Thematic Review – Earnings per share (IAS 33)

Supervision of Financial Reporting

October 2011

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Disclaimer

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1 Conclusion and summary

The presentation and disclosures regarding earnings per share (EPS) in the financial reporting are generally satisfactory. This is shown by the thematic review of Earnings per share that the Netherlands Authority for the Financial Markets (AFM) conducted on the financial reporting for 2010. The AFM does, however, see potential for improvement in the financial reporting in various respects.

All companies disclose the basic and diluted earnings per share in the consolidated income statement or the statement of other comprehensive income. In addition, companies report their EPS in various parts of the financial reporting (report of the executive board, key figures, long-term reviews). Generally speaking, the companies provide adequate disclosure on their earnings per share.

The AFM does, however, identify the following possibilities for improving requirements of information on EPS, so that the presentation could better meet the wishes of investors:

- Include a disclosure on the calculation and reconciliation of the weighted average number of shares used (see 4.3);
- State the additional EPS information in the disclosure instead of the primary statements of results (see 4.2);
- Pay more attention to after the balance sheet date events for the diluted EPS (see 4.6);
- Pay more attention to the time factor in the calculation of EPS (see 4.3);
- Present and disclose EPS for discontinued operations (see 4.4);
- Include an explanation of the calculation in the section on accounting policies in the financial statements (see 4.1);
- Include a discussion of EPS in the annual report section (see 4.1);
- Disclose the diluted EPS in those overviews in the financial reporting in which other measures per share are also reported (see 4.7).

<u>General</u>

The objective of IAS 33 is to provide principles for the determination and presentation of EPS, so that it becomes easier to compare the financial performance of different companies in the same reporting period, and the financial performance of the same company over different reporting periods.

In its thematic review, the AFM reviewed how EPS is calculated and reported.

We selected 45 companies with a listing on Euronext for the review. These companies are evenly distributed across the AEX, AMX and AScX indices.

Since the AFM has to conduct its thematic review on the basis of public information[1], it was not able to establish the background to some of its findings. After publication of this report, the AFM will further investigate the financial reporting of the companies concerned and may approach these companies with a request for further information.

EPS often included in the primary statements instead of in the disclosures

Several companies disclose additional information in their primary statements, varying from the average number of outstanding shares to a detailed disclosure. This latter item generally includes the calculation of EPS, reconciliations, statements of the development of the number of outstanding shares and other measures, such as dividend per share or result per share adjusted for extraordinary items. This additional information is useful to users, but according to IAS 33 it should be provided in the disclosure.

Disclosure on EPS

More or less all companies include a further explanation of their EPS in the notes to the financial statements. Disclosure on the result used to determine EPS is generally satisfactory. More than 70 percent of the AMX companies and 60 percent of the AEX and AScX companies provide the required disclosure on the weighted average number of shares used in the calculation of EPS. In the cases where this is not disclosed, it is frequently not clear how the companies concerned have arrived at the number of shares they have used. This disclosure therefore needs further improvement.

Other findings

EPS disclosed in the press releases accompanying the annual figures is generally in line with EPS information in the financial reporting. The diluted EPS is less frequently mentioned in the press releases.

The AFM also included analyst reports in its review. These show that approximately half of the analysts carry out their own calculation of EPS in their reports. This EPS figure is usually adjusted for extraordinary items such as amortisation of goodwill, impairments and reorganisation expenses. This confirms the importance of a proper disclosure. In their reports, analysts include a wide variety of other measures per share in addition to EPS, such as cash flow per share, revenue per share, EBIT per share and equity per share.

[1] *Based on Section 2(1) of the Financial Reporting Supervision Act (Wtfv), the AFM can request further disclosure if on the basis of publicly available facts or circumstances it has doubts regarding the correct application of the reporting requirements.*

2 Introduction

By conducting a generic review of certain aspects of financial reporting, the AFM's intention is to raise awareness of important issues. In this context, the AFM's thematic reviews conducted in 2011 include a review of the quality of the reporting of earnings per share (IAS 33), focusing on the reports prepared for the 2010 financial year.

The objective of IAS 33 is to provide principles for the determination and presentation of EPS, so that it is easier for users to compare the financial performance of different companies in the same reporting period, and the financial performance of the same company over different reporting periods. Under IAS 33, the general principle applies that the company must calculate and disclose its EPS according to the standard.
EPS is calculated by dividing the net profit or loss attributable to ordinary equity holders for the financial year by the weighted average number of outstanding ordinary shares during the financial year. The calculation of EPS must also take account of dilution effects.

EPS is one of the best-known financial ratios and constitutes an important source of information regarding a company's relative profitability for investors.

EPS is also relevant because it is one of the constituent factors in the price/earnings ratio, which is used by investors and investment analysts to assess share prices. The price/earnings ratio shows the multiple of a company's earnings that investors are prepared to pay in the market when purchasing its shares. Changes to the forecast for EPS can significantly affect a company's share price.

