## I. The issue

**Calculating basic earnings per share**
**considering preference dividends on non-cumulative preference shares**
**(IAS 33.14 (a))**

The objective of IAS 33, 'Earnings per share', (revised in 2003) is to prescribe principles for determining and presenting earnings per share (EPS) to improve comparison between different entities in the same period and between different accounting periods for the same entity.

However, due to non-uniform understanding and – therefore – heterogeneous application of some of the guidance of the Standard as described below, the objective may not be accomplished.

For the purpose of calculating basic earnings per share, according to IAS 33.14 (a) the after-tax amount of preference dividends that is deducted from the profit of loss is 'the after tax-amount of any preference dividends on non-cumulative preference shares declared in respect to the period'.

With respect to this guidance divergent interpretations have been observed for legal environments in which dividends to holders of equity instruments (both, to holders of ordinary and preference shares) are normally declared after the end of the reporting period and even after the financial statements are authorised for issue. In order to illustrate the main different interpretations identified, the following (simplified) example will be used:

**Example:** Entity A has the following shares in issue:
- 100 ordinary shares and
- 100 non-cumulative preference shares (in the meaning of IAS 33);

in year 1, the profit from continuing operations attributable to the parent entity amounts to CU 100;
in year 2, the profit or loss from continuing operations attributable to the parent entity amounts to CU 0;
in the course of the annual shareholders' meeting in July of year 2 a dividend of CU 1 per non-cumulative preference share is declared;
the financial statements for year 1, which have been authorised for issue on 31 May of year 2, include a note, according to which a dividend of CU 1 per non-cumulative preference share is proposed to the annual shareholders' meeting.

The following **main different approaches** (interpretations) have been **identified**:

(1) The after-tax amount of preference dividends that is deducted from Year 1's profit or loss is the after-tax amount of the preference dividends on the non-cumulative preference shares proposed to the shareholders' general meeting scheduled to take place after the reporting period and even after the financial statements are authorised for issue. As a result of the shareholders' general meeting the dividend will be declared.

Reasoning: This alternative is supported by the view, that the basic EPS calculated based on this approach provides economically meaningful information (if the amounts attributable to ordinary equity holders will – according to proposed (but not yet declared) dividends to the non-cumulative preference share-holders – be reduced, this should be taken into consideration when calculating basic EPS). On the other hand, this approach seems not to be in line with the guidance as provided in IAS 33.14 (a), which requires 'declaration' of the dividend, not simply its 'proposal'.

**Approach 1:** According to this approach, the basic EPS would calculate as follows:

**Year 1:** (profit of CU 100 minus preference dividend (proposed) on non-cumulative preference shares of CU 100)
/ 100 ordinary shares
= **CU 0 EPS**

**Year 2:** (profit of CU 0 minus preference dividend (proposed) on non-cumulative preference shares of CU 0)
/ 100 ordinary shares
= **CU 0 EPS**

(2) No after-tax amount of preference dividends are deducted from Year 1's profit or loss since at the time of preparation of the financial statements (the period ends with the authorisation for issue) no dividends have been 'declared in respect of the period'.

(a) Rather, the after-tax amount of the preference dividends on non-cumulative preference shares are deducted from profit or loss in the period, in which the dividends are declared. Thus, the term 'declared in respect of the period' as used in IAS 33.14 (a) is meant to read as 'declared during the (reporting) period'.

Reasoning: This approach follows the guidance of IAS 33.14 (a) in the meaning as described above and based on the understanding that this was the intention of the IASB when drafting this paragraph. However, this approach would lead to basic EPS which may provide information which is not economically meaningful in all instances. If preference dividends on non-cumulative preference shares are considered for basic EPS purposes on a 'delayed basis' of one year due to dividends being declared on non-cumulative preference shares in the period following the reporting period, basic EPS tend to (1) be overstated for the reporting period and (2) be understated for the period following the reporting period in which the dividends are declared.

