



LETTER OF COMMENT NO. 20

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Matthew L. Schroeder
Managing Director
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December 11, 2008

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Amendment to Statement 128, *Earnings per Share*. File Reference No. 1240-100

Dear Mr. Golden:

Goldman Sachs appreciates the opportunity to comment on the exposure draft that would amend Statement 128, *Earnings per Share*. Our comments are as follows:

- We support the convergence project and the efforts by both the FASB and the IASB to develop a single set of high quality standards that will be accepted globally. The proposed amendments to FASB Statement 128 and IAS 33 eliminate many of the differences in the denominator used in computing EPS under the two frameworks and represent yet another step towards convergence.
- We also support attempts to simplify accounting guidance whenever the benefits of greater transparency are not justified by the level of increased complexity. We appreciate the Boards' attempts to simplify the EPS calculation with respect to instruments measured at fair value with changes in fair value recognized in earnings, and the inclusion of end-of-period values when determining the denominator of diluted EPS under the treasury stock and reverse treasury stock methods.

With respect to instruments classified as liabilities, however, the change may not be consistent with the Board's stated objective for diluted EPS (Issue 1). In paragraph 6 of the proposed amendment, the Board states that the objective of diluted EPS is "to measure the performance of the entity over the reporting period while giving effect to

all dilutive potential common shares outstanding during the period.” In paragraph 7, the Board concludes that with respect to a freestanding instrument measured at fair value each period with changes in fair value recognized in earnings, the effect of that instrument on common shareholders during the period is reflected in the numerator of diluted EPS through the fair value changes recognized in earnings. This conclusion – that the current period change in the liability is the best measurement of the effect that these instruments have on current common shareholders – is a significant change from current practice. In addition, because these instruments are treated alike in both the basic and diluted EPS calculations, the diluted EPS calculation provides no new information.

While we do not have a conceptual objection to this decision and appreciate the simplicity that results from the path the Board has chosen, we believe additional research is needed before finalizing this conclusion. The Board should re-examine more thoroughly, with the input of analysts and user groups, what should be the objective of diluted earnings per share. The results of that research would provide a basis for determining the appropriate approach to calculating diluted EPS for such instruments.

We also note that the Board has an active project to further consider the classification of financial instruments between liabilities and equity. The outcome of this project could result in a greater range of instruments being measured at fair value. This change in EPS methodology is thus introduced in an environment where the potential scope of its application is unknown.

Finally, if the Board were to change its intended treatment in the calculation of diluted EPS of instruments classified as liabilities with changes flowing through income, it would have to change the way these instruments are treated under the treasury stock method. As the Board points out in paragraph B10 of the exposure draft, the proposed treatment of the end-of-period carrying value of the liability as assumed proceeds under the treasury stock method results in no effect on diluted EPS if equity instruments equal to the end-of-period carrying value of the liability are used to settle the liability.

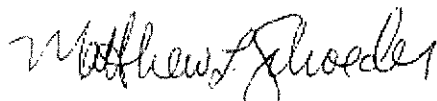
- We agree that in computing diluted EPS, entities should not reduce net income by an assumed amount of additional dividends that would have been declared had potential common shares or potential participating securities been outstanding. We agree that companies may very likely reach different decisions with respect to the per-share amount of dividends declared if dividends were distributed to all potential common shares or participating securities (Issue 2).
- We agree with the Board’s conclusion that additional disclosures related to EPS are not warranted (Issue 3).
- The inclusion of the computational guidance on computing diluted EPS under the two-class method – previously only included in an FSP that was never issued - is very helpful.

- As FAS 128 applies only to publicly-traded companies, we believe it would be helpful to incorporate the SEC’s guidance on accounting for increasing rate preferred stock (SAB Topic 5Q) in the discussion of the treatment of preferred stock dividends in paragraph 9. This guidance is included in IAS 33 (paragraph A4 under the proposal). We understand, however, that the Board intends to incorporate applicable SEC guidance in its Codification.
- The table of contents for Appendix C erroneously labeled Illustration 8 as “Application of the Treasury Stock Method for Stock Appreciation Rights and Other Variable Stock Option Award Plans.” The example provided in Illustration 8, however, (paragraphs 157-159) only contains vanilla options. The proposed amendment does not include a corrected table of contents listing for this example.

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Thank you for the opportunity to provide our views. We have also attached a copy of our comments on the IASB’s proposed amendments to IAS 33, *Simplifying Earnings per Share*, for your convenience. If you have any questions or comments regarding our letters, please do not hesitate to contact me.

Sincerely,



Matthew L. Schroeder

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Matthew L. Schroeder
Managing Director
Global Head of Accounting Policy



December 11, 2008

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Re: Exposure Draft Simplifying Earnings per Share (Proposed Amendments to IAS 33)

Dear Sirs:

Goldman Sachs appreciates the opportunity to comment on the exposure draft that would amend IAS 33, *Earnings per Share*.