Reference to the term EPS also obviously includes losses per share.

3 Objectives of the thematic review, design and population

The thematic review of EPS is intended to encourage companies to improve the quality of the financial reporting of their EPS. The supervision further contributes to increasing public knowledge of companies, and thereby to an improvement in the operation of the capital markets. The responsibility for the quality of the financial reporting rests primarily with the companies themselves. Practical compliance with the reporting requirements is essential, and contributes to confidence in corporate management among investors and other users of financial reporting.

The AFM will put questions to companies in cases where it has doubts regarding correct application as a result of this thematic review. In addition, it will use the results of this thematic review in its risk analysis for the selection of the 2011 corporate financial reporting to be included in next year's review.

In this review, the AFM investigated how companies calculate and report their EPS and whether they comply with the requirements of IAS 33. Furthermore, the AFM has compared EPS to EPS included in:

- the financial reporting for 2009;
- the key figures and the annual report as included in the financial reporting for 2010 and 2009;
- analyst reports;
- the press release issued with the presentation of the annual figures for 2010 and 2009.

The review population consists of 45 companies. 15 of these companies are listed in the AEX, 15 are listed in the AMX and 15 are listed in the AScX. The companies reviewed were selected randomly from the population in each index as at 31 December 2010.

4 Findings

4.1 All companies report information on their EPS in the various sections of the financial reporting

All companies report their EPS in the 2010 and 2009 financial statements either in the consolidated income statement or in the statement of other comprehensive income. They additionally disclose their EPS in other sections of their financial reporting. The table below shows where information on EPS is provided.

Table 1: EPS per section of the financial reporting for 2010

Section of the financial reporting	AEX	AMX	AScX
Primary statements			
• **Income statement**	14	13	11
• **Statement of other comprehensive income**	1	2	4
Key figures	10	13	11
Annual report (Report of the Executive Board)	11	13	10
Accounting policies	6	7	4
Notes to the consolidated financial statements	14	15	14
Other Data	7	7	7
Total companies per index	15	15	15

Virtually all companies disclose EPS in the notes to the financial statements. A further positive development is that some of the companies (38 percent) provide a further (qualitative) disclosure on EPS in the section on accounting policies in the financial statements. The AFM welcomes the inclusion of information on EPS in the section on accounting policies.

The AFM also finds it encouraging that companies pay attention to EPS in various places in their financial reporting. More than three-quarters of them discuss EPS in the annual report (Report of the Executive Board), including an account of matters such as the growth of EPS and the adjustment to EPS for extraordinary or non-recurring items. This helps users to gain a better understanding of the company's performance. Comparison of EPS between companies and/or sectors also becomes more meaningful. The AFM encourages other companies which have not yet included a discussion of their EPS in their annual report to include this information.

The *Other Data* section in most cases chiefly concerns, in addition to the long-term review, the sections on shareholder information, investor relations, the summary quarterly figures and a performance overview.

The results of the thematic review confirm that companies consider their EPS to be an important measure of performance.

4.2 All companies disclose EPS in the primary statements

Companies are obliged to disclose EPS in the consolidated income statement or the statement of other comprehensive income (known as the primary statements). The review shows that 84 percent of the companies disclose EPS in the consolidated income statement and 16 percent include it in the statement of other comprehensive income (see Table 1).
The review reveals that in addition to EPS itself, other measures and information relating to EPS are included in the primary statements.
These measures and information disclosed in the primary statements are listed in the table below.

Table 2: Information disclosed in primary statements

	AEX	AMX	AScX
Basic result	15	15	15
Diluted result	15	15	15
Basic result from continued operations	2	5	6
Diluted result from continued operations	2	5	6
Result from discontinued operations	1	2	2
Other	7	3	6

The review also shows that one company used only the earnings before amortisation as the measure for its EPS rather than the total net result according to IFRS. This is not in accordance with the applicable standard.

More than 35 percent of the companies (the *Other* category in table 2) disclose additional information in their primary statements. This ranges from the presentation of the average number of outstanding shares to a detailed disclosure including the calculation of EPS, together with reconciliations and movement schedules of the number of outstanding shares. Additional measures, such as *dividend per share* or *result per share adjusted for extraordinary items,* also appear in the primary statements. This information is often presented more prominently. IFRS requires that this information, which is useful to investors, is included in the disclosure.
If the basic EPS is the same as the diluted EPS, the standard permits companies to disclose the basic EPS on one line. A small minority of companies (12 percent) choose this option. The majority choose to disclose the basic and the diluted EPS on two separate lines even if the two measures are equal.

4.3 Majority of companies include the required disclosure on EPS

Companies are required to include further disclosures on EPS in the financial statements, including the result used and the weighted average number of shares, the calculation and the reconciliation.

