

1. According to the article:

“Mr. Willens says that the industries likely to benefit most from the proposed change are banking, drugs, high-technology, metals, paper and other heavy industries.”

These industries may use lot of stock options, warrants and convertible securities, and so under the new rule's definition of shares, the number of shares will decrease. The article also says:

“ Those that will benefit least include autos, consumer goods, foods, tobacco and nondurable goods, he adds.”

These industries must be using less stock options, warrants and convertible securities and so under the new rule's definition of shares, the number of shares will not change.

2. Safeway's EPS will be up by 19 %. So if, as the article suggests the P/E ratios will remain the same, then the stock of Safeway will also go up by 19 %.

3. The net income will NOT change for any company. Only the denominator used to compute the EPS, i.e. the number of shares will be less.

4. The article says the following:

“For example, based on Monday's close on the New York Stock Exchange of $72 \frac{7}{8}$ for Sterling Software's common shares, the company's P/E ratio would be 24.9 under the FASB's new proposal for basic EPS, compared with 28.7 under current accounting using primary EPS. To get back up to the 28.7 P/E ratio under the new standards, Sterling's common would have to rise to 84, a 15% increase.”

If the EPS changes for a firm due to the definition of the number of shares then an EFFICIENT market will not keep applying the same P/E ratio. It will reduce the P/E ratio from the level that it was using before the rule change. This new rule change and new earnings figure did not impart any new information to the market. So the market should not react.

The only condition under which this may be construed as good news is under positive accounting theory. If there are any contracts (for debt etc..) conditioned on the EPS figures then the new liberal rule will relax some covenant constraints. But from chapter 8, page 583-588, we see that no restriction is based on EPS.

5. The article says the following:

“But if the changes are approved by the FASB -- which is likely -- accountants would start calculating two new bottom lines beginning in 1997. And while the changes wouldn't occur until next year, "the Street will be aware of the proposal when looking at stock-price potential right now, so it could affect stock prices a lot sooner," Mr. Willens says.”

This quote claims that the market will react much sooner than the actual change in EPS. At least it is efficient in that it is expected to react faster. The market may be stupid later, but it is smart to recognize earlier that the stupid reaction will occur later.