

THE 'EPS' OF THE IFRS AS A BENCHMARK OF CORPORATE PERFORMANCE

Agota Kiss, Ildiko Orbán Mrs. Tamás Dékán

University of Debrecen, Faculty of Economics and Business, Institute of Accounting and Finance, Debrecen, Hungary

kiss.agota@econ.unideb.hu

orban.ildiko@econ.unideb.hu

Abstract: *The measurement of the corporate's performance; efficiency and effective use of resources has an increasing role nowadays. In a globalizing and strongly competitive market environment the adequate, up-to-date, reliable and accurate information is inevitable for the companies in order to operate efficiently. Accounting is a part of corporate information system that's primarily objective is to capture the economic changes and to present their effect on the wealth and income of the companies. The performance of companies is interpreted in many ways and there is an extensive literature that discusses performance measurement and depending on the objective and the interested parties there are several methods from simple indicators to the more complicated models. According to the most frequently used definition, performance measurement is the measurement process of the effectiveness and efficiency of activities (Neely et al., 1995). Based on the accounting information of the companies many performance indicators can be shaped that could be useful benchmarks. The companies listed on the stock exchange must put special emphasis on the measurement of their performance and its presentation in the financial statements compared to the non-listed companies as the investor's primary aim is to maximize the returns on their investments. The national level regulations in this area are not unified; hence the comparison of companies is problematic. The listed companies must present their financial statements in accordance to the International Financial Reporting Standards (IFRS). The standard boards realized the lack of comparability as a result of the non-unified performance measurement. Their opinion is that earnings per share (EPS) is a comparable indicator and shows a consistent picture about the earnings of the companies so in 1997 they issued the IAS 33 'Earnings per share' standard. The IAS 33 provides a standardized method to calculate the EPS that is able to inform the investors reliably about their earnings on their shares. In this study our aim is to introduce the theoretical framework of the standard issued by the International Accounting Standards Committee (IASC), the present the calculation methods of the basic and diluted EPS indicators. We will also the practical application of the method by analysing the financial statements of the 30 companies of the Deutscher Aktienindex (DAX). The current study focuses on the method of performance measurement supported by the IASB that alleviates the comparison of companies and not identical with the performance measurement methods used in the discipline of finance.*

Keywords: IFRS, earnings per share, basic and diluted EPS, DAX

JEL classification: M41

1. Introduction

In the last few years a global demand occurred for a commonly accepted and generally applicable international accounting system (Droppa – Becsky-Nagy 2015). The International Accounting Standard Committee (IASC) was formed in 1973 and turned to International Accounting Standard Board (IASB) in 2001. Their aim was to compile the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) (Darabos, 2014). IFRS is a system of rules based on the theoretical framework of

principles and guidelines and its primary objective is to regulate the unified reporting obligation of the companies that are in its scope in order to ensure the comparability of the company's performance (Orban, 2014). With the creation of IAS 33 standard the standards board's purpose was to enhance the comparability of performances via unifying the methods and guidelines that focus on the calculation of the earnings per share. As a result of the regulation of this indicator the comparison of economic entities with each other in the same time period or the same economic entity's performance in different time periods became possible (IAS 33). The application of IAS 33 is compulsory for companies that

- Entities whose ordinary shares or potential ordinary shares are publicly traded
- Entities in the process of listing ordinary shares or potential ordinary shares in public markets (IAS 33).

The standard defines the calculation methods of two types of EPS indicators as we can see it in Figure 1, the basic EPS and the diluted EPS. In cases of both indicators the earnings connected to a common share are described.

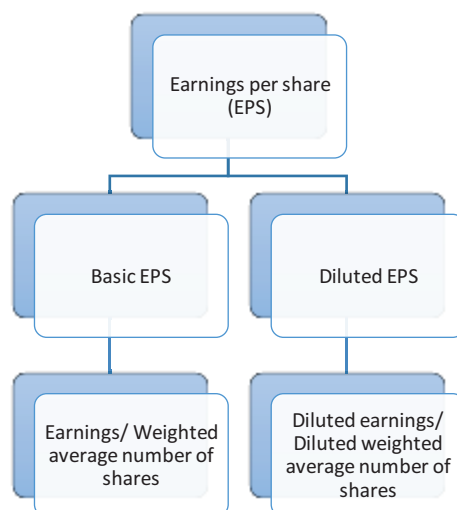


Figure 1: The different types of EPS indicator in IAS 33

Source: Own illustration based on IAS 33

2. Basic EPS

In the calculation of basic EPS the company's net income is divided by the weighted average number of the issued shares. Common shares are equity instruments that are subordinated to the other classes of equity instruments (Lakatos et al., 2013). A deficiency of the basic EPS is that while the easy calculation of common shares increases the transparency and consistency of the indicator, the calculation of the net income is affected by many other standards. The different alternatives offered by the regulation for example the application of different valuation methods can lead to the variability of the indicator.

In the calculation of the EPS we cannot take into account the Other Comprehensive Income (OCI) because the EPS is an indicator that represents the divisible income for the stakeholders of the company. As OCI contains mainly non-realized income categorizes we cannot calculate with it in case of EPS.

