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IAS® Standard 33 Earnings Per Share



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CASE STUDY – IAS 33 EARNINGS PER SHARE

Introduction

Earnings per share (EPS) is the most commonly used ratio to evaluate the financial performance of an entity over different periods and compare various entities' financial performance. In IAS 33, two different definitions of EPS, namely basic EPS and diluted EPS, are discussed.

The aim of this case study is to discuss the calculation of basic and diluted EPS and disclosures that should be done in the scope of IAS 33 in financial statements.

The Case Information

Agro-Int Company was founded in 1942 in Türkiye. The Company's main activity is producing and marketing agricultural fertilizers. The Company's mission is to provide the highest benefit to the agricultural sector with sustainable growth. As an extension of this mission, it was decided to establish a new organization in Uzbekistan. After long research, a manager who can speak English, Turkish, and Uzbek languages was hired. The manager lives in Kazakhstan, CEO of the Agro-Int wanted the manager to move to Uzbekistan. The manager received 15,000 share options at CU3 on April 1, 2022.

Agro-Int company's equity was CU1,000,000 on December 31, 2021. And the company had 1,000,000 shares on December 31, 2021. On March 1, 2022 total of 200,000 new bonus share was issued. The company's equity and profit on December 31, 2021, and December 31, 2022, are as follows (all amounts in CU):

Items	31.12.2021	31.12.2022
Equity	1,000,000	1,200,000
Net profit	450,000	550,000

Agro-Int Company has had a contingent share agreement since 2020. According to this agreement, 1% of the net profit will be distributed to the managers as shares in case the net profit exceeds CU500,000.

The entity sold 3,000 convertible bonds on August 1, 2021. A bond can be convertible into 3 ordinary shares. In 2022, CU2,400 was paid for convertible bond interest. Interest that was paid to convertible bond holders in 2021 was 1,000. The corporate tax rate in 2021 and 2022 is 20%.

The company's shares market price can be seen in the following table (all amounts in CU):

Year	Minimum market price	Maximum market price	Average market price
2021	1	3	2
2022	1	5	4

Discussion Questions

1. Please discuss the meaning and importance of basic EPS and diluted EPS for financial statement users.
2. Please calculate basic EPS and diluted EPS of Agro-Int Company for 2021 and 2022.

SOLUTION OF CASE STUDY – IAS 33 EARNINGS PER SHARE

1. Basic EPS expresses how much the company actually earns per share. Whereas diluted EPS enables financial statement users to see the entity's future. The existence of potential ordinary shares of the entity indicates the probability of an increase in the number of shares in the future. The realization of this possibility will lead to a decrease in the partnership rate of those holding the shares in the current period. Diluted earnings per share provide information on how much earnings per share would have been if potential ordinary shares had been converted to ordinary shares.

2.

Basic EPS:

In IAS 33, two different definitions of EPS, namely basic EPS and diluted EPS, are discussed. The profit figure calculated by taking into account the number of outstanding ordinary shares of the entity is called the basic EPS. When a bonus issue is issued, the total resources of the entity do not change, but the total number of shares does change. In this condition, to make it possible to make comparison between periods, earnings per share must be adjusted to the beginning of the earliest period presented, regardless of the actual issue date. When Agro-Int Company's basic EPS for 2021 calculated, the effect of bonus issues that were issued in 2022 should be taken into account.

31.12.2021	31.12.2022
<p>In 2021, the company had CU1,000,000 equity, 1,000,000 share and CU450,000 net profit. In 2022, the company issued 200,000 new bonuses issues. To make a comparison between periods, new bonus shares that were issued in 2022 should be taken into account when the basic EPS of 2021 is calculated.</p> $Basic\ EPS = \frac{450,000}{1,000,000 + 200,000}$ $Basic\ EPS = 0.375$	<p>In 2022, the company had CU1,200,000 equity, 1,200,000 share and CU550,000 net profit.</p> $Basic\ EPS = \frac{550,000}{1,200,000}$ $Basic\ EPS = 0.4583$

Diluted EPS:

Diluted EPS is also calculated by dividing profit or loss attributable to ordinary shares by the number of ordinary shares. But in this calculation, both numerator and denominator should be adjusted by considering the effect of potential ordinary shares. Share options, contingent share agreements, and convertible bonds are potential ordinary shares.