The statements included in the disclosures are listed in the table below.

Table 3: Statements in the disclosure per index

	AEX	AMX	AScX
Result used (numerator)	14	14	10
Reconciliation of result used	14	12	10
Weighted average number of shares (denominator)	14	15	14
Calculation and reconciliation of weighted average number of shares	9	11	9
Result from discontinued operations	2	2	1

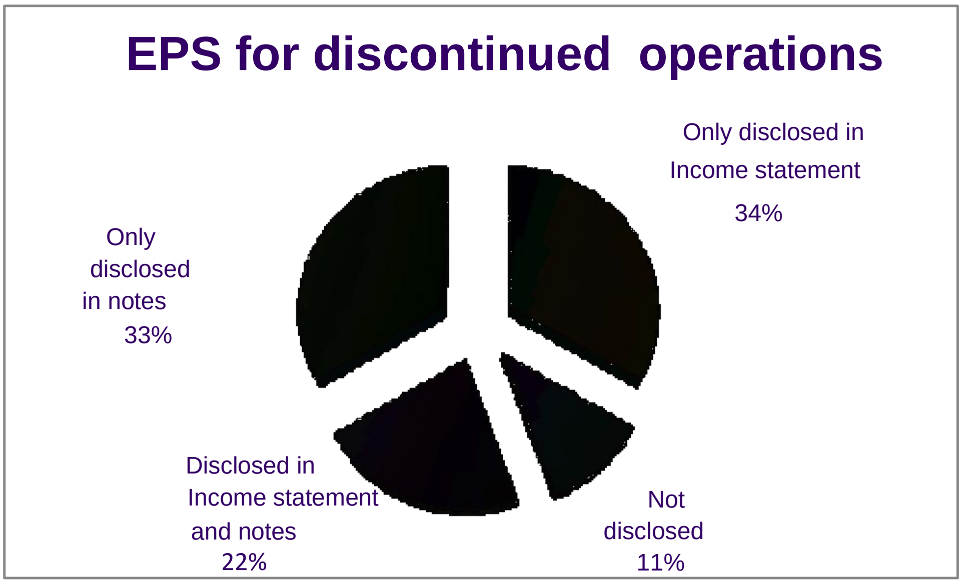
More or less all companies include further disclosures on EPS in the notes to the financial statements. Disclosure on the result used (the numerator in EPS calculation) is generally satisfactory. More than 93 percent of the AEX and AMX companies disclose the result used in EPS calculation, and thereby comply with the IFRS standards. With a rate of only approximately 67 percent, the compliance by the AScX companies was far less satisfactory, and improvement is necessary here.
Approximately 65 percent of all companies include the disclosure on the calculation and reconciliation of the weighted average number of shares (the numerator in EPS calculation), however the AMX companies (73 percent) score better than the AEX companies (60 percent) and the AScX companies (60 percent). Since it is not always clear, how the companies have arrived at the number of shares used, there is room for improvement in this disclosure.

Furthermore, three companies failed to take account of the passage of time in the calculation of EPS as a result of the issuance of new shares.

4.4 Virtually all companies include EPS from discontinued operations

According to IFRS, a company reporting a discontinued operation must disclose the basic and diluted EPS for the discontinued operation either in the income statement or in the notes to the financial statements. The review reveals that companies reporting a discontinued operation disclose EPS for the discontinued operation in various ways. These various ways are shown in chart 1.

Chart 1



Almost 90 percent of the companies disclose EPS from discontinued operations in their financial reporting. 11 percent fail to make this disclosure. The AFM considers the fact that 22 percent of the companies disclose their EPS from discontinued operations in both the primary statements and the notes to be a positive development. This gives the users of the financial statements a proper account of the effect of discontinued operations on the company's EPS. Unfortunately, this concerns as yet only a small group.

4.5 More than half of analysts use the same EPS as in the financial reporting

Analysts use EPS as an important variable in their valuation models, especially in the calculation of the price/earnings ratio. The AFM used the most recent analyst reports in its review.

The review shows that in half of the cases, EPS in the analyst report is the same as EPS in the financial reporting. In the other cases, the analysts use an adjusted EPS. This usually concerns an EPS adjusted by the analyst himself for items such as amortisation of goodwill, impairments, reorganisation expenses etc.

The degree to which analysts adjust the available EPS confirms the importance of better disclosure by the reporting company itself.

