XX December 2008

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

DRAFT COMMENT LETTER

Comments should be sent to Commentletter@efrag.org by 1 December 2008

Dear Madam/Sir

Re: Exposure Draft *Simplifying Earnings per Share*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft *Simplifying Earnings per Share*. This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues.

The exposure draft contains proposals for amendments designed to simplify IAS 33 *Earnings per Share* (EPS) and to converge the computation of EPS with FAS 128 *Earnings per Share.*

Our detailed comments are set out in the appendix to this letter. To summarise our main views are as follows:

- As the IASB and the FASB are currently involved in a joint project on distinguishing equity from liabilities, and the outcome of this project is likely to change the current split between equity and liabilities, we question the wisdom of spending scarce Board resources on this project at the current time. Our recommendation would be to defer further work on this project until later;

- Although EFRAG agrees that the introduction of the fair value method is an improvement from a measurement perspective, we think that it needs to be accompanied by additional disclosures if some important information is not to be lost.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Frederiek Vermeulen or myself.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
EFRAG's detailed comments on the ED *Simplifying Earnings per Share*

General comments

1 The IASB is currently involved in a joint project with the FASB on financial instruments with characteristics of equity. A number of alternatives have been considered in this project as to how to draw the line between equity and liability in a more meaningful manner and it seems likely that a change in the split between equity and liabilities will be made. EFRAG questions the wisdom of spending scarce Board resources at the present time on trying to converge and simplify the calculation of Earnings per Share (EPS) when such an important element in the calculation—what is equity—has not been converged and is expected to change. We think it would be better to delay the EPS project until the equity and liabilities project has been completed. That would also enable the Boards' limited resources to be re-allocated to more urgent projects.

2 In this respect we would like to refer to our earlier comments on the Board's agenda priorities. (See EFRAG's letter to the IASB on its agenda setting dd. 22 July 2008.)

Question to constituents

EFRAG is aware that some users and other interested parties argue that how to calculate EPS is not an issue that should be addressed by accounting standards, as it is not dealing with an accounting issue. Furthermore some users believe that how best to calculate EPS is for users to decide, and users are content to rely on their own calculations in their day to day work.

We would therefore particularly welcome views from constituents as to whether the IASB should even have a standard on EPS (and, by implication, whether IAS 33 *Earnings per Share* should be withdrawn).

3 Although we believe that the IASB should not be carrying out a project on Simplifying earnings per Share at this time, to be constructive, we have nevertheless responded to the questions in the 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?*

4 EFRAG agrees that the denominator in the computation of EPS should be based on the shares participating in profit or loss with ordinary shareholders. EFRAG welcomes therefore the introduction of the principle that the weighted average number of ordinary shares for basic EPS should include only those instruments that give (or are deemed to

give) their holder the right to share currently in profit or loss of the period. In EFRAG´s view this principles-based approach reflects better the economics of the interests of each ordinary share of a parent entity in the performance of the entity over the reporting period.

(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?

5 EFRAG agrees that the principle referred to above has been applied correctly to mandatorily convertible instruments and ordinary shares issuable for little or no cash or other 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 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 principle for contacts to repurchase an entity's own shares for cash or other financial assets should also apply to mandatorily redeemable shares? Do you agree with the proposed treatment of gross physical settled contracts to repurchase an entity´s own shares and mandatorily redeemable shares? Why or why not?

6 It is EFRAG's opinion that the denominator for EPS should not be affected by shares that will have to be repurchased. We think this amendment is in line with the objective of EPS and the principle the IASB proposes to include in paragraphs 18 and 19 of the ED.

7 EFRAG agrees with the proposed amendment on gross physically settled contracts to repurchase an entity's own shares and mandatorily redeemable ordinary shares. Indeed, judging from the various consultations we have had to date with the user community on the proposed amendments it seems clear that this proposed treatment is already common practice.

8 However, EFRAG notes that some divergence will remain between US GAAP and IFRS for contracts with a choice of gross physical or net settlement.

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 recognizing those changes in profit or loss eliminates the need for further adjustments to the calculation of EPS? Why or why not?

