

Earnings per Share: Do We Get Relevant Information?

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This paper attempts to examine the level of disclosures of information to Earnings per Share (EPS). Research was conducted through detailed analysis of the disclosures of the financial statements of the listed textiles companies of Dhaka Stock Exchange (DSE). We collected and analyzed the annual reports of 29 listed textiles companies of Bangladesh. We used the disclosures checklist to find out the compliance level of disclosures for EPS and find that the absence of relevant information about EPS. This paper provides insight from their reality of EPS disclosures by the textile companies. It will also contribute to the literature of required disclosures compliance of the developing countries like Bangladesh.

Keywords: EPS, disclosures, compliance

Introduction

Financial statements have been the best media for communicating the extent of the performance of organizations to the various stakeholders of organizations. Financial statements are required to possess some qualitative characteristics which make them relevant for decision making by investors.

Earnings per Share (hereafter EPS) is a very widely used financial ratio, which is used to indicate the company's bottom-line performance. Investors use EPS to compare the profitability among the firms. Many studies find that market prices responded profoundly to consecutive increasing profitable firms (see Barth, Elliot, & Finn, 1999; Myers & Skinner, 1999). Since EPS is one of the most significant aspects for the stakeholders, its relevance and reliability are also significant. EPS can often be used as a tool of earnings management through the use of maximizing earnings (Healy, 1985; Gaver, Gaver, & Austin, 1995) or manipulating the outstanding shares (Myers & Skinner, 1999).

There is a research gap in International Financial Reporting Standards (IFRS) related compliance study for developing countries like Bangladesh. Lack of IFRS related compliance studies motivates us to make the study. This paper attempted to evaluate the degree of compliance of the listed textiles companies to disclosure requirements of EPS. We take the definition and criteria of relevant information of International Accounting Standard Board (IASB) framework. This study reveals that in materiality aspect the EPS information provided by the companies is not relevant. The findings of this study will contribute to the development and monitoring of EPS compliance.

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This paper is organized as follows. Section 2 reviewed previous literature on the disclosures of EPS and identified the research gap. Section 3 outlines the research design. Section 4 describes the empirical data and discusses our findings. Finally, the last section presents our conclusions.

Literature Review

Significance of EPS

Financial statements have its route since 1800 in the United States, but at that time focused only on the balance sheet accounts and the changes to the balance sheet accounts. The current income statement first seemed in the 1830's in the annual reports of railroad companies in the USA. United States Steel Corporation produced its first income statement in 1901, and Westinghouse Corporation began in 1911. Some large US corporations did not prepare income statements until 1930 (Vangermeersch, 1996).

Profit is a fundamental variable which influences the market value of the firms as well as investment and credit decisions of the investor. Per-share earnings can be used to measure the earnings ability of firms which is required to be disclosed by companies (Valix & Peralta, 2007). Graham, Campbell, and Rajgopal (2005) surveyed 400 financial executives in the US and reported that the majority, by far, were of the opinion that earnings were the most critical performance measure they say to outsiders. EPS is a widely used performance measurement which exhibits the company's bottom line performance. Market highly priced increasing trends of EPS (Myers & Skinner, 1999).

Value Relevance of EPS

EPS is one of the essential tools for the investor to make an investment decision. Literature supports the importance of EPS as one of the most significant ratios. EPS is the only ratio that required disclosures with mandated formulae. Moreover, there are ample evidences that EPS is used as one of the most significant instrument to use as an investment vehicle.

A lot of studies prove that EPS has a significant impact on the market price of the share. A higher EPS might have a positive effect on the market price of the share. The higher stock price will create a positive impact on investors and also the poor EPS might depress stock prices but these relationships are circular and not direct.

EPS is the third most crucial ratio for financial analysts, trailing to Return on Equity (ROE) and the Price/Earnings (P/E) ratio in importance (Gibson, 1987). Since the P/E ratio cannot be computed without EPS, EPS can be considered the second most crucial ratio. Moreover, in business crisis prediction EPS along with other financial ratios is used to predict the financial distress. Significant finance ratios, such as adequacy of long-term capital, current ratio, inventory turnover, EPS and debt coverage stability, fixed asset turnover, profit growth rate, revenue per share, net profit growth rate before tax and after tax, etc., are widely used as financial distressed prediction (Min, Lee, & Han, 2006; Shin, Lee, & Kim, 2005).

