Thematic Review:

Earnings per Share (IAS 33)

September 2022

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Earnings per Share (IAS 33)

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1. Executive summary

Introduction

Earnings per share (EPS) – broadly a company's profit or loss divided by the number of its ordinary shares – is a well understood key performance indicator (KPI) but, although the basic calculation appears simple, some aspects of it are not straightforward. When more complex arrangements are involved, applying IAS 33[1] can be challenging.

This complexity is reflected in the findings of the routine reviews of companies' financial statements performed by the Financial Reporting Council's Corporate Reporting Review (CRR) team. These show that some of the main principles of IAS 33 are not always well understood, or applied correctly, even in relatively straightforward circumstances. On several occasions, queries raised by CRR on a company's annual report have resulted in a restatement of the company's reported EPS in the following year.

All listed companies, reporting under IFRSs or UK GAAP (see section 4), are required to report EPS in accordance with IAS 33 in both their annual and interim financial statements, and to include comparatives for all periods presented. The standard does not affect a company's accounting, but EPS is reported in the primary financial statements.

While acknowledging that EPS should never be used in isolation to make judgements on a company's performance, it does have the advantage, unlike any other general purpose KPI, of being defined within accounting standards and being subject to audit. It is an important measure, widely used by investors to compare a company's performance over time and against its peers. Management also often uses EPS internally and externally to assess and describe performance. Consequently, a material error in EPS could have a significant effect on decisions made by users of a company's financial statements.

This report highlights some of the more common errors we have found in both our routine reviews and the work performed for this thematic review. Using case studies and examples, it aims to explain the issues involved and show how companies can improve the reliability of their EPS by complying with the detailed requirements of IAS 33, and providing more helpful disclosures.

Represents opportunities for improvement by companies to move them towards good practice.

Represents an omission of required disclosure or other issue. We want companies to avoid such issues in their reporting of EPS.

Represents a case study which illustrates improvements to reporting and disclosures as a result of engagement with companies as part of our routine reviews.

1 International Accounting Standard (IAS) 33 'Earnings per Share' sets out the calculation, presentation and disclosure requirements for EPS under International Financial Reporting Standards (IFRSs).

1. Executive summary (continued)

Summary of key observations

Our findings highlight a number of areas where there is scope for companies to improve their reporting of EPS:

- The weighted average number of ordinary shares outstanding is key to the calculation of EPS, but IAS 33 does not require specific disclosures to explain how the number has been determined. Sometimes it is not clear from a company's disclosures how the weighted average number of shares relates to the number of shares in issue and potential ordinary shares.
- A company may have made judgements about the substance of a share reorganisation or other arrangement that affects how it is treated in the EPS calculation. It is rarely possible to tell from disclosures when this has been the case.
- Certain requirements of IAS 33 appear to have been overlooked or not well understood by companies.

We believe these points can be addressed by more transparent disclosures, and a greater awareness of what IAS 33 requires.

To help achieve this, we:

- Recommend companies provide further information to explain the basis for the weighted average number of shares, if it is significantly different from information disclosed about issued ordinary shares and potential ordinary shares.
- Expect judgements that have a material effect on EPS to be disclosed in accordance with paragraph 122 of IAS 1 'Presentation of Financial Statements' (or paragraph 8.6 of FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland', for companies reporting under that standard).
- Expect the disclosures provided for adjusted EPS to meet the requirements of the ESMA Guidelines on APMs[2] and to explain the methodology applied in the calculation, including the basis used for tax on adjusting items.

Also, we remind companies that:

- The IAS 33 definition of whether potential ordinary shares are dilutive or antidilutive is based on profit or loss from continuing operations.
- Share reorganisations that involve a bonus element require retrospective adjustment in the weighted average number of ordinary shares used for EPS for all periods presented.
- When preference shares are classified as equity, earnings used for EPS are adjusted for all the effects of those preference shares, including dividends and any premiums arising on redemption.
- A company whose listing was achieved using a reverse acquisition should apply the methodology set out in IFRS 3 'Business Combinations', for calculating the weighted average number of shares for the period of the reverse acquisition and for comparative periods.

2 https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf

2. Scope of the thematic review

Scope

For this thematic review, we have taken account of the findings of our routine desktop reviews performed over the last few years. As all listed companies are required to report EPS, we look at EPS calculations and disclosures in almost every set of accounts we review. We have also performed a limited scope desktop review looking particularly at how EPS was reported in a small selection of 15 annual reports for years ending in 2021. These were taken from a range of different industries and included companies with share transactions or other arrangements that appeared likely to have an effect on EPS. The issues arising were the same in both populations.

This thematic highlights the basic requirements of IAS 33 and those aspects of the standard that we find are more frequently applied incorrectly or tend to cause confusion.

Issues relating to EPS reporting do not feature in the CRR's Top Ten matters of challenge,[3] but they do occur reasonably frequently in the reports we review and are not restricted to companies of any particular size or industry.