We support the convergence project and the efforts by both the FASB and the IASB to develop a single set of high quality standards that will be accepted globally. The proposed amendments to IAS 33 and FASB Statement 128, *Earnings per Share* eliminate many of the differences in the denominator used in computing EPS under the two frameworks and represent another step towards convergence.

We also support attempts to simplify accounting guidance whenever the benefits of greater transparency are not justified by the level of increased complexity. We appreciate the Boards' attempts to simplify the EPS calculation with respect to instruments measured at fair value with changes in fair value recognized in earnings, and the inclusion of end-of-period values when determining the denominator of diluted EPS under the treasury stock and reverse treasury stock methods.

However, we note that as a result of the proposals for instruments measured at fair value, only the current period change in fair value will be reflected in EPS calculations. This approach is a significant change from current practice. In addition, because these instruments are treated alike in both the basic and diluted EPS calculations, the diluted EPS calculation provides no new information.


While we do not have a conceptual objection to this decision and appreciate the simplicity that results from the path the Board has chosen, we question whether the objective of diluted EPS should be further explored in conjunction with analysts and users before finalizing this conclusion.

We also note that the Board has an active project to further consider the classification of financial instruments between liabilities and equity. The outcome of this project could result in a greater range of instruments being measured at fair value. This change in EPS methodology is thus introduced in an environment where the potential scope of its application is unknown.

* * * * *

We have provided our responses to specific matters raised in the exposure draft as an Appendix to this letter. We have also attached a copy of our comments on the FASB's proposed amendments to Statement 128 for your convenience. If you have any questions, or comments regarding this letter please do not hesitate to contact me or Sue Lloyd, Managing Director on 020 7774 9438.

Sincerely,

A handwritten signature in cursive script that reads "Matthew L. Schroeder".

Matthew L. Schroeder

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 instruments that give their holder the right to share currently in profit or loss for the period should be included in the weighted average number of ordinary shares for basic EPS. We believe that it is consistent with the objective of basic earnings per share (as set out in IAS 33.10) to include in the denominator only those instruments that presently entitle holders to share in profit or loss in the period.

However, we understand there is uncertainty about how to determine which instruments are considered to have a basic EPS effect. In particular, what is meant by instruments currently issuable for little or no cash or consideration? If a holder sacrifices a bond to get shares, is this consideration?

Currently IAS 33 specifically states how mandatorily convertible instruments are included in the calculation of basic EPS. The exposure draft proposes deleting this paragraph and in its place puts emphasis on the inclusion of participating instruments and instruments currently issuable for little or no cash or other consideration. However, it is not clear whether mandatory convertible instruments that are both presently convertible by the holder and non-participating, are considered in basic EPS.

The exposure draft puts emphasis on instruments that without further action give their holder an entitlement to share in profits. It is less clear what characteristics (beyond very low exercise prices) result in other instruments being included. For example, are presently convertible non-participating mandatory convertible instruments intended to be included – or does the need to convert preclude inclusion? If such instruments are included, would a presently convertible, non-participating convertible bond be included – and if so, does it matter whether the conversion option is in the money? (We note in respect of the latter instrument, that this would be a material change to the scope of instruments that increase the numerator of basic EPS calculations). It would be helpful to clarify the concept of the ‘right’ to profit or loss as instruments of this type are not currently included in either paragraphs 19 or A8.

From a drafting perspective we also query whether the words ‘non-participating’ should be included in sub-paragraphs (c) and (d) of paragraph A8 without further clarification. This drafting may imply that the ordinary shares issued as the result of a conversion of a participating instrument or in lieu of the interest or principal on a participating instrument are *not* included in basic EPS. Our understanding is that if the instrument were instead participating, then that instrument itself would have been included in basic EPS. Whether the instrument were participating or non-participating, the ordinary shares subsequently issued should be included in basic EPS. It may be useful to clarify this.

Paragraph 18 may also cause confusion from a drafting perspective. The instruments set out in (b) and (c) are not strictly speaking considered to determine the weighted average number of ordinary shares for the basic EPS calculation. Rather these instruments are included in the allocation of profit or loss in order to then calculate basic EPS. Rewording the paragraph to say ‘In calculating basic earnings per share an entity shall consider.....’ may reduce the risk of such confusion.

In addition, we query whether paragraph 19 should also include within its scope other participating instruments currently issuable for little or no cash or other consideration that are not measured at fair value (for example, a gross physically settled call over equity classified preference shares with a participating dividend feature). It would seem that for the same reason such ordinary shares are considered in calculating basic EPS, participating instruments should be considered in calculating basic EPS using the two-class method.