EPS as Earnings Management Tool

EPS can often be used as a tool of earnings management. Earnings management has been found when managers want to manipulate bonus to maximize the earnings (Healy, 1985; Gaver et al., 1995) or managers want to exceed the earnings threshold (Degeorge, Patel, & Zeckhauser, 1999). Most studies showed that managers want to manipulate the numerator. However, there are some studies which found that managers also manage the denominator, i.e., outstanding shares (Myers & Skinner, 1999). Managers try to manipulate both numerator and denominator to manipulate the earnings, i.e., EPS.

Disclosures of EPS and Research Gap

Many studies have been conducted on the disclosures required by IFRSs. Most of them are from developed country perspectives. IAS 33 requires the disclosures of two EPS figures: basic and diluted EPS (IAS 33, n.d.). IAS 33 requires an entity to disclose the following:

- (a) the amounts of the numerators of basic and diluted EPS,
- (b) a reconciliation of those amounts to profit or loss,
- (c) the weighted average number of ordinary shares used for basic and diluted EPS, and
- (d) a reconciliation of these denominators to each other.

Diluted EPS shows the extent to which earnings to the existing shareholders will reduce if further issues of additional shares are made by arrangement in place at the reporting date. Many consider diluted EPS to be more useful information than basic EPS. Disclosure of diluted EPS is required when there is a material difference from the basic EPS.

Glaum and Street (2003) made a study on a sample of 100 firms that apply IAS and 100 that use US GAAP, and found that compliance levels range from 100% to 41.6%, with an average of 83.7%. The average compliance level is significantly lower for companies that apply IAS as compared to companies using US GAAP. Ahmed and Karim (2005) made a study on the determinants of IFRS disclosures by the listed companies in Bangladesh. They find company size, profitability, stock exchange security category, and multinational subsidiary are the significant determinants of IFRS disclosures. In another study, Ali, Ahmed, and Henry (2004) examine the level of compliance with disclosure requirements mandated by 14 national accounting standards for a large sample of companies within the three major countries in South Asia, namely India, Pakistan, and Bangladesh. The results indicate significant variation in total disclosure compliance levels across countries and different national accounting standards. Though no study is yet to find on the compliance of disclosures issue of EPS in Bangladesh, other related studies reveal that disclosures compliance is not satisfactory.

Moreover, according to the International Monetary Fund (IMF), Bangladesh's economy is the second fastest growing major economy of 2016, with a rate of 7.1%. Textiles sector provides a single source of growth for rapid growth in Bangladesh. Bangladesh is the world's second-largest apparel exporter of western (fast) fashion brands. Sixty percent of the export contracts of western brands are with European buyers and about forty percent with American buyers. Only 5% of textile factories are owned by foreign investors, with most of the production being controlled by local investors (Dhaka Tribune, n.d.). So, textile industries have a large group of local shareholders who solely rely on the company information to take their investment decisions. Thus, the relevance of bottom line is utmost significance to them and this bottom line is expressed through the EPS of the company. So, importance of the textile sectors and the gap in the IFRS related compliance studies motivate us to conduct the research.

Methodology

Sample Selection and Data Collection

The population of the study was the listed textile companies in Dhaka Stock Exchange (DSE). The data collected for the research involve the examination of annual reports for the year 2017. There are 50 listed textile companies in DSE and out of these 29 companies annual reports are available during the study period. So, these 29 companies are considered for the research.

Determination of Relevance of EPS

To determine the relevance of EPS, we take the definition of IASB framework. Relevant information is defined as capable of making differences in the decision which includes three fundamental components—predictive role, confirmatory role, and materiality. Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make by those reports, which provide financial information about a specific reporting entity. To find out the materiality of EPS-related disclosures authors developed a disclosure checklist with the Earnest Young (EY) guidelines.

