AS20: EARNINGS PER SHARE (EPS)

Hello students, you will be studying AS20 Earnings Per Share in this module 18, as part of the Unit 2 Accounting Pronouncements.

In this unit you will be studying the objective, scope of the standard, definition of terms, measurement criteria, restatement, and disclosure.He will also have an illustration on how to calculate the weighted average number of shares.

After studying this chapter,you will be able to compute the Earnings Per Share.

OBJECTIVES OF THE STANDARD

This standard prescribes the principles for the determination and presentation of the Earnings Per Share. This helps you to improve the comparison of performance between different enterprises during a particular period of time or between 2 firms.

The focus of this standard is on the denominator of the calculation of EPS.

SCOPE OF THE STANDARD

- This standard should be applied by all entities. Small and medium-sizeD companies and medium sized non corporate entities falling in level one or level 2 need not disclose the Diluted Earnings Per Share.
- If a company is a holding company or a parent company, the EPS should be calculated for the parent company as well as for the subsidiary company. So you need to calculate EPS on the consolidated financial statements as well as the individual financial statements of the parent company.

IMPORTANT DEFINITIONS

EQUITY SHARE OR SHARE

A share that is not a preference share is called an equity share.

PREFERENCE SHARE

A share that carries preferential right over the payment of dividend and the repayment of capital.

FINANCIAL INSTRUMENT

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

POTENTIAL EQUITY SHARES

These are financial instruments or contracts that may entitle or entitle a holder to equity shares, for example, convertible preference shares and convertible debentures are examples of potential equity shares.

SHARE WARRANTS OR OPTIONS

These are financial instruments that give the holder the right to acquire shares. Financial asset is any asset that may be cash. It may also be a contractual right, received in cash or any other financial asset from an enterprise, a contractual right to exchange financial instruments with another enterprise, or it can be the equity shares of another enterprise.

MEASUREMENT OF EARNINGS PER SHARE

Now there are two ways that we measure earnings per share. The first method is called the Basic Earnings Per Share and the second one is called the Diluted Earnings Per Share.

In the first method of measurement of the Basic Earnings Per Share, we take the net profit or the net loss attributable to equity shareholders and we divide it by the weighted average number of equity shares outstanding during the period.

What is the net attributable profit or what is the net profit attributable to the shareholders? So in other words, what is the numerator of this formula? So the net profit attributable to the equity shareholders is nothing but the net profit or loss for the period minus preference dividend minus any tax on preference dividend.

What will be the weighted number of equity shares?

The weighted number of equity shares is calculated using these three steps, the first step is to calculate the number of shares outstanding at the end. So we take the number of shares outstanding at the beginning we add the number of shares issued during the period and we minus the shares that have been brought back during the period. This is our first part of the calculation.

The next part of the calculation is to calculate something called the time weighting factor. The time weighting factor is the number of days or the number of months, the shares are outstanding till the end of the financial period divided by the number of days or the number of months during the financial period. So if you're taking months in the numerator, you have to take months in the denominator. And see you will calculate the weighted number of equity shares. That is a * B.

Let us have a look at this illustration. Now on 1st of April 2019, the balance at the beginning of the year was 2000 shares. Now. On 31st of August 2019, you issued 500 shares for cash, and now your balance is 2500. On the 1st of February 2020, you bought back shares of Rupees 300. So now your value or your balance outstanding at the end of the year is 2200. You are required to calculate the weighted number of equity shares. So now let us see how we prepare this.

So first we prepare a table having five columns, the date, particulars, balance, number of months till the 31st of March 2020 and the number of equity shares. So the first one is a balance at the beginning of the year 2000. The second time we issued the shares on 31st August, that is 500 and on the1st of Feb we have bought shares of Rupees 300. These three amounts will enter into the balance column. Now from the 1st of April till the 31st of March, you have 12 months. You have 12 months. Now you have to calculate the weighted number of equity shares you will take. 2000 multiplied by 12 / 12 because the total months in the period is 12 and the number of months from first April 2019 to the 31st of March 2020 are 12 months. In the second case,after multiplying, we will get 2000 as the weighted number of equity shares.

In the second case, you have issued shares 500 on the 31st of August 2019, so 500 shares have been issued by you. Now, how many months are there from 31st August 2019 the 31st of March 2020? So we have September, October, November, December, January, February and March. So we have a total of seven months. The number of months during the period are 12. So after you multiply this you will get 292 shares.

The next calculation that we have to make is the buyback of shares. Now these shares have been bought back on the 1st of February 2020, so there are 300shares that you have brought back. These 300 shares. All outstanding for the period from first of Feb to the 31st of March. That is 2 months. The total number of months in the period is 12, so after you multiply this you will get an answer of 50.

So the weighted number of equity shares is 2000 + 292 -- 50. You will get an answer of 2242 shares, so this is the way you calculate the denominator of the basic earnings per share.

The next we have is the diluted earnings per share. Now the diluted earnings per share is nothing but the net profit attributable to the shareholders plus dividend on shares plus interest on debentures and minus any tax expenses.

This is the numerator of the equation. The weighted number or the weighted average number of equity shares that are outstanding are the weighted average number of equity shares outstanding during the period. The same way we have calculated in the previous ride plus any potential equity shares. So suppose in your problem you have convertible preference shares or convertible debentures, then this will be added to your weighted average number of equity shares. So first you will calculate the weighted average number of equity shares as shown here. And in case you have convertible shares or convertible preference shares or convertible debentures, you will add it to this amount. So your numerator or diluted earnings per share is nothing but the diluted earnings divided by the weighted average number of equity shares outstanding.

Now there is something called restatement. Suppose if there is an increase in the potential equity shares or in the equity shares because of a bonus issue or because of a share split, then you have to restate the basic earnings per share and the diluted earnings per share for all the periods that have been presented.

Why do we do this? The reason is because the number of equity shares will increase, so our denominator will change.
If there is a change, or if there is a share issue or a share split after the balance sheet date, that is after say, 31st of March 2000, but before the approval of the Board of directors, then the share calculations of the current period as well as the share calculation of the prior period have to be adjusted.

DISCLOSURES

1. The Basic and Diluted Earnings Per Share should be presented in the profit and loss account for each class of equity shares that have a different right to the share profits of the company.
2. Basic EPS and Diluted EPS should be presented even if the amounts are negative.
3. If there are Extraordinary items in the profit and loss account, then we must disclose the basic and diluted earnings per share. But these extraordinary items do not come in the calculation of basic and diluted earnings per share.The amount used as a numerator, and the reconciliation of the numerator to the net profit of the period must be shown. The Weighted number of equity shares shown in the denominator should also be shown.And the nominal value of shares along with the EPS should also be shown.

These are my references.

Thank you.