EARNINGS PER SHARE – AS 20

OBJECTIVE

To prescribe principles for the determination and presentation of EPS which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise

SCOPE

1. Mandatory for all enterprises except for SMCs and SMEs (Level II & III) who may not disclose diluted EPS.
2. In CFS information should be presented on basis of consolidated information.

DEFINITIONS

EQUITY SHARE is a share other than a preference share.

PREFERENCE SHARE is a share carrying preferential rights to dividends and repayment of capital.

FINANCIAL INSTRUMENT is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise.

POTENTIAL EQUITY SHARE is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares.

SHARE WARRANTS or options are financial instruments that give the holder the right to acquire equity shares.

EXAMPLES OF FINANCIAL ASSETS

a) cash ;

b) a contractual right to receive cash or another financial asset from another enterprise;

c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or

d) an equity share of another enterprise.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another enterprise or to exchange financial instruments with another enterprise under conditions that are potentially unfavourable.

EXAMPLES OF POTENTIAL EQUITY SHARES

a) **debt instruments or preference shares, that are convertible** into equity shares;

b) **share warrants**;

c) options including **employee stock option plans** under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans; and

d) shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares), such as the acquisition of a business or other assets, or shares issuable under a loan contract upon default of payment of principal or Interest, if the contract so provides.

PRESENTATION

Basic and diluted earnings per share in p&l (even if amount is negative) for each class of equity shares for all periods presented.

MEASUREMENT

Basic EPS = Net profit or loss after tax ***less*** preference dividend / weighted avg no. of equity shares during the period

Net profit after tax is after deducting prior period item and extraordinary item.

Preference dividend = Dividend on non-cumulative preference shares provided for the period

\+ Dividend on cumulative preference shares for the period whether provided/ not. Prior period dividends not to be included.

Weighted Avg no of = equity shares: (Equity shares as on 1.4.20xx + issued during year – buy back during year) X Time weighting factor

As summarized:

Calculation of Profits/Loss attributable to Equity shareholder

Net Profit/Loss for the period (after adjusting all prior period & extraordinary items)	xxxx
Less: Tax Liability (Current & Deferred Tax)	xxxx
Net Profit attributable to Shareholder's	**xxxx**
Less: Preference share dividend & any attributable tax on Pref. Dividend	xxxx
Net Profit/loss attributable to Equity shareholder's	**xxxx**

Shares are included in the weighted average number of shares from the date consideration for shares are receivable.

1. Equity shares for cash: when cash is receivable
2. Conversion of debt to equity: date of conversion
3. Equity shares in lieu of interest/ principal: date interest ceases to accrue
4. Equity shares in exchange of liability: date liability is settled
5. Equity shares for asset: date of acquisition
6. Equity shares for rendering services: when services are rendered
7. Amalgamation in nature of purchase: date of acquisition
8. Amalgamation in nature of merger: beginning of period
9. Partly paid equity shares: treated as a fraction of an equity share relative to a fully paid equity share
10. Shares with different nominal value: converting all shares to equivalent shares of same nominal value.

EVENTS WHICH CHANGE THE NUMBER OF SHARES WITHOUT CHANGE IN RESOURCES

a) Bonus issue
b) Bonus element in rights issue
c) Share split
d) Consolidation of shares (reverse share split)

BONUS ISSUE: Eg: bonus issue of 2 shares for every 1 share held

Shares before issue X 3 = total no. of shares
Shares before issue X 2 = additional shares
In bonus issue Adjusted EPS is calculated for prior periods as if the issue had occurred in the beginning of those periods.

RIGHTS ISSUE: Exercise price < FV of shares (hence a bonus element present)

Step 1: Theoretical ex right FV per share	(A + B)/ (C+D) A= **FV of all shares** o/s before exercise of rights B= **Amount received** from exercise of rights C= no. of shares o/s **before rights** offer D= no of shares issued in **exercise of rights**
Adjustment Factor	<u>FV per share before Rights</u> Theoretical ex right FV per share
EPS for current reporting period	<u>Net profit for equity shareholders</u> (shares o/s before rights x adjustment factor x time weight factor) + (shares after rights issue x time weight factor)

Restate EPS for previous period

Net profit of previous period
(No. of shares o/s before rights offer x adjustment factor)

DILUTED EPS

In calculating diluted EPS effect is given to all dilutive potential equity shares o/s during that period.