Adjusted EPS

Our reviews also looked at the use by companies of non-GAAP EPS measures presented as APMs. We considered particularly the extent to which such measures comply with IAS 33 and the requirements of the Guidelines on Alternative Performance Measures (the Guidelines), issued by The European Securities and Markets Authority (ESMA). [4] We also took into account the recommendations included in our separate thematic review report on APMs, which was published in October 2021.[5]

Matters not covered in this thematic

This thematic summarises briefly the requirements of IAS 33 to provide context for the issues highlighted. It is not intended to cover all aspects of the standard and should not be relied upon as a guide to its detailed requirements.

3 https://www.frc.org.uk/getattachment/8430f391-6f44-4ec3-b1f8-c3d6b00c9a1e/FRC-CRR-Annual-Review_October-2021.pdf
4 https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf
5 https://www.frc.org.uk/getattachment/74ed739d-2237-4d3e-a543-af8ada9b0e42/FRC-Thematic-Review-on-APMs-October-2021.pdf

3. The importance of EPS for investors

There are differing opinions about the usefulness of EPS as a tool for assessing and comparing company performance but, despite this, it remains a widely used metric.

As well as being a KPI in its own right, used to compare a company's performance over time, or to compare its performance against peers or its industry sector, EPS is also a key input into the calculation of a company's price-earnings (P/E) and price-earnings to growth (PEG) ratios. It can also be aggregated to assess the performance of an investment portfolio or used as an input into valuation models.

Reliable EPS information is, therefore, essential to investors. There are, however, limitations inherent in the EPS metric that mean that it should be used with care.

The comparison of a company's basic EPS and diluted EPS can help to highlight the effects of potential future changes in a company's equity structure, particularly when a company has convertible debt. However, the usefulness of this comparison may be reduced as diluted EPS does not reflect how likely it is that conversion rights will be exercised in the future.

A company also has the ability to manage its EPS to some extent by reducing the weighted average number of ordinary shares outstanding through share buy backs or reverse share splits. The effect on earnings of different accounting policies, including those relating to non-GAAP adjustments to earnings, may also restrict the comparability of EPS between companies or different industry sectors.

To help counter these limitations, investors value disclosures that explain the methodology and assumptions used in calculating EPS, particularly when there is a change in the calculation of a previous year's EPS. Disclosures that explain the reasons for differences between basic and diluted EPS are also considered very useful.

Diligent compliance with IAS 33, together with the disclosure enhancements recommended in this thematic, will help companies present investor-relevant, reliable EPS information in their annual and interim reports.

Company remuneration policies frequently use EPS as a target metric. Sometimes that EPS might differ from those reported under IAS 33 or as an APM. Investors need to understand how an EPS metric used in a remuneration policy is calculated and the effect of any changes in it.

Disclosures should make clear whether an EPS metric used in a company's remuneration policy is the same EPS that is reported elsewhere in the annual report. If it is not, the basis for the EPS used for remuneration should be explained, together with any changes in it year-on-year, the reasons for those changes and their effect on remuneration levels.

Finally, some third party data platforms publish multiple EPS measures, which may include adjustments to the numerator or denominator used in the IAS 33 calculation, or use forecast rather than historical earnings. The basis used to calculate these is not always clear. Although they are outside the scope of this report, we believe these metrics would be more helpful if the basis of their calculation was clearly explained.

4. Main principles of IAS 33

Scope

IAS 33 is mandatory for companies whose ordinary shares or potential ordinary shares are either already publicly listed or in the process of being issued to the public. The standard applies both to companies that report under IFRSs and to those that report under the UK GAAP standard FRS 102,[6] which cross-refers to IAS 33 for EPS reporting. Companies within the scope of IAS 33 are required to report EPS in both their annual and interim reports.

EPS is calculated for a company's ordinary shares. IAS 33 requires a company to report EPS calculated on two bases – basic and diluted.

Basic EPS

Basic EPS is calculated by dividing the profit or loss attributable to ordinary equity holders of the parent company (the numerator) by the weighted average number of ordinary shares outstanding for the period (the denominator). 'Outstanding' primarily reflects shares already in issue (excluding shares held by the company itself as treasury shares or their equivalent), but there are circumstances in which it might also include shares that have not yet been issued.

The numerator for basic EPS:

The profit or loss used for basic EPS is after deducting all expenses, including taxes and non-controlling interests, and adjusted to reflect any income or expense recognised for preference shares classified as equity (or their equivalent), including preference dividends.

This is in order to derive the profit or loss that is 'attributable to ordinary equity holders', and to exclude any profits or losses that are attributable to other classes of equity and non-controlling interests.

The aspect of the numerator for which we have seen most application issues is the adjustment to profit or loss for the effect of preference shares classified as equity (see section 5 of this report).

The denominator for basic EPS:

Basic EPS is calculated using the weighted average number of ordinary shares outstanding during the period. The weighted average is calculated by adjusting the number of shares outstanding at the beginning of the period by the number of shares bought back or issued during the period, multiplied by a time-weighting factor to reflect the proportion of the period for which those shares were outstanding.

The weighted average number of ordinary shares is also adjusted retrospectively from the beginning of the earliest period presented for any change in the number of ordinary shares outstanding without a corresponding change in resources. This covers new shares issued for no consideration and reductions in the number of shares without any repayment, and includes any such change that occurs after the end of the reporting period but before the financial statements are authorised for issue. This treatment maintains the comparability of EPS from one period to the next when a capital reorganisation has taken place, and also facilitates the use of EPS for calculating a price-earnings ratio based on a company's current share price following the reorganisation.