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 agree with these proposals in the Exposure Draft. These changes would have the benefit of aligning the EPS treatment of obligations to repurchase own shares with the accounting for such obligations and would also result in convergence of the EPS treatment for those contracts accounted for in the same way under IFRS and US GAAP (i.e. fixed share forwards). We also agree that the proposal should apply to mandatorily

redeemable ordinary shares in order to align EPS with the accounting treatment of those instruments.

However, in respect of the drafting of these provisions we make the following observations:

- Ordinary shares subject to a written put or forward repurchase contract will still be outstanding as a matter of law and, irrespective of whether the dividend is remitted as part of the contractual arrangements, they are entitled to dividends along with all other ordinary shares. We thus query whether such an instrument, which is an outstanding ordinary share as a matter of law, can satisfy the definition of ‘an instrument that gives its holder the right to participate in dividends with ordinary shares according to a predetermined formula.’ The ordinary shares subject to the relevant contract are, prima facie, ordinary shares. They cannot participate with ordinary shares because they receive ordinary dividends rather than a formulaic return based on the dividend.
- We find paragraphs A31 and A32 confusing and would suggest that something along the following lines may be simpler to follow (suggested changes underlined):

A31 An entity treats ordinary shares that are subject to a contract to repurchase them in exchange for cash or other financial assets (for example, gross physically written put options or forward purchase contracts) as if it had already repurchased or redeemed those shares. Therefore, in all cases the entity excludes those shares from the denominator of the basic and diluted earnings per share calculations.

A32 Consistent with the ‘two-class’ method set out in paragraphs A23-A24, any amounts including dividends and participation rights in undistributed profit or loss attributable to the shares that have not been recognised in calculating profit or loss shall be deducted in determining earnings available to ordinary shareholders. However, if the dividends on such shares (or its equivalent) are remitted back to the entity, the ‘two class’ method is not applied.

- As the concepts introduced by this paragraph are new to users of IFRS it would be useful to supplement these paragraphs with an example illustrating the methodology where there is a forward purchase contract over own shares both with and without the remittance of dividends.
- The treatment of mandatorily redeemable ordinary shares is mentioned in the Basis for Conclusions (BC16) but it is not specifically referred to in the body of the exposure draft. In contrast, the equivalent instruments are specifically referred to in FAS 150. To avoid confusion it would be worthwhile to make a specific reference to such instruments.

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?

Generally speaking, we support attempts to simplify the accounting guidance whenever the benefits of greater transparency are not justified by the level of increased complexity. The proposed modification has the advantage of simplifying and clarifying the EPS calculation. Currently under IAS 33 it is arguably unclear whether or not the earnings line should be adjusted to reverse the profit or loss impact of remeasuring such instruments.¹

We note however that this modification introduces quite a significant change to the current approach to diluted EPS. Given this, we question whether it would have been appropriate to re-examine more thoroughly with the input of analysts and user groups, what the appropriate objective of diluted earnings per share should be, as a basis for determining the appropriate approach to calculating diluted EPS for such instruments.

The proposed modification is significant for the following reason. The new approach only provides a measure of the *current period* impact of instruments measured through profit or loss. An instrument could be significantly in-the-money overall but in the current period have a neutral or even a positive impact on profit or loss. By simply including unadjusted profit or loss in the earnings line and making no further adjustments, EPS will not recognise the overall ‘cost’ of the derivative to existing ordinary shareholders. This contrasts with the ‘treasury stock method’ applied to a derivative that attempts to measure the full dilutive impact of the instrument. The proposed change in method also means that the basic EPS and diluted EPS impact of instruments measured at fair value is identical and thus by implication the diluted EPS information gives no new information.

We also note that the IASB has an active project considering the appropriate classification of liabilities and equity. The outcome of this project could result in a greater range of instruments being measured at fair value. This change in methodology is

¹ This is because IAS 33. (c) requires that the changes in Profit or Loss that would arise from the conversion of dilutive potential ordinary shares be removed from the numerator. Therefore, in determining diluted EPS for derivatives (standalone or embedded) that are marked-to-market, the current period impact on Profit or Loss needs to be removed from Profit or Loss whether the ‘if converted’ (due to IAS 33.49) or ‘TSM’ methods are applied.

thus introduced in an environment where the potential scope of its application is unknown.

From a drafting perspective, references are made to instruments included within the scope of this change as ‘derivative components of compound instruments’. Pursuant to IAS 32 *Financial Instruments: Presentation* a ‘compound instrument’ is one that contains an equity component that is thus not marked-to-market. Thus a compound instrument as defined in IAS 32 could never be within the scope of the proposed fair value amendment. To avoid confusion it may be better to use the term ‘hybrid instrument’ rather than ‘compound instrument’.

