

HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation

10

Earnings per share - Financial instruments and other contracts that may be settled in shares

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

References: SSAP 5 *Earnings per share*

ISSUE

1. There are various forms of financial instruments or other contracts that may be settled by a reporting enterprise either by payment of financial assets or by payment in the form of a transfer of ordinary shares of the reporting enterprise to the holder. In some cases, the manner of settlement is chosen by the issuer of the financial instrument and in other cases the manner of settlement is chosen by the holder of the financial instrument. An example of this type of instrument is a contractual obligation of the reporting enterprise that may be settled by payment of cash or the issuance of ordinary shares of the reporting enterprise.
2. The issue is whether financial instruments or other contracts that may be settled by payment of financial assets or issuance of ordinary shares of the reporting enterprise, at the option of the issuer or the holder, are potential ordinary shares under SSAP 5.
3. This Interpretation addresses contracts which specify such alternative settlement methods in their terms.

CONCLUSION

4. All financial instruments or other contracts which may result in the issuance of ordinary shares of the reporting enterprise to the holder of the financial instrument or other contract, at the option of the issuer or the holder, are potential ordinary shares of the reporting enterprise.

BASIS FOR CONCLUSION

5. SSAP 5 paragraph 6 states that a potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares. In accordance with SSAP 5 paragraph 23, if a potential ordinary share is dilutive (that is, its conversion to ordinary shares would decrease net profit per share from continuing ordinary operations) then its dilutive effect is included in calculating diluted earnings per share. SSAP 5 provides guidance for determining whether a potential ordinary share is dilutive, and if it is dilutive, calculating its dilutive effect.

6. The words "may entitle" in the definition of a potential ordinary share imply that if it is possible that the holder will receive ordinary shares, regardless of whether it is the holder's choice or the issuer's choice, the contract is considered to be a potential ordinary share. An intended manner of settlement, or policy or past pattern of choosing a particular settlement method, does not overcome the possibility that the holder may be entitled to receive ordinary shares under the terms of the financial instrument or other contract. This is consistent with SSAP 5 paragraph 32, which requires an enterprise to assume the exercise of dilutive options and other dilutive potential ordinary shares.
7. While all liabilities could potentially be settled in shares by future agreement of the parties, the scope of this Interpretation does not extend beyond contracts that specify alternative settlement methods in their terms.

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