6 Financial Reporting Standard 102, 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'

4. Main principles of IAS 33 (continued)

The outstanding number of ordinary shares used for basic EPS generally reflects shares that are currently in issue, but there are a limited number of circumstances in which the number of outstanding shares should also include shares that have not yet been issued. These circumstances include when shares are issuable subject to contingent conditions that have already been met, and shares whose issue is subject only to the passage of time.

Aspects of the denominator that have caused us to raise questions with companies in the past are:

- the calculation of the weighted average number of shares (see section 6);
- share reorganisations requiring retrospective application (section 7); and
- contingently issuable shares and other adjustments (section 8).

Diluted EPS

The calculation of diluted EPS reflects the effects of dilutive potential ordinary shares (POSs).

A POS is a financial instrument or other contract that may entitle its holder to ordinary shares. Examples of POSs include convertible debt, convertible preference shares, share options and warrants, share rights, employee share purchase plans, and contingent share issuance contracts or agreements arising in a business combination.

A POS is dilutive if its conversion to ordinary shares would decrease EPS or increase loss per share from continuing operations.

The numerator used for diluted EPS is the profit or loss used for basic EPS, adjusted for the effects of dilutive POSs. This means that the numerator reflects the profit or loss that would be attributable to ordinary equity holders if all the dilutive POSs were converted to ordinary shares.

Similarly, the denominator is the weighted average number of ordinary shares outstanding used for basic EPS, adjusted for the effect of all dilutive POSs.

The most common issue we have identified in the calculation of diluted EPS is the application of the definition of dilutive and antidilutive (see section 9).

EPS as an Alternative Performance Measure (APM)

The basic and diluted EPS explained above are GAAP measures calculated using profit or loss as defined by IAS 33 and IFRSs more generally. If a company chooses to present an additional 'adjusted' EPS calculated using different profit or loss figures as an APM, IAS 33 includes some specific requirements for its calculation, presentation and disclosure. These include using the weighted average number of shares calculated in accordance with the standard and presenting both basic and diluted EPS amounts, rather than one or other in isolation.

The issue we see most commonly in relation to an adjusted EPS is whether and how IAS 33 should be applied when it is presented only outside the financial statements (see section 10).

4. Main principles of IAS 33 (continued)

Presentation and disclosure

The main presentation requirements of IAS 33 are:

- when a company reports profit or loss for continuing operations and discontinued operations, EPS is presented separately for continuing operations, discontinued operations and the overall result;
- EPS for both continuing operations and the overall result must be presented on the face of the statement of comprehensive income (or separate income statement);
- EPS for discontinued operations can be presented either on the face of the primary statements or in a note to the financial statements; and
- basic and diluted EPS must always be presented together with equal prominence for all periods, including when amounts are negative.

Required disclosures include:

- the amounts used as numerators in EPS calculations and a reconciliation to the equivalent profit or loss reported in the primary financial statements; and
- the denominator used in the EPS calculations, together with a reconciliation between the denominator used for basic EPS and that used for diluted EPS.

We do not often see significant non-compliance with these requirements, although the disclosure of the denominator is frequently raised as an area in which clarity could be improved (see section 6).

Reverse acquisitions

The methodology for calculating EPS for a company that is subject to a reverse acquisition is set out in another accounting standard: IFRS 3 ‘Business Combinations’. These requirements are relevant when a company achieves a listing via a reverse acquisition.

In these cases, the number of shares outstanding prior to the reverse acquisition, including for all prior periods presented, is restated so that the number of shares before and after the acquisition are determined on a consistent basis. These requirements are summarised in section 11.

Materiality considerations

As with all aspects of financial reporting, companies consider materiality when applying IAS 33, both in the approach to calculating EPS amounts and when considering the appropriate level of detail in related disclosures. Where this report identifies opportunities to enhance disclosures, they are intended to apply only when the matter involved is material.

5. The numerator – Profit or loss attributable to ordinary equity holders

The profit or loss used to calculate EPS is the profit or loss attributable to ordinary equity holders of the parent company. For consolidated financial statements, this is the consolidated profit or loss attributable to owners of the parent (i.e. excluding any non-controlling interests). In both cases, this is adjusted for returns on other classes of equity instruments (such as equity-classified preference shares) that have not already been deducted in determining profit or loss.

Basic EPS

IAS 33 explains that the adjustments required to profit or loss for equity-classified preference shares are:

- the after-tax effect of preference dividends;
- differences arising on the settlement of preference shares; and
- any other similar effects of the preference shares.

One company in our selection had adjusted for the coupon on equity preference shares but did not also adjust for the premium on their redemption. Another had not adjusted for dividends on equity preference shares.

We remind companies that adjustments should be made for all effects of equity preference shares or their equivalent, if they will have a material effect on EPS.

Some companies, particularly in the banking and finance sectors, have classes of equity that are equivalent to preference shares but which are given a different label, such as 'management shares' or 'restricted bonds'. Where we have seen this, the companies have appropriately applied the adjustment requirements for preference shares to these instruments.

