

## IAS 33 - QUESTION

Q.1 The profit after tax earned by AAZ Limited during the year ended December 31, 2007 amounted to \$ 127.83 million. The weighted average number of shares outstanding during the year was 85.22 million.

Details of potential ordinary shares as at December 31, 2007 are as follows:

- The company had issued debentures which are convertible into 3 million ordinary shares. The debenture holders can exercise the option on December 31, 2009. If the debentures are not converted into ordinary shares they shall be redeemed on December 31, 2009. The interest on debentures for the year 2007 amounted to \$ 7.5 million.
  - Preference shares issued in 2004 are convertible into 4 million ordinary shares at the option of the preference shareholder. The conversion option is exercisable on December 31, 2010. The dividend paid on preference shares during the year 2007 amounted to \$ 2.45 million.
  - The company has issued options carrying the right to acquire 1.5 million ordinary shares of the company on or after December 31, 2007 at a strike price of \$ 9.90 per share. During the year 2007, the average market price of the shares was \$ 11 per share.
- The company is subject to income tax at the rate of 30%.

**Required:**

- (a) Compute basic and diluted earnings per share.
- (b) Prepare a note for inclusion in the company's financial statements for the year ended December 31, 2007 in accordance with the requirements of International Accounting Standards.

**IAS 33 - SOLUTION**

(a)

<b>Step # 1: Ranking in order of dilution</b>				
	Increase in earnings	Increase in no of ordinary shares	Earnings per incremental shares	RANK
	\$		\$	
<b>Convertible Debentures</b>				
Increase in earnings (\$ 7.5m x 70%)	5,250,000			
Increase in shares		3,000,000	1.75	3
<b>Convertible Preference Shares</b>				
Increase in earnings	2,450,000			
Increase in shares		4,000,000	0.61	2
<b>Options</b>				
Increase in earnings	-			
Increase in shares (1.5m x 1.1 / 11)		150,000	-	1

<b>Step # 2: Testing for dilutive effect</b>				
	Profit from operations attributable to ordinary shareholders	Ordinary shares	EPS	Effect
	\$		\$	
<b>Basic Earnings Per Share</b>	*125,380,000	85,220,000	1.47	-
<b>Options (Rank 1)</b>	-	150,000		
	125,380,000	85,370,000	1.469	Dilutive
<b>Convertible Preference Shares (Rank 2)</b>	2,450,000	4,000,000		
	127,830,000	89,370,000	1.43	Dilutive
<b>Convertible Debentures (Rank 3)</b>	5,250,000	3,000,000		
	133,080,000	92,370,000	1.44	Anti - Dilutive

\*\$ 127,830,000 – \$ 2,450,000 = \$ 125,380,000

(b) AAZ Limited  
Notes to the financial statements  
For the year ended December 31, 2007

**EARNINGS PER SHARE**

	<b>2007</b>
<b>Basic alternative to ordinary share holders</b>	
Profit (\$)	125,380,000
Weighted average number of ordinary shares outstanding during the year	<u>85,220,000</u>
Earnings per share - basic (\$)	<u><b>1.471</b></u>
<b>Diluted</b>	
Profit after taxation (\$)	<u>127,830,000</u>
Weighted average number of ordinary shares, options and convertible preference shares outstanding during the year	<u>89,370,000</u>
Earnings per share - diluted (\$)	<u><b>1.430</b></u>

Because diluted earnings per share is increased when taking the convertible preference shares into account (from \$ 1.430 to \$ 1.44), the convertible debentures are anti-dilutive and are ignored in the calculation of diluted earnings per share.