9 The ED proposes the use of the so-called fair value method for all financial instruments that can be settled in cash or shares, are classified as liabilities and are measured at fair value in their entirety with changes in fair value recognised in earnings. Under this method, such instruments would be excluded from the computation of diluted EPS. The ED further proposes that the denominator shall not include incremental shares resulting from their assumed exercise or conversion. The Board does not propose any additional disclosures beyond those already required in IAS 33.

10 EFRAG notes that an alternative view has been developed by an IASB member. His dissenting view includes the following comment "(...) Although the proposal not to calculate a separate diluted EPS for instruments measured at fair value through profit and loss can be theoretically justified, he does not believe that the proposals (…) would be beneficial for users. (...) users would in practice need to make estimates of the expected value change (the cost of capital for the instrument) for (the) period or estimate a forecast value change for the following period to produce useful measures of performance" [IAS 33.AV5]

11 EFRAG believes that the fair value method represents a more realistic picture of dilution in the way that, in contrast to the treasury stock method, it assumes neither the hypothetical exercise of all in-the-money options nor the subsequent repurchase of shares from proceeds of the exercise. The fair value adjustments will reflect the economic effect of the instruments on the current owners for the instruments currently subject to the treasury stock method and the two-class method. EFRAG therefore supports the introduction of the proposed treatment. However, EFRAG also believes that under this approach additional disclosures would be necessary because the currently if-converted method might be more useful for some instruments (e.g. convertible instruments) from an investor's standpoint. In particular, EFRAG thinks that disclosure of the number of options which could be converted and the number of shares that would result from their conversion should be provided.

Question to constituents

EFRAG would also welcome comments from constituents as to exactly which information they believe would be lost under the fair value method and how it might best be replaced. For example, EFRAG thinks that one possibility might be to re-instate the following disclosure requirement, which used to be paragraph 47 of IAS 32 but was withdrawn on implementation of IFRS 7:

47	For each class of financial asset, financial liability and equity instrument, both recognised and unrecognised, an enterprise should disclose:	
(a)	Information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows.	

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?

12 We agree that for the computation of diluted EPS an entity should assume the settlement of forward contracts (not measured at fair value through profit or loss) to sell its own shares.

(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?

13 We agree that 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 rather than at the average market price. We believe that this will result in a better reflection of the performance of an entity and in a more consistent application of the treasury stock method. We also agree with the IASB that the difference between the number of ordinary shares issued and the number that would have been issued at the end-of-market price should be treated as an issue of ordinary shares for no consideration.

Question 5 – Participating instruments and two-class ordinary shares

Paragraph A23 proposes to extend the scope of the application guidance for participating instrument 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 the dilutive convertible instruments, 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?

14 We agree with the ED´s proposal to make it clearer that, for the computation of basic EPS, the two-class method should be applied for convertible participating instruments.

15 EFRAG notes that paragraph A14 of current IAS 33 explains how participating equity instruments and two-class ordinary shares affect diluted EPS. If those instruments are convertible into ordinary shares, conversion is assumed if the effect is dilutive. 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. Although paragraph A14 of current IAS 33 is clear on how to calculate diluted EPS under the two-class method for participating instruments we agree with the IASB's view that it might in certain cases not maximise the dilution of EPS and thus not meet the objective of IAS 33 in providing a measure of the interest of each ordinary share in the performance of an entity, while giving effect to the dilutive potential ordinary shares outstanding during the period. We agree that, for the computation of EPS, more detailed application guidance helps determining whether a convertible financial instrument would have a diluted effect.

16 Some European entities have preferred shares that do not participate in profit or loss. The number of shares used in the calculation of EPS obviously needs to take into account those shares, although we believe that to do that one needs to consider the nominal value. For example, assume an entity has 100,000 preferred shares with no voting rights and the nominal value of each preferred share is 50 EUR, and it also has 100,000 ordinary shares with voting rights that have a face value of 100 EUR. We think for EPS purposes the combined number of shares would be 150,000 with a theoretical nominal value of 100 EUR each.

17 EFRAG notes that the 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?

18 Apart from the issue discussed in paragraph 11 above, EFRAG thinks that the disclosures requirements in the current version of IAS 33 are sufficient and that no other disclosures should be considered at this moment.