Diluted EPS

The profit or loss used to calculate diluted EPS is that used for basic EPS, adjusted so that it is consistent with the weighted average number of shares used for the calculation, and reflects what the profit or loss would be if all the dilutive POSs were converted into ordinary shares.

These adjustments may include:

- the reversal of the adjustments made for basic EPS that relate to equity preference shares, to the extent those shares are dilutive;
- the after-tax effect of interest relating to dilutive POSs (for example, interest on convertible debt classified as a liability); and
- the after-tax effect of any other changes in income or expense that would result from the conversion of dilutive POSs.

We did not identify any instances of non-compliance with these requirements in our selection, except for those corresponding to the omissions in the basic EPS calculation noted above.

6. The denominator – Weighted average number of shares

IAS 33 requires the following information to be disclosed about the weighted average number of ordinary shares used for calculating EPS:

- the number used for calculating basic and diluted EPS, together with a reconciliation between those two numbers showing the individual effect of each class of POS; and
- when applicable, the fact that the number used for all periods has been adjusted retrospectively for the effect of a share reorganisation.

One company in our selection did not explicitly state that a share reorganisation had been adjusted retrospectively.

These disclosures provide some useful information, but they do not explain how the weighted average number of shares has been determined. Neither do they necessarily link the weighted average number of shares to information about ordinary shares and POSs disclosed elsewhere in the financial statements.

The weighted average number of shares is effectively a 'black box' at the centre of the EPS calculation. The financial statements usually give some information about shares and POSs that has been fed into the box, and show the answer that comes out, but often give little indication of what has happened inside the box.

Despite this, we were generally able to use information from other parts of the financial statements, together with publicly available share price information and some simplifying assumptions, to assess the reasonableness of the reported values for both basic and diluted EPS.

However, difficulties arose when the calculations had to reflect arrangements such as:

- the company's own ordinary shares held as treasury shares or by an employee benefit trust (example 2 in IAS 33 demonstrates that such shares are not treated as 'outstanding' for the purposes of the weighted average number calculation);
- contingently issuable shares for which all necessary conditions have been satisfied; and
- shares issuable solely after the passage of time.

Contingently issuable shares and shares issuable solely after the passage of time are discussed further in section 8.

Where the weighted average number of shares used in the EPS calculation differs significantly from the number implied by information disclosed about ordinary shares and POSs elsewhere in the financial statements, or where the calculation is complex, readers may benefit from additional disclosures that provide further explanation and enable them to understand the calculation.

7. The denominator – Share reorganisations

The weighted average number of ordinary shares is adjusted retrospectively for all periods presented for any change in the number of ordinary shares outstanding without a corresponding change in resources. This covers new shares issued for no consideration and reductions in the number of shares without any repayment. Adjustments should also be made for any such transactions that occur after the reporting date but before the financial statements are authorised for issue.

Simpler examples of this sort of transaction include:

- a capitalisation or bonus issue;
- a share split; and
- a reverse share split (consolidation of shares).

Some less intuitive examples of transactions that might, or might not, give rise to a retrospective adjustment are explained below and on the following pages.

A bonus element in a rights issue or other issue of shares

A common example of a transaction in which a bonus issue might give rise to a retrospective adjustment to EPS is a rights issue where pre-emption rights exist (i.e. a rights issue in which all existing shareholders could participate).

Where the rights are:

- priced at a discount to fair value; and
- offered to all existing shareholders;

the Application Guidance in paragraph A2 of IAS 33 includes a formula for calculating the bonus factor by which the number of ordinary shares prior to the date of the rights issue is adjusted:

$$\text{Bonus factor} = \frac{\text{Fair value per share immediately before the exercise of rights}}{\text{Theoretical ex-rights fair value per share}^{7}}$$

However, in some cases, significant judgement may be required over whether there is a bonus element that requires retrospective adjustment. For example:

- An issue of shares at a discount to quoted market price to all existing shareholders may not be considered to include a bonus element because the particular facts and circumstances of the transaction indicate that the issue price is fair value.
- An issue of shares at a discount to fair value but which is not fully pre-emptive (e.g. due to legal restrictions on who might participate in the transaction) may still be considered to include a bonus element if, in substance, it has been offered to all existing shareholders.

7 Calculated by adding the aggregate fair value of the shares immediately before the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights are to be publicly traded separately from the shares before the exercise date, fair value is measured at the close of the last day on which the shares are traded together with the rights.

7. The denominator – Share reorganisations (continued)

One company in our selection did not adjust retrospectively for a share reorganisation that appeared to be equivalent to a rights issue at a discount, and did not provide any explanation of why no retrospective adjustment had been made. We have also identified similar issues in several previous routine reviews.

Case study – Bonus element in a non-pre-emptive share issue at a discount

Background

A company had undertaken a share consolidation and issued a significant number of ordinary shares as part of a capital restructuring after its year end but before the financial statements were approved for issue. The company disclosed that it had adjusted the weighted average number of shares retrospectively for the share consolidation, but not for the share issue.