Disclosures Checklist

We developed a disclosure checklist to measure the degree of compliance of the companies with the required disclosures. One of the big four Audit firms EY has developed IFRS disclosures checklist for the preparation and reviews process of financial statements (Accounting and Reporting Checklist, n.d.). Based on their disclosures list of IAS 33, we developed a disclosures checklist. The followings disclosures issues are considered to create the disclosures checklist.

(1) If the entity presents both consolidated financial statements and separate financial statements prepared under IFRS 10 Consolidated Financial Statements and IAS 27 Separate Financial Statements, does it present the disclosures required by IAS 33 only by the consolidated information?

(2) If the entity chooses to disclose earnings per share based on its separate financial statements, does it present such earnings per share only in the statement of comprehensive income and not in the consolidated financial statements?

(3) Does the company separately disclose EPS for continuing operation (if it has any discontinued operation)?

(4) If the entity presents a separate statement of profit or loss as described in IAS 1, does it disclose basic and diluted earnings per share only in that separate statement?

(5) Does the entity present basic and diluted earnings per share, even if the amounts are negative (that is, a loss per share)?

(6) Does the entity disclose the amounts used as the numerators in calculating basic and diluted earnings per share and reconcile those amounts to profit or loss attributable to the parent entity for the period (which includes the individual effect of each class of instruments that affects earnings per share)?

(7) Does the entity disclose the weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share, and reconcile these denominators to each other (which includes the individual effect of each class of instruments that affects earnings per share)?

(8) Does the entity disclose the instruments (including contingently issuable shares) that could potentially dilute basic earnings per share in the future, but were not included in the calculation of diluted earnings per share because they are anti-dilutive for the period(s) presented?

(9) The ordinary share transactions or potential ordinary share transactions, other than increases as a result of a capitalization, bonus issues, or share splits or decreases as a result of a reverse share splits, that occur after the reporting period, but before the financial statements are authorized for issue that would have changed the number of ordinary shares or potential ordinary shares outstanding at the end of the period significantly if those transactions had occurred before the end of the reporting period.

Each item of the disclosures list is given equal weight. First, we design disclosure compliance checklist of 10 requirements. Second, a list of each company is generated either any of the three responses: (1) for

disclosures of the item, (2) for non-disclosures, and (3) for non-applicable disclosures for the company. We aggregate the score of each company and compare it with other company. Evans and Taylor (1982) recommend this type of disclosures in-depth examination of published financial statement to measure the degree of compliance with IASs since it will allow the more general scenario of IASs compliance. Descriptive analysis is conducted to find out the average percentage of the level of compliance concerning the disclosure index.

Result Analysis and Discussion

Table 1 presents the level of compliances. The findings show that most of the companies did not comply with the requirement of the disclosures.

Compliance and Non-compliance Percentage

Authors have developed a total of nine disclosures issues for 27 sample firms that mean there are a total of 243 firm-disclosures issues. Out of these 243 firm-disclosures issues, only 33 issues are compliance, 162 issues are non-compliance, and the rest are not applicable disclosures.

Table 1

Level of Compliance and Non-compliance by the Textile Companies

	Number	Percentages
Compliance disclosures	33	13%
Non-compliance disclosures	162	67%
N/A disclosures	48	20%

