require the receipt of shares at future fair value should not be considered a reduction in the number of shares outstanding for basic EPS and should not be considered potentially dilutive for diluted EPS (e.g. a variable number of shares to be received as a settlement of a financial asset). This statement is relevant for arrangements where the number of shares issued (acquired) varies in order that the number of shares multiplied by their fair value at the date of issue (acquisition) exactly equals the amount of the liability (asset) that is extinguished at the date the shares are issued (acquired). To the extent the number of shares multiplied by the fair value of the shares on the date of issue or delivery does *not* equal the amount extinguished on the extinguishment date then there will be a potential dilutive effect. Without a clear statement that the future issue or acquisition of ordinary shares at future fair value as extinguishment for a liability or receipt is ignored for EPS purposes it could lead to the anomalous result that a variable number of shares to be acquired/issued to the value of fixed amount will be potentially dilutive, when we believe it should not, yet, if the entity had chosen to designate the financial asset/liability as at FVTPL under the fair value option (or because it met the definition of held for trading) it would not be dilutive due to the proposed paragraph 40.

We note that in the proposed amendments to FASB Statement No. 128 on EPS in paragraph B10 it states that the proposed amendments to the treasury stock method will result in a fixed monetary obligation that may be settled in a variable number of shares not being dilutive.

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?

We agree that forward sale contracts over own equity that are not measured as at FVTPL are potentially dilutive by applying the treasury stock method, i.e. the entity determines the number of shares that are effectively issued for nil consideration, which will be the case when the period end share price is higher than the forward price under the contract. This is generally the approach that is currently applied in practice and it is helpful that IAS 33 clarifies this.

We note that the question above appears to imply that the entity should always assume forward sale contracts (unless measured as at FVTPL) are settled in the calculation of diluted EPS. This follows from the wording in paragraph IN7 which says “The boards propose to clarify that for the calculation of diluted EPS an entity assumes that ordinary shares relating to such a contract are sold and the effect is dilutive, unless they are measured at fair value through profit or loss.” In fact, dilution should not be assumed, but is to be determined based on the actual fact pattern and the application of the treasury stock method.

We agree with the use of the period end, not average, share price, for determining the number of shares deemed to be issued for nil consideration.

We question the relevance of including “joint ventures or associates” in paragraph A33 and A34. A conversion feature that converts into ordinary shares of a joint venture or associate would not meet the definition of equity in the consolidated or separate financial statements as the instrument is not an equity instrument of the issuer. We suggest therefore to delete references to “joint ventures or associates” in paragraph A33 and A34. In addition, we believe that A34 should be amended as it is only those derivatives over interests in subsidiaries that are not measured as at FVTPL that should be subject to the paragraph. Our proposal would be to amend A34 as follows (new text underlined, deleted text struck through):

For the purpose of determining the earnings per share effect of instruments issued by a reporting entity that are convertible into ordinary shares of a subsidiary, ~~joint venture or associate~~, that are not fair value through profit or loss, the instruments are assumed to be converted and the numerator (profit or loss attributable to ordinary equity holders of the parent entity) adjusted as necessary in accordance with paragraph 32.

We believe paragraph 26 should be amended as follows:

“An entity shall not increase the denominator for the number of additional ordinary shares that would arise from the exercise, settlement or conversion of ~~instruments~~ potential ordinary shares (or the derivative components of ~~compound~~ hybrid instruments) that are measured at fair value through profit or loss.”

The inclusion of the term ‘settlement’ reflects the inclusion of forward sale contracts as they are settled, not exercised or converted; ‘potential ordinary share’ is more specific than ‘instrument’ as the instrument must result in the potential delivery of ordinary shares; such arrangements are ‘hybrid’ instruments, not ‘compound’ instruments as the instruments fails the definition of equity.

Paragraph 27 should also be amended: “it is not necessary to increase the denominator for the number of additional shares that would arise from the exercise, ~~or~~ conversion or settlement of those instruments in shares.”

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?

Our general concern regarding the EPS impact of participating instruments is that the drafting is not clear. For example, it could be made clearer that determining the amount of earnings and number of ordinary shares allocated to two-class ordinary shares or participating instruments is required *only* in order to determine the amount of earnings and number of ordinary shares available for ordinary shareholders. As per paragraph 58 of the ED (and paragraph 66 of the existing IAS 33), basic and diluted EPS should be presented for each class of ordinary shares that has a different right to share in profit for the period. It is not a requirement to disclose EPS for participating instruments. This point could be made clearer in paragraph 18 and paragraphs A24 and A25.

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?

As referred to in our response to Question 3 on the fair value method we note the simplification of the calculation of EPS for those instruments measured as at FVTPL and the lack of disclosure about these arrangements will mean that users will not appreciate the number of shares that will be issued in the future.

The lack of information in understanding how many instruments are to be settled by ordinary shares, and the degree to which these instruments are dilutive for instruments that are measured as at FVTPL, is exacerbated when, for example, the instrument has not *changed* in fair value during the period (or comparative period), yet the option is deeply in-the-money, and therefore the entity will issue ordinary shares cheaply. The fact that current ordinary shareholders will have future earnings diluted by issuing shares cheap will no longer be visible in the financial statements and therefore supplementary disclosure of the fair value of this instrument to the extent not already disclosed in the financial assets and liabilities notes should be considered. Such disclosure could be achieved by requiring separate disclosure within the financial assets and liabilities notes of instruments that are share settled – this is similar to our approach recommended in our recent response to you on *Financial Instruments with Characteristics of Equity* and is consistent with the recently issued proposal to amend IFRS 7 that states that financial instruments that are settled by the issue of shares are excluded from the liquidity risk analysis of financial liabilities.

The combination of disclosing the fair value of share settled instruments, the gains/losses in the period on those instruments and the number of shares to be issued under share settled instruments may fill the gap in information that is created by removing the dilutive effect of instruments as at FVTPL in the EPS calculation. We believe due consideration should be given to the comments of users to determine whether additional disclosure is required.

Other comments

Contingently issuable shares

Paragraph A16 which deals with the application of paragraph 54 of the ED is incorrect. The contingently issuable shares referred to in paragraph A16 should be included in the calculation of diluted EPS from the beginning of the period (or from the date of the contingent share agreement, if later) where the conditions in the contingent share agreement are satisfied at the end of the period.