The FRC's approach

We noted from the prospectus for the issue of shares that it included a firm placing of shares at a significant discount to the market price. As this arrangement appeared to include a bonus element, we asked the company to explain why the weighted average number of shares had not been adjusted retrospectively.

The company's response

The company explained that, as the firm placing was not made to all shareholders, and also resulted in an increase in cash resources, it did not consider that it included a bonus element. In support of its approach, the company highlighted the references in IAS 33 to the retrospective treatment of rights issues offered to 'all existing shareholders'.

Conclusion

We considered that this was an instance of directors exercising judgement in applying accounting policies that should have been disclosed under paragraph 122 of IAS 1 'Presentation of Financial Statements'.[8] The company agreed to make such a disclosure in its next annual report.

Where a judgement has been made about whether or not a transaction gave rise to a need for a retrospective restatement, management's considerations in reaching a conclusion should be highlighted and explained.

8 For companies reporting under FRS 102, the equivalent requirement is in paragraph 8.6 of the standard.

7. The denominator – Share reorganisations (continued)

A stock dividend

Stock dividends, also known as scrip or share dividends, are dividends paid to ordinary share holders in the form of additional ordinary shares, rather than in cash. Sometimes they also involve a cash alternative, which might be at a discount to the fair value of the shares being offered. The following table indicates the circumstances in which such a transaction might be considered to include a bonus element that requires retrospective adjustment in the EPS calculation.

Cash alternative to receipt of shares?	Retrospective adjustment?	Commentary
None	Yes, for the total of shares issued	The total share issue is equivalent to a bonus issue that increases the number of shares without a corresponding change in resources.
Cash equal to the fair value of the shares	No	When shares are chosen, the company avoids a cash outflow equivalent to the fair value of the shares. Therefore, the number of shares increases with a corresponding change in resources and there is no bonus element.
Cash lower than the fair value of the shares	Yes, for shares in the bonus element	Shares are issued at a discount to the market price, resulting in a bonus element for the portion of the shares that are effectively issued for no consideration.

The number of shares in the bonus element arising on a stock dividend should be calculated in the same way as it is in a rights issue, using the method set out in paragraph A2 of the Application Guidance in IAS 33 (see page 13).

Shares from a stock dividend that are not required to be adjusted retrospectively are reflected in the weighted average number of shares from the date on which the dividends are reinvested.

A company that had made a scrip dividend at a significant premium to the cash alternative had not reflected any bonus element retrospectively in its EPS calculation, and had not explained why. After we highlighted this to the company, it chose to restate its comparative EPS figures for the effect of the scrip dividend in its next annual report and accounts.

7. The denominator – Share reorganisations (continued)

A share consolidation that is in substance a share repurchase at fair value

A share consolidation is usually a reduction in the number of shares without a corresponding change in resources, and so would require retrospective adjustment in the EPS calculation. However, a share consolidation may be part of an overall arrangement in which the company effectively repurchases shares at fair value. An example of this is a share consolidation accompanied by payment of a special dividend. Such an arrangement would not require retrospective adjustment, as it involves a corresponding change in resources.

Example

On 1 April 2021, a company had 2,500,000 ordinary shares. On 1 December of the same year, it completed the following transactions:

- payment in cash of a special dividend of £1.5m in total, being £0.60 per share to all existing shareholders; and
- a 5:4 share consolidation, reducing the number of outstanding ordinary shares by 500,000 to 2,000,000.

The market price of the company's ordinary shares immediately before the special dividend was £3 per share.

There were no other changes to the capital structure.

For the year ended 31 March 2022, the company calculated the denominator for basic EPS to be 2,334,247 shares as follows:

	Shares outstanding	Weighting (days)	Weighted average shares
Shares outstanding at 1 April	2,500,000		
1 April to 30 November	2,500,000	244/365	1,671,233
1 December – deemed repurchase of shares	(500,000)		
1 December to 31 March	2,000,000	121/365	663,014
Weighted average number of shares (denominator)			2,334,247

The share consolidation in December was accompanied by a special dividend equal to the amount the company would have paid if it had repurchased the shares at market price (500,000 shares at £3 each = £1.5m). For calculating EPS, the company concluded that the overall effect of the share consolidation and special dividend was a share repurchase at fair value.

Consequently, the company did not adjust the denominator retrospectively for the consolidation, but reflected the decrease prospectively from 1 December.

7. The denominator – Share reorganisations (continued)

A company might conclude that a rights issue, stock dividend or other issue of shares at a discount does not require retrospective adjustment to the weighted average number of shares because it does not include a bonus element.

Similarly, a share consolidation may not require retrospective adjustment because it is considered to be part of an overall arrangement that is in substance a share repurchase at fair value.

Where this is the case, we expect the judgement to be explained in accordance with paragraph 122 of IAS 1 'Presentation of Financial Statements',[9] if it has a material effect on EPS.

9 For companies reporting under FRS 102, the equivalent requirement is in paragraph 8.6 of the standard.

8. The denominator – Other adjustments

The weighted average number of ordinary shares used for basic EPS represents the number of ordinary shares that are 'outstanding' during the period. This primarily reflects ordinary shares already in issue, but there are circumstances, in addition to retrospective adjustments for bonus issues and their equivalents (see section 7), in which it also includes shares that have not yet been issued. This section explains the more common examples identified in our reviews of companies' financial statements.