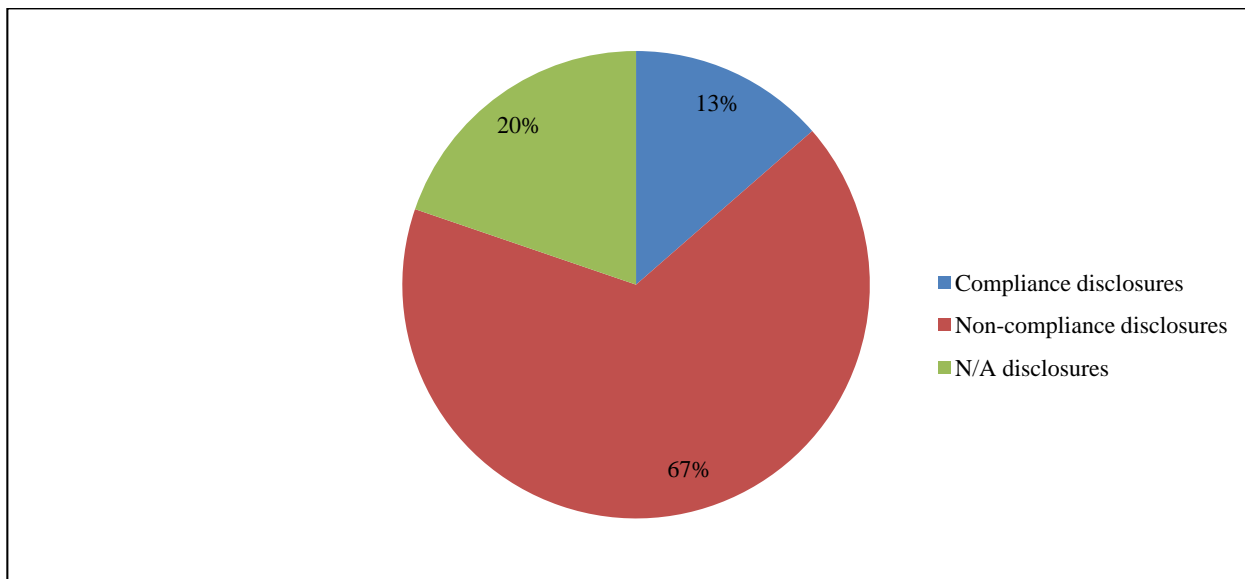


Figure 1. Percentages of compliance by the listed textile companies.

Figure 1 shows that almost 67% are non-compliance where's only 13% of compliance of the individual disclosures requirements. Hewaidy and Al Mutawaa (2010) mentioned that below 40% represents an enormous gap between the requirements of disclosure and the IFRS requirements. So, it is revealed that the total revelations percentages of the EPS disclosure by the textiles companies are far below than even the low level of compliance. Thus based on this deep level of compliance, EPS relevancy is undoubtedly a controversial issue here.

Individual Disclosures by the Companies

Table 2 shows individual compliance levels.

Table 2

Number of Compliance and Non-compliance of the Individual Requirement

Sl	Requirements/disclosures	Compliance	Non-compliance	Not applicable
1	EPS on consolidated financial information	0	4	23
2	EPS on separate financial information	0	4	23
3	EPS for continuing operation	3	23	1
4	Basic and diluted earnings per share only in that separate statement	3	23	1
5	Disclosure of negative EPS	13	14	0
6	Reconciliation of the amount of profit	0	27	0
7	Weighted average number of ordinary shares its reconciliation	5	22	0
8	Disclosures of the instruments that could potentially dilute basic earnings per share in the future	3	24	0
9	The ordinary share transactions after reporting period	6	21	0