Adjustments to Net Profit

Net Profit For The Period

Add: **Dividend** recognized in the period for dilutive potential equity shares

Add: **Interest less tax** recognized in the period for dilutive potential equity shares

Add: **after tax amount of any other change in expenses**/ income due to conversion of dilutive potential equity shares

Share application money pending allotment or advance share application money is treated as dilutive potential equity shares.

WEIGHTED AVERAGE NO. OF EQUITY SHARES

For Diluted EPS weighted average no. of equity shares o/s during the period is increased by weighted average no. of additional equity shares which would have been o/s assuming conversion of all dilutive potential equity shares.

DILUTED EPS = Net profit for equity shareholders (After adjustment of diluted earnings)
Weighted avg equity shares o/s during the period (assuming all dilutive potential equity shares are converted)

DILUTED EARNINGS

Net profit after tax for equity shareholders

Add: dividend on convertible equity shares

Add: Interest net of tax on convertible debentures

Net profit available for diluted EPS

<u>As summarized</u>

<u>Diluted Earnings</u>

Net Profit/loss attributable to Equity shareholder's (as calculated in slide no. 8)	<u>xxxx</u>
Add: Payments that are not required to be made because of such conversion (eg. dividend on convertible pref. share or interest on convertible debt)	<u>xxxx</u>
Less: Payments that are required to be made because of such conversion (e.g expenses on conversion)	<u>xxxx</u>
Diluted Earnings	<u>xxxx</u>

<u>SHARE OPTIONS</u>

It is assumed that all dilutive Options and dilutive Potential Equity Shares have been exercised.

Fair Value= Avg price of the equity shares during the period.

Options are dilutive if Issue price < Fair Value

Hence Options contract consists of

a) Certain no. of shares issued at FV
b) Remaining no. of shares issued for NIL consideration

Issue of shares at NIL consideration =No. of shares issuable under the Option *less* Equivalent no of shares that would have been issued at FV.

Example - Effects of Share Options on Diluted Earnings Per Share
(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the year 20X1	Rs. 12,00,000
Weighted average number of equity shares outstanding during the year 20X1	5,00,000 shares
Average fair value of one equity share during the year 20X1	Rs. 20.00
Weighted average number of shares under option during the year 20X1	1,00,000 shares
Exercise price for shares under option during the year 20X1	Rs. 15.00

Computation of earnings per share

	Earnings	*Shares*	*Earnings per share*
Net profit for the year 20X1	Rs. 12,00,000		
Weighted average number of shares outstanding during year 20X1		5,00,000	
Basic earnings per share			Rs. 2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/20.00	*	(75,000)	
Diluted earnings per share	Rs. 12,00,000	5,25,000	Rs. 2.29

**The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration {see para 37(b)}*

Example - Convertible Debentures
(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the current year	Rs. 1,00,00,000
No. of equity shares outstanding	50,00,000
Basic earnings per share	Rs. 2.00
No. of 12% convertible debentures of Rs. 100 each Each debenture is convertible into 10 equity shares	1,00,000
Interest expense for the current year	Rs. 12,00,000
Tax relating to interest expense (30%)	Rs. 3,60,000
Adjusted net profit for the current year	Rs. (1,00,00,000 + 12,00,000 - 3,60,000) = Rs. 1,08,40,000
No. of equity shares resulting from conversion of debentures	10,00,000
No. of equity shares used to compute diluted earnings per share	50,00,000 + 10,00,000 = 60,00,000
Diluted earnings per share	1,08,40,000/60,00,000 = Re. 1.81

<u>Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.</u>

<u>The effect of anti-dilutive potential equity shares is ignored in calculating diluted EPS.</u>

Order in which potential equity shares are considered

They are ranked in order of dilutive effect from the most dilutive to least dilutive.
Dilutive effect = Increase in equity shares earnings due to conversion/Increase in shares

Example - Determining the Order in Which to Include Dilutive Securities in the Computation of Weighted Average Number of Shares
(Accounting year 01-01-20XX to 31-12-20XX)

Earnings, i.e., Net profit attributable to equity shareholders	Rs. 1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	Rs. 75.00
Potential Equity Shares	
Options	1,00,000 with exercise price of Rs. 60
Convertible Preference Shares	8,00,000 shares entitled to a cumulative dividend of Rs. 8 per share. Each preference share is convertible into 2 equity shares.
Attributable tax, e.g., corporate dividend tax	10%
12% Convertible Debentures of Rs. 100 each	Nominal amount Rs. 10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

Computation of Diluted Earnings Per Share

	Net Profit Attributable (Rs.)	*No. of Equity Shares*	*Net profit attributable Per Share (Rs.)*	
As reported	1,00,00,000	20,00,000	5.00	
Options		20,000		
	1,00,00,000	20,20,000	4.95	Dilutive
12% Convertible Debentures	84,00,000	40,00,000		
	1,84,00,000	60,20,000	3.06	Dilutive
Convertible Preference Shares	70,40,000	16,00,000		
	2,54,40,000	76,20,000	3.34	Anti-Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (from Rs. 3.06 to Rs 3.34), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share is Rs. 3.06.