SHARE OPTION: Options issued in the current period are deemed to have been exercised at the beginning of the period.	
31.12.2021	31.12.2022
<p>The manager was given 15,000 share options at CU3 on April 1, 2022. Thus they don't affect the diluted EPS of 2021.</p>	<p>The manager received 15,000 share options at CU3 on April 1, 2022. Thus they should be received into account.</p> <p>Income from the exercise of the options is:</p> $15,000 \times 3 = 45,000$ <p>The number of ordinary shares that can be purchased from the market at the average market price is:</p> $\frac{45,000}{4} = 11,250$ <p>These shares are antidilutive. Shares that have dilutive effects are:</p> $15,000 - 11,250 = 3,750$ <p>These shares can have a dilutive effect and should be taken into account when EPS is calculated. Thus diluted EPS is:</p> $\frac{550,000}{1,200,000 + 3,750} = 0.4569$ <p>These options should be taken into consideration when the diluted EPS is calculated. In order to basic EPS (0.4583) is higher than the diluted EPS (0.4569).</p>
<p>CONTINGENT SHARE AGREEMENT: Contingently issuable ordinary shares are included in the calculation if the condition is met in the current period, even if it is related to future periods. If the contingently issuable ordinary shares agreement is made in the prior period, the contingently ordinary shares are considered to have existed since the beginning of the current period when calculating the current period's diluted earnings per share.</p>	
<p>In 2021, the company's net profit was CU450,000. As the net profit did not exceed CU500,000, the relevant condition was not fulfilled. So contingent share agreement is not taken into account.</p>	<p>In 2022, the company's net profit was CU550,000. As the net profit exceeded CU500,000, the relevant condition was fulfilled. So contingent share agreement should be taken into account.</p> <p>The number of shares to be distributed to the managers is as follows:</p>

	$\frac{550,000 \times 0.01}{4} = 1,375$ <p>Diluted EPS is:</p> $\frac{550,000}{1,203,750 + 1,375} = 0.4564$ <p>When the contingently issuable shares were taken into account, the diluted EPS decreased to 0.4564 from 0.4569. Thus contingently issuable shares should be taken into account when the diluted EPS is calculated.</p>
<p>CONVERTIBLE BONDS: When the number of ordinary shares emerging from the conversion of convertible instruments is calculated, time-weighting factor are considered.</p>	
<p>The entity sold 3,000 convertible bonds on August 1, 2021. In 2021, the company paid CU1,000 in interest to convertible bond holders. The corporate tax rate in 2021 is 20%.</p> <p>The after-tax value of the interest paid for the bonds is:</p> $1,000 \times (1 - 0.20) = 800$ <p>The weighted average number of potential shares is:</p> $3,000 \times 3 \times \frac{5}{12} = 3,750$ <p>Diluted EPS is:</p> $\frac{450,000 + 800}{1,200,000 + 3,750} = 0.3745$ <p>With the issuance of the convertible bonds, the diluted EPS decreased to 0.3745 from 0.375. Thus convertible bonds should be taken into account when the diluted EPS is calculated.</p>	<p>In 2022, the company paid CU2,400 in interest to convertible bond holders. The corporate tax rate in 2022 is 20%.</p> <p>The after-tax value of the interest paid for the bonds is:</p> $2,400 \times (1 - 0.20) = 1,920$ <p>The weighted average number of potential shares is:</p> $3,000 \times 3 \times \frac{12}{12} = 9,000$ <p>Diluted EPS is:</p> $\frac{550,000 + 1,920}{1,205,125 + 9,000} = 0.4566$ <p>When the convertible bonds are taken into account, diluted EPS increases to 0.4566 from 0.4564. Thus convertible bonds should not be taken into account when the diluted EPS is calculated.</p>