Contingently issuable ordinary shares

Contingently issuable ordinary shares are 'ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions in a contingent share agreement' (IAS 33, paragraph 5). A common example of contingently issuable shares is share-based payment arrangements that are subject to performance conditions and have little or no exercise price.

Contingently issuable shares are included in the calculation of basic EPS from the date when all necessary conditions are satisfied. Therefore, for a share-based payment, once the performance conditions have been met and the instrument has vested, the number of shares is included in the calculation of basic EPS if 'little or no' consideration is required to exercise it.

The identification of whether a share-based payment has vested is likely to be straightforward, based on the terms and conditions of the award. However, judgement will be required to determine whether the shares are issuable for 'little or no' consideration, unless the award has a nil exercise price.

For a number of companies in our selection, disclosures suggested that certain share-based payment arrangements might have vested but ordinary shares had not yet been issued. It was rarely possible to identify how those unissued ordinary shares had been treated.

When a judgement has been made over the inclusion of vested but unissued ordinary shares in the weighted average number of ordinary shares, and the effect on EPS is material, we expect it to be disclosed under paragraph 122 of IAS 1.[10]

Contingently issuable shares that have not yet vested, or which are issuable for more than a little consideration, are POSs that should be included in the calculation of diluted EPS, to the extent that they are dilutive and would be issuable if the end of the reporting period were the end of the contingency period.

10 For companies reporting under FRS 102, the equivalent requirement is in paragraph 8.6 of the standard.

8. The denominator – Other adjustments (continued)

Shares issuable solely after the passage of time

Shares that are issuable solely after the passage of time are not contingently issuable shares. This means that shares issuable under arrangements that simply defer their issue for a period of time, without any other conditions having to be met, are included in the calculation of basic EPS. Such arrangements include:

- deferred share awards, with no service or other condition or exercise price; and
- deferred (but not contingent) share consideration in a business combination.

Arrangements that are initially contingently issuable shares may become issuable solely after the passage of time once all their conditions have been satisfied.

It was generally not possible to identify from their disclosures whether companies in our selection had included deferred shares issuable only after the passage of time in their weighted average number of ordinary shares for basic EPS.

9. Definition of dilutive and antidilutive

Only POSs that are considered dilutive are included in diluted EPS. IAS 33, paragraph 5, includes definitions of both 'dilution' and 'antidilution'.

Dilution is	Antidilution is
a **reduction**	an **increase**
in earnings per share or	
an **increase**	a **reduction**
in loss per share	
resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.	

[Emphasis added]

Application of the definition

Paragraphs 41 and 42 explain how these principles apply to the calculation of diluted EPS:

41. Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase loss per share from **continuing operations**. [Emphasis added]

42. An entity uses profit or loss from continuing operations attributable to the parent entity as the **control number** to establish whether potential ordinary shares are dilutive or antidilutive. [Emphasis added]

When only continuing operations are reported

When a company reports only continuing operations, the relationship between the amounts presented for basic EPS and diluted EPS reflects the definition of dilution. If basic EPS is a loss per share, the diluted EPS should not show a decreased loss per share compared to basic EPS.

When both continuing and discontinued operations are reported

The use of continuing operations as a control number means that, if POSs are dilutive when applied to the profit or loss from continuing operations (as adjusted to represent profit or loss attributable to ordinary equity holders of the parent entity), they are also treated as dilutive for the calculation of diluted EPS for discontinued operations and the overall profit or loss.

Similarly, if POSs are antidilutive for EPS for continuing operations, they are also antidilutive for EPS for discontinued operations and the overall profit or loss.

When a company reports discontinued operations, this might result in EPS for discontinued operations and the overall result appearing to contradict the definition of 'dilution', for example, by showing a decreased diluted loss per share compared to basic loss per share. This is demonstrated in the example on the following page.

9. Definition of dilutive and antidilutive (continued)

Example

This example shows the calculation of diluted EPS when a company reports a profit from continuing operations, a loss from discontinued operations and a loss for the overall result.

Profit /(loss) attributable to equity holders of the parent:		
Continuing operations	£10,000	(a)
Discontinued	(£12,000)	(b)
Overall result	(£2,000)	(c)=(a)+(b)
Weighted average number of ordinary shares:		
For basic EPS	10,000	(d)
Dilutive POSs	2,000	(e)
For diluted EPS	12,000	(f)=(d)+(e)
Earnings per share – Continuing operations:		
Basic	£1.00	(a)/(d)
Diluted	£0.83	(a)/(f)
Loss per share – Discontinued operations:		
Basic	(£1.20)	(b)/(d)
Diluted	(£1.00)	(b)/(f)
Loss per share – Overall result:		
Basic	(£0.20)	(c)/(d)
Diluted	(£0.17)	(c)/(f)

The POSs are dilutive because their conversion to ordinary shares would decrease EPS from continuing operations from £1.00 (basic EPS) to £0.83 (diluted EPS).