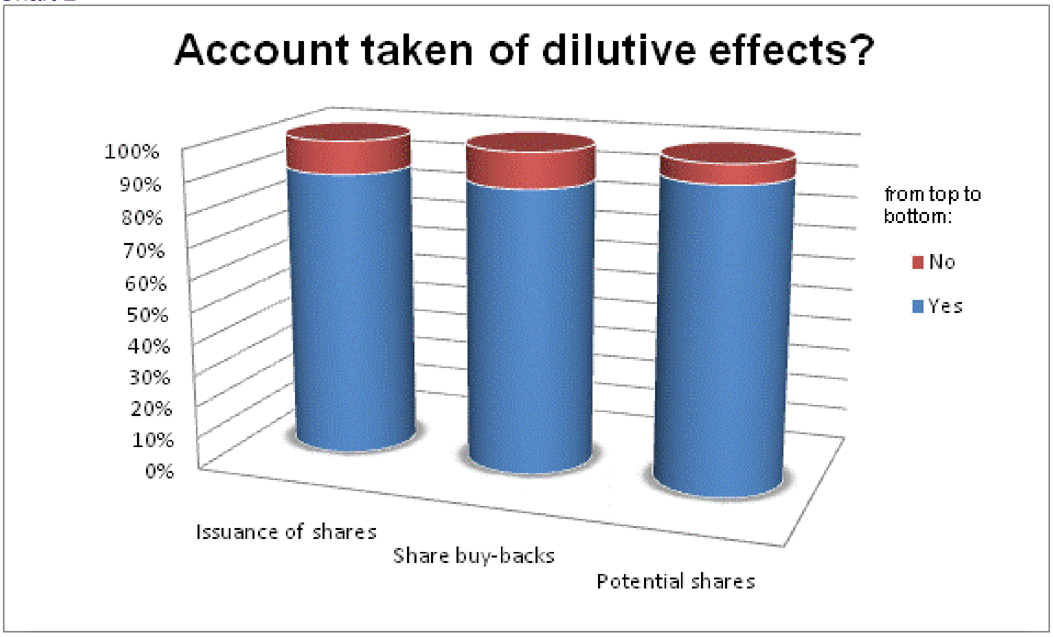
In addition to EPS, analyst reports often include dividend, equity and other measures per share. The other measures per share include cash flow per share, revenue per share, EBIT per share, free cash flow per share, enterprise value per share, embedded value per share etc.

4.6 Large majority of companies take account of dilution effects

According to the standard, when calculating its EPS the company should take account of extraordinary circumstances that can have a dilutive effect on EPS, such as issuance of new shares, share buy-backs and the availability of potential shares (such as options, warrants and convertible bonds). If they are exercised, potential shares can have a dilutive effect on EPS for the existing shareholders.

Chart 2 shows the degree to which account is taken of dilutive effects for each circumstance.

Chart 2



Transactions after the balance sheet date can affect the diluted EPS and must be included in the calculation. Four companies effected transactions after the balance sheet date that should have been taken account of in the calculation. Only two of these four companies actually took account of the transaction concerned in the calculation of EPS.

The review thus reveals that in general, companies take proper account of extraordinary circumstances and situations such as the buy-back and issuance of shares in the calculation of their EPS. However there is still room for improvement regarding the potential dilutive effect of transactions occurring after the balance sheet date.

4.7 Large number of companies report several measures per share

Companies report other measures per share in addition to EPS. These are disclosed in various sections of the financial reporting. In addition to EPS (basic and diluted), measures disclosed include equity per share, dividend per share and adjusted EPS.
Further details are shown in the table below.

Table 4: Number of companies stating various measures per share in their financial reporting

	Annual report[2]	Key figures	Long-term review
Equity	13	16	13
Dividend	33	26	19
Result	33	33	20
Diluted result	10	7	5
Other	19	24	17

The *Other* category includes various measures per share such as adjusted EPS (excluding impairments and amortisation, reorganisation expenses etc.), cash flow per share, operating result per share, etc.

After EPS, dividend per share is the most commonly reported measure per share. It is notable that the diluted result is the least frequently reported measure. For a full account of the performance, the diluted EPS should be included in the overviews in which the companies disclose the other measures per share.

4.8 EPS in press releases corresponds to EPS information in the financial reporting

The review shows that in 88 percent of the cases, EPS in the press release accompanying the annual figures is identical to EPS disclosed in the financial reporting. The small minority for which this is not the case disclose an adjusted EPS (including or excluding extraordinary items). The AFM does not consider this to be acceptable. In our experience, this kind of presentation is frequently driven by opportunistic considerations.
In addition, this review shows that half of the companies include different measures per share in their press release than the measures they disclose in the notes to the financial statements.

[2] *Annual report here refers to the Report of the Executive Board.*

Table 5: Number of companies stating various measures per share in their press release for 2010

	AEX	AMX	AScX
Equity	2	3	5
Dividend	11	11	10
Result	12	13	15
Diluted result	10	12	10
Adjusted result	2	3	1
Other	7	9	7

The thematic review shows that the diluted EPS is less frequently mentioned in the press release than it is in the financial reporting. The AFM would like to see both the basic and the diluted EPS stated in the press release.

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