Paragraph A34 is intended to set out the accounting for instruments that are not measured at fair value through profit or loss. Instruments convertible into shares in a joint venture or associate will always be treated as derivatives for the purposes of IAS 39 – accordingly references to such entities should be deleted from this paragraph. Additionally, instruments convertible into ordinary shares of a subsidiary may be measured at fair value through profit or loss (if there were for example settlement alternatives) so this paragraph should exclude those instruments measured at fair value through profit or loss.

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 should be assumed to be settled in the same way as options, warrants and their equivalents. Their settlement (absent default) is actually certain unlike options or warrants so arguably their case for inclusion is even stronger. In practice our experience is that forward sale contracts are already been treated this way for EPS purposes in any event so this is simply a (useful) clarification.

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 agree that in computing diluted EPS, entities should not reduce net income by an assumed amount of additional dividends that would have been declared had potential common shares or potential participating securities been outstanding. We agree that companies may very likely reach different decisions with respect to the per-share amount of dividends declared if dividends were distributed to all potential common shares or participating securities

We agree with the amendment to extend the scope of guidance for participating instruments to include liability classified instruments. The nature of the instrument rather than its classification should determine its EPS treatment.

Additional comments

Basis for Conclusions – paragraph BC8

In paragraph BC8, the Board lists "interpretive guidance in US GAAP that goes beyond the level of detail in IAS 33." We are not clear as to whether the Board's statement is meant to acknowledge this literature as authoritative or merely acceptable application guidance. This intent should be clarified. Furthermore, whether authoritative or acceptable, we believe the Board should include the interpretive guidance in its standard, as it is inefficient to compel users to search for guidance issued by another standard setter in preparing financial statements under IFRS.

The US GAAP guidance that the Board refers to in BC 8 includes the conclusion that entities should include unvested share-based payments that are participating in its EPS calculations using the two-class method (FSP EITF 03-6-1), and calculation guidance that illustrates how entities should handle dividends paid on shares that are not expected to vest (charged to compensation expense). We believe this guidance is helpful, and important as IFRS 2 does not specify how entities should handle these dividends.

Paragraph 47

In order to apply the 'treasury stock method' as set out in paragraph 47 it is necessary to consider the number of shares that would have been issued based on the market price with the number of shares issued pursuant to the instrument. The additional shares issued under the instrument are included in the denominator of the diluted earnings per share calculation. The shares issued at market are thus not actually ignored – they are a factor

in the calculation. This may be clearer if the last sentence of sub paragraph (a) were replaced with the following:

‘These shares are not added to the denominator in calculating diluted earnings per share.’

Convertible instruments – paragraph 51

Paragraph 51 of the exposure draft is intended to address the basic earnings per share calculation of instruments to which the ‘if converted method’ applies. So the primary scope of this paragraph is convertible bonds that are compound instruments under IAS 32. Stand alone derivatives are addressed in paragraphs 44-50. Accordingly, the words in brackets should be deleted from paragraph 51.

Shares issued as consideration

In accordance with IAS 32, an instrument that results in the delivery of a variable number of shares (for example, shares to the value of 100 at the date of settlement) is classified as a liability. Such instruments are usually measured by the issuer at amortized cost rather than fair value.

Under IAS 33 as currently drafted, although this instrument results in shares essentially being issued at market at the time of settlement which conceptually should be a non-dilutive transaction, the instrument may have a dilutive impact. The reason for this is that paragraph 49 arguably applies. This requires that diluted earnings per share be calculated for such instrument by:

- adding back the after tax cost of the interest expense to earnings (IAS 33(b)); and
- including the number of shares underlying the instrument in the weighted average number of ordinary shares (IAS 33.36)

Applying this calculation such an instrument can have a dilutive impact despite resulting in the issue of shares at market. The exposure draft does not propose amending this treatment. In contrast, as described in paragraph B10 of the FASB’s exposure draft of amendments to FAS 128, this is proposed to be clarified. We believe that this clarification should also be made to IAS 33.

Contingently issuable shares

The exposure draft proposes amending the definition of a contingently issuable share to exclude the requirement that it be issuable for little or no consideration. As a result, the issue of a contingently issuable share may result both in an earnings affect (due to the receipt of consideration by the issuer) and the issue of new shares. Paragraphs A17-A20 however, only seem to address the numerator affect.

We query whether a ‘treasury stock method’ approach may be required as a result of the proposed amendment to this definition.

Contingently issuable potential ordinary shares would seem to include instruments that will be required to be fair valued (in full or in part), such as an option over a convertible bond. Accordingly, paragraph A21 should exclude from its scope instruments that are fair valued through profit or loss.