As a result, the POSs are also treated as dilutive when calculating the diluted loss per share for discontinued operations and for the overall result. As the company reports an overall loss, the diluted loss per share both for discontinued operations and for the overall result shows a decreased loss per share compared to the equivalent basic loss per share.

9. Definition of dilutive and antidilutive (continued)

In our routine reviews, it is not uncommon for us to see companies that inappropriately assess whether POSs are dilutive separately for continuing operations, discontinued operations and the overall result, instead of using continuing operations as the control.

Companies are reminded that the assessment of whether POSs are dilutive or antidilutive is made using the profit or loss from continuing operations.

However, non-compliance is not restricted to companies that report discontinued items.

One company in our selection that reported an overall loss for the year, and did not report discontinued operations, disclosed a diluted loss per share that was lower than its basic loss per share.

Companies are reminded that, when a loss is reported for continuing operations, the diluted loss per share for continuing operations cannot be lower than the basic loss per share for continuing operations, and any profit or loss per share from discontinued operations and total operations will be unaffected by potential ordinary shares.

10. Adjusted EPS – IAS 33 or not IAS 33?

Companies may present an 'adjusted EPS' measure as an alternative performance measure (APM), calculated using a profit or loss different from that required to be used by IAS 33.

IAS 33, paragraph 73, includes specific requirements if a company discloses, in addition to basic and diluted EPS, an amount per share 'using a reported component of the statement of comprehensive income other than one required by this Standard':

- The amount per share should be calculated using the weighted average number of shares determined in accordance with IAS 33.
- Both basic and diluted amounts per share must be presented with equal prominence.
- The basis used for the numerator must be indicated, including whether it is before or after tax.
- The numerator must be reconciled to a line item reported in the statement of comprehensive income or income statement.

To the extent that an adjusted EPS is presented as an APM, we expect companies to disclose and explain the measure in accordance with The European Securities and Markets Authority's (ESMA)[11] Guidelines on Alternative Performance Measures (the Guidelines). We issued a separate thematic review report on APMs in October 2021,[12] which highlights the requirements of the Guidelines and sets additional expectations developed from other FRC publications and our routine monitoring work.

Adjusted EPS presented within the financial statements

When companies present adjusted EPS within the financial statements, we generally find that they comply with the requirements of IAS 33.

Disclosures made by companies in our selection were generally clear about whether an adjusted EPS was calculated before or after tax. However, the basis on which the tax had been calculated was often less clear, with the effective tax rate applied to adjustments differing from the overall effective tax rate without any explanation of why that was the case.

As explained in our APM thematic report,[12] when a company presents an after tax adjusted EPS, we expect the tax effect of material adjustments to be disclosed and the disclosure to enable readers to understand differences between the adjusted and total effective tax rate.

11 https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf
12 https://www.frc.org.uk/getattachment/74ed739d-2237-4d3e-a543-af8ada9b0e42/FRC-Thematic-Review-on-APMs-October-2021.pdf

10. Adjusted EPS – IAS 33 or not IAS 33? (continued)

Adjusted EPS presented only outside the financial statements

Strictly, when companies present adjusted EPS only outside the financial statements, the requirements of IAS 33 do not apply. However, in practice, the requirements to explain the basis for the numerator and reconcile it to the primary statements are consistent with the requirements for defining and reconciling APMs set out in the Guidelines.

The most common departures from the requirements of IAS 33 that we see in EPS-based APMs presented outside the financial statements are:

- disclosing only basic adjusted EPS, or only diluted adjusted EPS instead of both; and
- using a number of shares that is different from the IAS 33 weighted average number of shares.

Disclosing only an adjusted EPS measure in the strategic report, without the comparable GAAP measure, is not consistent with the 'equal prominence' requirement in the Guidelines.

Assets per share measures

Companies in some industries, for example investment companies, disclose an asset-based per share measure as an APM, such as net assets or equity per share.[13] Companies generally apply similar methodologies to those set out in IAS 33, despite it not strictly being within the scope of the standard (as IAS 33 applies only to earnings-based measures). For example they:

- adjust net assets to exclude amounts attributable to preference shares classified as equity; and
- exclude treasury or other own shares from the number of ordinary shares.

When asset-based per share measures are presented within the financial statements, we expect companies to comply with paragraph 73 of IAS 33, except for the requirement for the calculation of the denominator.

When the measure is calculated on the amount of net assets at the period end, the denominator reflects ordinary shares and POSs outstanding at the reporting date, rather than a weighted average number.

The assessment of whether POSs are dilutive at the reporting date might produce a different result compared to that used for a weighted average calculation. For example, in the case of share options, the calculation might reflect the market share price at the reporting date, rather than its average for the period.

13 Many property companies calculate net asset value (NAV) per share in accordance with the Best Practice Recommendations of the European Public Real Estate Association (EPRA).

10. Adjusted EPS – IAS 33 or not IAS 33? (continued)

Assets per share measures (continued)

The disclosures of asset-based per share measures we have seen do not always make clear how the denominator has been calculated when it differs from the weighted average number under IAS 33.

The basis used for the denominator used for asset-based per share measures should be clearly explained.