Calculation of basic EPS

When we calculate the numerator of Basic EPS than the profit or loss from continuing operations is adjusted for:

- Non-controlling interest's share of profit
- Dividends on preference shares (after tax), differences arising in settlement of preference shares, and other similar effects where preference shares are classified as equity.

In the denominator there is the weighted average number of shares, that is the

- Time weighted average number of shares issued from date consideration receivable
- For additional shares where no consideration received – time weighted average number of shares from beginning of year /date of issue of shares with consideration (e.g. bonus issue)
- Restate comparatives (Lakatos et al., 2013).

3. Diluted EPS

The dilution is the decrease of the profit per share or the increase of the loss per share based on the assumption that there were conversion of convertible instruments, options and warrants were exercised or with special conditions new common shares were issued that diluted the ordinary shares (IAS 33). The diluted EPS calculated with this method represents the least favourable case for the holders of common shares

The possible methods of dilution and the process of calculation:

- *Convertible securities:* The net income must be modified with the after-tax effects of dividends and interest that is connected to common stocks with dilutive potential and for any other changes in income that could be a result of the conversion of the potential common shares. The denominator should include stocks that would be issued on the conversion.
- *Options and warrants:* In the calculation of diluted EPS we must assume the exercise of outstanding dilutive options and warrants. The assumed proceeds from exercise should be regarded as having been used to repurchase ordinary shares at the average market price during the period. The difference between the number of ordinary shares assumed issued on exercise and the number of ordinary shares assumed repurchased shall be treated as an issue of ordinary shares for no consideration.
- *Contingently issuable shares:* Contingently issuable ordinary shares are handled as outstanding and they are being involved in the calculation of basic and diluted EPS as well if the conditions stand. If the conditions have not been met, the number of contingently issuable stocks included in the diluted EPS calculation is based on the number of shares that would be issuable if the end of the period were the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires (IAS 33).

In the analyses of the data of the financial statements of the 30 companies of Deutscher Aktienindex (DAX) we investigated how accurately the financial statements meet the requirements of IAS 33 and how the different cases of dilution appears in their reports.

Table 1: The companies of DAX Index and the appearance of dilution in their EPS

Companies	The appearance of EPS in the Report and reasons of dilution
Adidas AG	basic EPS = diluted EPS
Allianz SE	share-based compensation plans
BASF	basic EPS = diluted EPS
Bayer AG	basic EPS = diluted EPS
BMW AG	deferred shares
Commerzbank AG	basic EPS = diluted EPS
Continental AG	basic EPS = diluted EPS
Daimler AG	stock options
Deutsche Bank AG	deferred shares
Deutsche Boerse AG	basic EPS = diluted EPS
Deutsche Lufthansa AG	basic EPS = diluted EPS
Deutsche Post AG	convertible bonds
Deutsche Postbank AG	basic EPS = diluted EPS
Deutsche Telekom AG	basic EPS = diluted EPS
E.On SE	basic EPS = diluted EPS
Fresenius Medical Care	potentially dilutive shares
Henkel AG	basic EPS = diluted EPS
Hypo Real Estate	information is not available about the value of EPS
Infineon Technologies AG	basic EPS = diluted EPS
Linde AG	share option schemes
MAN SE	basic EPS = diluted EPS
Merck & Co.	basic EPS = diluted EPS
Metro AG	basic EPS = diluted EPS
Munich Re AG	basic EPS = diluted EPS
RWE AG	basic EPS = diluted EPS
SAP AG	potentially dilutive shares
Siemens AG	convertible bonds
ThyssenKrupp	basic EPS = diluted EPS
TUI AG	stock options
Wolkswagen	basic EPS = diluted EPS

Source: Own compilation based on the financial statements of the companies of DAX Index from 2013

Out of the 30 examined companies 29 published their calculated EPS indicator in accordance to the form described by the International Financial Reporting Standards. As we can see in Table 1 in the cases of 19 companies the value of basic EPS was the same with the diluted EPS. These companies did not have potential common shares that conversion could lead to the dilution of their earnings per share indicator. We could observe 10 companies where potential ordinary equity appeared that might have diluting effect. The diluting effect of the convertible securities appeared as a result of the use of convertible bonds in cases of 2 companies, furthermore the potentially convertible shares diluted the value of EPS in 4 companies. In cases of 3 companies the use of stock options was the reason of the dilution. 1 economic entity's diluted EPS was caused by share-based compensation plans.

4. In conclusion

The purpose of the IASB is to create an indicator that is calculated with the same method based on unified guidelines in order to provide a consistent framework of corporate performance measurement that is able to provide comparable information about the companies. Earnings per share (EPS) indicator was chosen by the IASB as a benchmark of corporate performance that is able to evaluate performance without being influenced by the market assessment. Companies that are listed on the stock exchange or in the process of going public are obliged to present the value of this indicator in their reports.

Based on the companies of the DAX 30 Index that shares are publicly traded on the stock exchange we can state that 97% of these companies met the requirements imposed by the International Financial Reporting Standards so we can conclude that the reporting discipline of the companies is positive. The calculation method of the basic and diluted EPS was described in detail in the financial reports of the companies. In cases of 10 companies out of 30 occurred events that led to the issuing of potential common stocks that may have diluting effect on the value of the EPS indicator and could have worsen the value of the earnings per share indicator.

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