Increase in Earnings Attributable to Equity Shareholders on Conversion of Potential Equity Shares

	Increase in Earnings	*Increase in no. of Equity Shares*	*Earnings per Incremental Share*
Options			
Increase in earnings	Nil		
No. of incremental shares issued for no consideration {1,00,000 x (75 - 60) / 75}		20,000	Nil
Convertible Preference Shares			
Increase in net profit attributable to equity shareholders as adjusted by attributable tax [(Rs.8 x 8,00,000)+ 10%(8 x 8,00,000)]	Rs. 70,40,000		
No. of incremental shares {2 x 8,00,000}		16,00,000	Rs. 4.40
12% Convertible Debentures			
Increase in net profit {Rs. 10,00,00,000 x 0.12 x (1 - 0.30)}	Rs. 84,00,000		
No. of incremental shares {10,00,000 x 4}		40,00,000	Rs. 2.10

It may be noted from the above that options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (see para 42).

Potential equity shares are **weighted for the period they were outstanding**. Potential equity shares that were cancelled or allowed to lapse during the reporting period are **included in the computation of diluted earnings per share only for the portion of the period during which they were outstanding**. Potential equity shares that have been converted into equity shares during the reporting period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion. From the date of conversion, the resulting equity shares are included in computing both basic and diluted earnings per share.

RE-STATEMENT

If the number of equity shares or potential equity shares outstanding is increased as a result of bonus issue, share split, consolidation of shares, the calculation of basic and diluted equity per share should be adjusted for current period and previous periods.

DISCLOSURE

a) the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

b) the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

c) the nominal value of shares along with the earnings per share figures.

EXAMPLES: from ICAI compendium on Accounting Standards—(see below)

Example - Bonus Issue

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the year 20X0	Rs. 18,00,000
Net profit for the year 20X1	Rs. 60,00,000
No. of equity shares outstanding until 30th September 20X1	20,00,000
Bonus issue 1st October 20X1	2 equity shares for each equity share outstanding at 30th September, 20X1 20,00,000 x 2 = 40,00,000
Earnings per share for the year 20X1	$\frac{\text{Rs. } 60,00,000}{(20,00,000 + 40,00,000)}$ = Re. 1.00
Adjusted earnings per share for the year 20X0	$\frac{\text{Rs. } 18,00,000}{(20,00,000 + 40,00,000)}$ = Re. 0.30
Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X0, the earliest period reported.	

Example - Rights Issue

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit	Year 20X0 : Rs. 11,00,000 Year 20X1 : Rs. 15,00,000
No. of shares outstanding prior to rights issue	5,00,000 shares
Rights issue	One new share for each five outstanding (i.e. 1,00,000 new shares) Rights issue price : Rs. 15.00 Last date to exercise rights: 1st March 20X1
Fair value of one equity share immediately prior to exercise of rights on 1st March 20X1	Rs. 21.00

Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{number of shares issued in the exercise}}$$

$$\frac{(\text{Rs. } 21.00 \times 5,00,000 \text{ shares}) + (\text{Rs. } 15.00 \times 1,00,000 \text{ shares})}{5,00,000 \text{ shares} + 1,00,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = Rs. 20.00

Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} \quad \frac{\text{Rs. } (21.00)}{\text{Rs. } (20.00)} = 1.05$$

Computation of earnings per share

	Year 20X0	Year 20X1
EPS for the year 20X0 as originally reported: Rs.11,00,000/5,00,000 shares	Rs. 2.20	
EPS for the year 20X0 restated for rights issue: Rs.11,00,000/ (5,00,000 shares x 1.05)	Rs. 2.10	
EPS for the year 20X1 including effects of rights issue $\frac{\text{Rs. } 15,00,000}{(5,00,000 \times 1.05 \times 2/12) + (6,00,000 \times 10/12)}$		Rs. 2.55

Courtesy: ICAI Study Materials and Compendium of Accounting Standards.

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