As with all APMs, we expect the disclosure of EPS-based and other per share APMs to be in accordance with the Guidelines. They should make clear the methodology used for their calculation, including any significant judgements involved, so that users of the financial statements can understand how they compare to those used for basic and diluted EPS presented under IAS 33.

11. Reverse acquisitions

A reverse acquisition occurs when the company that issues securities to affect a business combination (the legal acquirer) is identified as the acquiree for accounting purposes. They are commonly seen when a private trading company is seeking a listing but may also arise in other circumstances.

In these situations, there may be a significant difference between the capital structure of the accounting and legal acquirer.

Application Guidance included in IFRS 3 'Business Combinations' sets out the approach to accounting for a reverse acquisition, and also the methodology for determining the weighted average number of shares for calculating EPS:

- for the period in which the reverse acquisition occurs; and
- for all comparative periods presented.

The methodology set out in IFRS 3 ensures that the weighted average number of shares used reflects the equity structure of the legal acquirer and is comparable year-on-year.

The period in which the reverse acquisition occurs

In calculating the weighted average number of ordinary shares:

- the number of ordinary shares outstanding from the beginning of the period to the acquisition date is the weighted average number of ordinary shares of the legal acquiree (accounting acquirer) outstanding during the period multiplied by the exchange ratio established in the merger agreement; and
- the number of ordinary shares outstanding from the acquisition date to the end of that period is the actual number of ordinary shares of the legal acquirer (the accounting acquiree) outstanding during that period (IFRS 3, paragraph B26).

Comparative periods

The weighted average number of ordinary shares is the legal acquiree's historical weighted average number of ordinary shares outstanding multiplied by the exchange ratio established in the acquisition agreement (IFRS 3, paragraph B27).

Our selection included two newly listed companies that had been subject to a reverse acquisition. Both had applied the methodology in IFRS 3, although one did not explicitly state that it had done so.

We expect companies that have achieved a listing via a reverse acquisition, to explain how this methodology has been applied in its accounting policies for the periods affected.

11. Reverse acquisitions (continued)

Example

This example, adapted from paragraphs IE9 and IE10 of IFRS 3, shows the application of the EPS calculation methodology for a reverse acquisition explained in IFRS 3 (see page 26).

On 30 September 2022, Company A issues 150 ordinary shares in exchange for all 60 ordinary shares of Company B. This is determined to be a reverse acquisition. Company B is identified as the accounting acquirer. Other relevant information for each company is as follows:

	Company A (legal parent, accounting acquiree)	**Company B** (legal subsidiary, accounting acquirer)
Number of ordinary shares outstanding immediately before the acquisition	100	60
Net profit for the year 2021	n/a	£600
Consolidated net profit for the year 2022[14]	n/a	£800
Number of ordinary shares outstanding in years 2021 and 2022		
1 January 2021	100	60
31 December 2021	100	60
30 September 2022 – Issued	150	-
31 December 2022	250	60

There was no change in the number of ordinary shares issued by Company B during the years ended 2021 and 2022.

The weighted average number of shares and basic EPS in Company B's consolidated accounts for 2021 (restated) and 2022 are as follows:

Restated EPS for the prior year ended 31 December 2021

Weighted average number of shares outstanding of Company B	60 (a)
Exchange ratio = number of shares in Company A exchanged for each share in Company B (150 / 60)	2.5 (b)
Weighted average number of shares for EPS	150 (c) = (a)x(b)
Net profit for the year	£600 (d)
Restated basic EPS	£4.00 = (d)/(c)

EPS for the current year ended 31 December 2022

Weighted average number of shares outstanding (by month):

1 January to 30 September (as above)	150	9/12	113
30 September to 31 December	250	3/12	62
For the year for EPS calculation			175 (a)
Net profit for the year			£800 (b)
Basic EPS			£4.57 = (b)/(a)

14 Includes the net profit of Company A from the date of acquisition by Company B.

12. Key expectations and reminders

We encourage companies to consider the findings within this report when preparing their EPS calculations and disclosures.

In particular we:

- Recommend companies provide further information to explain the basis for the weighted average number of shares, if it is significantly different from information disclosed about issued ordinary shares and potential ordinary shares
- Expect judgements that have a material effect on EPS to be disclosed in accordance with paragraph 122 of IAS 1[15]
- Expect the disclosures provided for adjusted EPS to meet the requirements of the ESMA Guidelines on APMs and to explain the methodology applied in calculating adjusted EPS, including the basis used for tax on adjusting items

We also remind companies of the following:

- The IAS 33 definition of whether potential ordinary shares are dilutive or antidilutive is based on the profit or loss from continuing operations
- Share reorganisations that involve a bonus element require retrospective adjustment in the weighted average number of ordinary shares used for EPS for all periods presented
- When preference shares are classified as equity, earnings used for EPS are adjusted for all the effects of those preference shares including dividends and any premiums arising on redemption
- A company whose listing was achieved using a reverse acquisition should apply the methodology set out in IFRS 3 for calculating the weighted average number of shares for the period of the reverse acquisition and for comparative periods

15 For companies reporting under FRS 102, the equivalent requirement is in paragraph 8.6 of the standard.

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