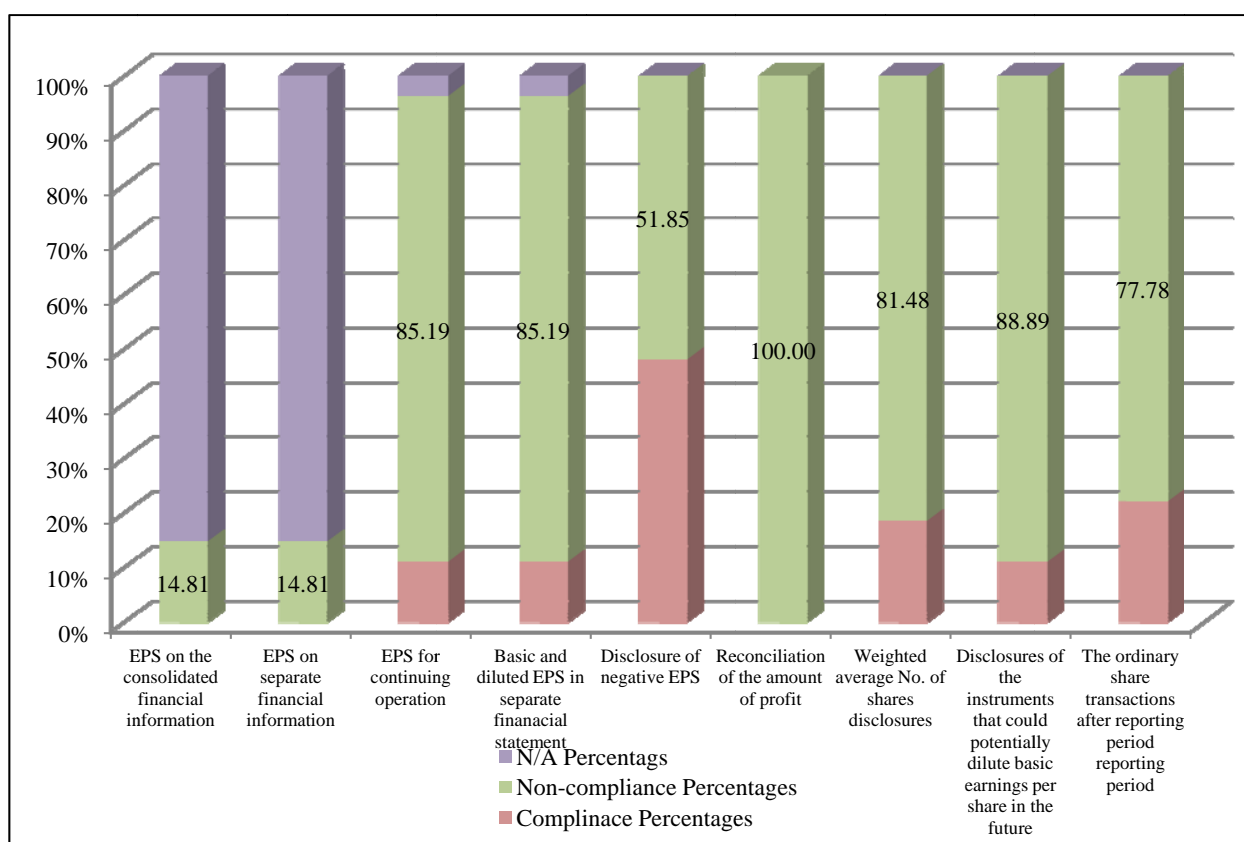


Figure 2. Percentage of compliance and non-compliance of the individual disclosure issue.

Regarding compliance of the nine points of EPS, the analysis shows that compliance percentages are not satisfactory at all for any of the disclosures issues. Every item falls below 20% compliance which is far below the definition of the minimum level of disclosures requirement of IFRS (Hewaidy & Al Mutawaa, 2010).

However, most non-compliance are observed in the disclosures of EPS from continuing operation (85%), reconciliation of profit (100%), disclosures of weighted average number of share and its reconciliation (88%),

disclosures of potentially diluted securities (89%), and ordinary share transactions after reporting period (78%). The findings reveal that there is a poor level of compliance of disclosures by the listed textile companies. Since this study covers most of the companies, analysis discloses the level of disclosures of the industry. So it is specific that EPS information is not accurate and relevant for the users with this reduced level of disclosures of information.

Conclusions

Using the disclosures compliance checklist, the extent of exposures of EPS by the textile companies, this study confirms that EPS disclosures by the textile companies are not good at all. The study reveals that the shareholders often come up with the EPS of the company which is not relevant. For effective implementation of the reporting of earnings per share, Bangladesh Securities & Exchange Commissions (BSEC) should ensure proper monitoring. Companies lack the motivation to report the EPS which reveals the inadequate tracking and awareness about one of the most investment vehicles. This study has a significant contribution to find out the compliance and noncompliance of the EPS-related disclosures. But more details analysis of reporting would give better insight which may require a questionnaire and interview. A future study in this area will provide a better idea.

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