

You have been requested by Mr Ed Gars, the financial director of Hoodlum Ltd, to review the earnings per share calculation. The calculation has been prepared by his group financial accountant for inclusion in the annual financial statements of Hoodlum Ltd for the year ended 31 March 20x5. All companies within the group are wholly owned.

	20X5
Earnings per share	\$3,54
The calculation of earnings per share is based on earnings of \$177 million attributable to ordinary shareholders and 50 million ordinary shares in issue.	

1. A detailed review of the management accounts revealed the following relevant information:

1.1 Statements of comprehensive income for the year ended 31 March 20x5:

	Hoodlum Ltd- Group \$ Million	Decis (Pvt) Ltd \$ Million
Turnover	<u>2 500</u>	<u>1 100</u>
Income before interest and tax	360	175 67
	147,5	
Interest paid	20	5
Taxation	127,5	62
Net income	<u>212,5</u>	<u>108</u>

1.2 During the year the board of directors of Hoodlum Ltd decided to discontinue the Pex division of the company. This division has incurred trading losses of \$6 million. These losses have been included in the income before interest and tax of Hoodlum Ltd.

1.3 On 1 September 20x4 Hoodlum Ltd acquired a 22% shareholding in Decis (Pvt) Ltd. Decis (Pvt) Ltd will in future sell the majority of its production to Hoodlum Ltd and Ed Gars assumed direct responsibility for supervising the operations of Decis (Pvt) Ltd.

The net income of Decis (Pvt) Ltd was earned evenly through the year, with the exception of a capital after tax profit of \$8 million which arose on the expropriation of an investment property on 1 January 20x5 after capital gains of \$1.7 million was paid.

The results of Decis (Pvt) Ltd have not been included in the income statement of the Hoodlum Ltd group set out above.

2. A review of the statutory records of Hoodlum Ltd as at 1 April 20x4 revealed the following:

	\$ Million
Authorised share capital	
70 000 000 ordinary shares of \$2 each	140
10 000 000 15% cumulative redeemable preference shares of \$1 each	10
10 000 000 8% cumulative convertible preference shares of \$0,50 each	<u>5</u>
	<u>155</u>
Issued share capital	
50 000 000 ordinary shares of \$2 each	100
5 000 000 15% cumulative redeemable preference shares of \$1 each	5
6 000 000 8% cumulative convertible preference shares of \$0,50 each	<u>3</u>
	<u>108</u>

3. A review of the share register and the minute book of Hoodlum Ltd revealed the following:

3.1 The 15% preference shares are redeemable at the option of the company and are classified as equity. The full dividend was declared in the current year.

3.2 At the annual general meeting of Hoodlum Ltd held on 15 May 20x4 the shareholders approved the establishment of a share incentive scheme for the executive directors of Hoodlum Ltd. On 1 June 20x4 options were granted to directors at no cost. These options entitled directors to subscribe for 5 million ordinary shares at \$35.33 per share. In terms of the scheme the options granted are exercisable in 4 annual tranches of 25% each, commencing 3 years after the date of the granting of the option. The fair value of the options at the date of issue was \$24. The average price of Hoodlum Ltd's shares during the period 1 June 20x4 to 31 March 20x5 was \$72.

The scheme contains an equalisation clause which states that, should Hoodlum Ltd make further rights issues, all options entitlements are to be adjusted to reflect a pro rata increase of such additional options. The options are to be set at a 20% discount to any rights issue price. The options shall be exercisable on a basis similar to the original options granted, commencing 3 years after the date of such rights issues. The fair value of the additional options at the date of issue (1 January 20x5) was \$36. The average price of Hoodlum Ltd's shares during the period 1 January 20x5 to 31 March 20x5 was \$74.

All the executive directors to whom options were granted were still in the employ of the company on 31 March 20x5 and are expected to remain so in the future.

3.3 On 1 January 20x5 10 million ordinary shares were issued as a result of a 1 for 5 rights issue at \$55 per share, for which the cash consideration was received by Hoodlum Ltd on 1 January 20x5.

4. You also establish, based on the share price history before the rights issue, and taking into account the liquidity of the market and the amount of funds to be raised, that the fair value at 1 January 20x5 was \$68,75 per share.

5. The conversion rights attaching to the 8% cumulative convertible preference shares of \$0,50 each are as follows:

"The 8% cumulative convertible preference shares are compulsory convertible to an equal number of ordinary shares on 1 January 20x8."

No dividend was declared on these convertible preference shares in the current year.

YOU ARE REQUIRED TO:

- (a) calculate the following for the Hoodlum Ltd group for the year ended 31 March 20x5:
- (i) Earnings per share;
 - (ii) Diluted earnings per share;
 - (iii) Headline earnings per share.
- (b) write a memorandum to Mr Gars explaining how the information in (a) above should be disclosed in the annual financial statements of the Hoodlum Ltd group for the year ended 31 March 20x5.

Normal tax rate 25.75%

Ignore comparative figures.

(60 Minutes)
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