**Approach 2 (a):** According to this approach, the basic EPS would calculate as follows:

**Year 1:** (profit of CU 100 minus preference dividend (declared) on non-cumulative preference shares of CU 0)
/ 100 ordinary shares
= **CU +1 EPS**

**Year 2:** (profit of CU 0 minus preference dividend (declared) on non-cumulative preference shares of CU 100)
/ 100 ordinary shares
**= CU -1 EPS**

(b) If, however, the after-tax amount of the preference dividends on non-cumulative preference shares will not be deducted from Year 1's profit or loss in the (reporting) period since no preference dividends were declared, the after-tax amount of the preference dividends on non-cumulative preference shares will also not be deducted from profit or loss in any following reporting period (upon a dividend has been declared, respectively), since the declaration is not being made 'in respect of the period' (in which the profit has been generated).

Reasoning: This approach follows the guidance of IAS 33.14 (a) in a meaning which is meant to read as "declared in respect of the period in which the profit has been generated". Thus, in the reporting period (Year 1) no preference dividends on non-cumulative preference shares are considered since they are not 'declared' in the meaning of IAS 33.14 (a). In the financial statements for the period following the reporting period (i.e. year 2), in which the dividend has been declared, the preference dividends on non-cumulative shares are not deducted from profit or loss since the dividends are not 'declared in respect of the period in which the profit distributable has been generated'. As a result, dividends on non-cumulative preference shares are never deducted from profit or loss in a legal environment, in which the dividends are (normally) declared with a time-lag as explained above. Therefore, the basic EPS on an aggregated level is overstated by the preference dividends on non-cumulative preference shares.

**Approach 2 (b):** According to this approach, the basic EPS would calculate as follows:

**Year 1:** (profit of CU 100 minus preference dividend (declared) on non-cumulative preference shares of CU 0)
/ 100 ordinary shares
= **CU +1 EPS**

**Year 2:** (profit of CU 0 minus preference dividend (declared) on non-cumulative preference shares of CU 0)
/ 100 ordinary shares
**= CU 0 EPS**

**'Participating equity instruments' in the meaning of IAS 33.A13 f.**

With respect to the above issue to appropriately interpret IAS 33.14 (a), some of the application guidance provided in Appendix A to IAS 33 could possibly be supportive. IAS 33.A13 f. deals with 'participating equity instruments and two-class ordinary shares'. According to IAS 33.A14 (a), to calculate basic and diluted earnings per share

> 'profit or loss attributable to ordinary equity holders of the parent entity is adjusted (a profit reduced and a loss increased) by the amount of dividends declared in the period for each class of shares and by the contractual amount of dividends (or interest on participating bonds) that must be paid for the period (for example, unpaid cumulative dividends).'

If the two paragraphs A13 f. of IAS 33 would apply to preference shares in the meaning of IAS 33 as well, the above cited paragraph would support the approach 2 (a) described above since an adjustment would be necessary to reduce a profit or loss by the amount of dividends declared in the period for each class of shares. In contrast to IAS 33.14 (a), which uses the term ‘declared in respect of the period’, in IAS 33.A14 (a) the term ‘declared in the period’ is used, which appears to support the view of approach 2 (a). According to its wording IAS 33.A13 f. seems to apply to preference shares in the meaning of IAS 33 as well.

## II. Current practice: diversity in practice

We have looked through various national annual reports of listed companies and identified significantly divergent practice evenly split over the two approaches 1 and 2 (a). When contacting some national audit firms, we were ensured that internationally approach 2 (b) is used as well.

## III. Reasons for the IFRIC to address the issue:

**a) Is the issue widespread and has it practical relevance?**

Based on the above mentioned investigations and inquiries, it was confirmed that the issue as described in this document is widespread and of practical relevance.

**b) Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?**

As outlined above – there are currently three approaches we are aware of, which lead to fundamentally different calculations of basic earnings per share.

**c) Would financial reporting be improved through elimination of the diversity?**

Financial reporting would greatly be improved by clarifying this issue since EPS is considered to be one of the key performance indicators in financial reporting. An appropriate clarification in the course of the AIP project of the IASB would enhance comparability among companies’ financial reporting.

**d) Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and *Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process?**

We are of the opinion that the issue is sufficiently narrow in order to be addressed in the course of the Annual Improvements Process (AIP) of the IASB.

**e) If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process).**

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## Submitted by:


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