Earnings Per Share

A. ***Simple Capital Structure***--if a corporation's capital structure consists only of common stock or includes no potentially dilutive convertible securities, options, warrants, or other rights that upon conversion or exercise could dilute earnings per common share, a single presentation, expressed in terms such as basic earnings per common share, is required to be disclosed on the face of the income statement for income from continuing operations, income before extraordinary items, and net income and is computed by dividing the income available to common stockholders by the weighted average number of common shares outstanding during the period

1. Income Available to Common Stockholders--each element of income for which earnings per share presentation is required should be reduced by the current period dividend claim on cumulative preferred stock whether the dividend has been declared or not and by the current period dividend claim on noncumulative preferred stock only if the dividend has been declared

a. Illustrations

Illustration 1.
A corporation reported net income of $300,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 1,000 shares of 8% cumulative preferred stock with a par value of $100 outstanding during the current year; the preferred stock dividend was declared

Earnings Per Share	($300,000 - 8% x $100 x 1,000) / 100,000	$	2.92

Illustration 2.
A corporation reported net income of $300,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 1,000 shares of 8% cumulative preferred stock with a par value of $100 outstanding during the current year; the preferred stock dividend was not declared

Earnings Per Share	($300,000 - 8% x $100 x 1,000) / 100,000	$	2.92

Illustration 3.
A corporation reported net income of $300,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 1,000 shares of 8% noncumulative preferred stock with a par value of $100 outstanding during the current year; the preferred stock dividend was declared

Earnings Per Share	($300,000 - 8% x $100 x 1,000) / 100,000	$	2.92

Illustration 4.
A corporation reported net income of $300,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 1,000 shares of 8% noncumulative preferred stock with a par value of $100 outstanding during the current year; the preferred stock dividend was not declared

Earnings Per Share	$300,000/ 100,000	$ 3.00

2. ***Weighted Average Number of Common Shares Outstanding***--the number of common shares outstanding at the beginning of the period is increased or decreased by any common shares issued or retired during the period weighted by the fraction of the period in which they were outstanding

a. Stock Dividends or Stock Splits--if a stock dividend or stock split occurs either during the current period or after the end of the current period but before the financial statements are issued, the computation of the weighted average number of common shares outstanding requires that the common shares outstanding before the occurrence of the stock dividend or stock split be restated to reflect the effects of the stock dividend or stock split

Illustration--a corporation had 100,000 shares of common stock outstanding on January 1; the corporation issued 2,000 shares of common stock on April 1; the corporation issued a 5% stock dividend on the outstanding common shares on June 1; the corporation repurchased 3,000 shares of common stock on October 1; the corporation issued 6,000 shares of common stock on December 1:

Weighted Average Number of Common Shares Outstanding		
January 1	100,000 x 1.05 x 12 / 12	105,000
April 1	2,000 x 1.05 x 9 / 12	1,575
October 1	(3,000) x 3 / 12	(750)
December 1	6,000 x 1 / 12	500
		106,325

B. ***Complex Capital Structure***--if a corporation's capital structure includes potentially dilutive convertible securities, options, warrants, or other rights that upon conversion or exercise could dilute earnings per common share, a dual presentation, expressed in terms such as basic earnings per share and diluted earnings per share, is required to be disclosed on the face of the income statement for income from continuing operations, income before extraordinary items, and net income and is computed by dividing the income available to common stockholders by the weighted average number of common shares outstanding during the period

1. Convertible Securities

a. If Converted Method--earnings per share is computed by dividing the income available to common stockholders by the weighted average number of common shares

outstanding during the period as if the convertible security were converted

1) Income Available to Common Stockholders--each element of income for which earnings per share presentation is required should not be reduced by the current period dividend claim on convertible preferred stock and should be increased by the current period interest expense, net of tax, on convertible bonds

2) Weighted Average Number of Common Shares Outstanding--the weighted average number of common shares outstanding should be adjusted as if the convertible security were converted at the beginning of the period or the date of issuance of the convertible security if the convertible security were issued during the period

a) Variable Conversion Rates--the weighted average number of common shares outstanding is adjusted for the most advantageous conversion rate available to the holders of the convertible security

b. Antidilution--a convertible security whose inclusion in earnings per share computations would increase earnings per share should be excluded from earnings per share computations

c. Illustrations

Illustration 1.
A corporation reported net income of $800,000 during the current year; the corporation had a weighted average number of common shares outstanding of 80,000 during the current year; the corporation had 5,000 shares of 8% cumulative, convertible preferred stock with a par value of $100 outstanding during the current year; the preferred stock was issued at par; each share of preferred stock is convertible into 2 shares of common stock:

Basic Earnings Per Share	($800,000 - 8% x $100 x 5,000) / 80,000	$	9.50
Per Share Effect of preferred	8% x $100 x 5,000 / (2 x 5,000)	$	4.00
Diluted Earnings Per Share	$800,000 / (80,000 + 2 x 5,000)	$	8.89

Illustration 2.
A corporation reported net income of $800,000 during the current year; the corporation had a weighted average number of common shares outstanding of 200,000 during the current year; the corporation had 5,000 shares of 8% cumulative, convertible preferred stock with a par value of $100 outstanding during the current year; the preferred stock was issued at par; each share of preferred stock is convertible into 2 shares of common stock:

Basic Earnings Per Share	($800,000 - 8% x $100 x 5,000) / 200,000	$	3.80
Per Share Effect of preferred	8% x $100 x 5,000 / (2 x 5,000)	$	4.00
Diluted Earnings Per Share	$800,000 / (200,000 + 2 x 5,000)	$	3.81

The preferred stock is antidilutive; therefore, only a basic earnings per share presentation is required.

Illustration 3.
A corporation reported net income of $800,000 during the current year; the corporation had a weighted average number of common shares outstanding of 80,000 during the current year; the corporation had $750,000 of 10% convertible bonds with a par value of $1,000 outstanding during the current year; the bonds were issued at par; each bond is convertible into 20 shares of common stock. Ignore taxes.

Basic Earnings Per Share	$800,000/ 80,000	$10.00
Per Share Effect of bonds	10% x $1,000 x 750 / (20 x 750)	$ 5.00
Diluted Earnings Per Share	$800,000+10% x $1,000x750 / (80,000 + 20 x 750)	$ 9.21

Illustration 4.
A corporation reported net income of $800,000 during the current year; the corporation had a weighted average number of common shares outstanding of 200,000 during the current year; the corporation had $750,000 of 10% convertible bonds with a par value of $1,000 outstanding during the current year; the bonds were issued at par; each bond is convertible into 20 shares of common stock. Ignore taxes.

Basic Earnings Per Share	$800,000/ 200,000	$ 4.00
Per Share Effect of bonds	10% x $1,000 x 750 / (20 x 750)	$ 5.00
Diluted Earnings Per Share	$800,000+10% x $1,000x750 / (200,000 + 20 x 750)	$ 4.07

The bonds are antidilutive; therefore, only a basic earnings per share presentation is required.

2. *Options and Warrants*--stock purchase contracts, stock subscriptions not fully paid, deferred compensation packages providing for the issuance of common stock, and convertible securities that allow or require the payment of cash upon conversion are considered the equivalent of stock options and stock warrants

a. ***Treasury Stock Method***--earnings per share is computed by dividing the income available to common stockholders by the weighted average number of common shares outstanding during the period as if the stock options and stock warrants were exercised and the proceeds from the exercise of the stock options and stock warrants were used to purchase common stock for the treasury using the average market price of the stock if the average market price of the stock is above the exercise price during the period being reported

1) Income Available to Common Stockholders--each element of income for which earnings per share presentation is required does not need to be adjusted

2) Weighted Average Number of Common Shares Outstanding--the weighted average number of common shares outstanding should be adjusted as if the stock options and stock warrants were exercised at the beginning of the period or the date of issuance of the stock options and stock warrants if the stock options and stock warrants were issued during the period

a. Variable Exercise Prices—-the weighted average number of common shares outstanding is adjusted for the most advantageous exercise price available to the holders of the stock options

b. Antidilution--stock options and stock warrants whose inclusion in earnings per share computations would increase earnings per share should be excluded from earnings per share computations

c. Illustrations

Illustration 1.
A corporation reported net income of $800,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 10,000 stock options outstanding during the current year; the option price is $45 per share; the average market price of the common stock is $50 per share, and the closing market price of the common stock is $55 per share

Basic Earnings Per Share	$800,000/ 100,000	$ 8.00
Proceeds from exercise	10,000 x $45	$ 450,000
Treasury stock	$450,000 / $50	9,000
Per Share Effect of options	0/(10,000 - 9,000)	$ 0.00
Diluted Earnings Per Share	$800,000 / (100,000 + 10,000- 9,000)	$ 7.92

Illustration 2.
A corporation reported net income of $800,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 10,000 stock options outstanding during the current year; the option price is $45 per share; the average market price of the common stock is $40 per share, and the closing market price of the common stock is $55 per share

Basic Earnings Per Share	$800,000/ 100,000	$ 8.00
Proceeds from exercise	10,000 x $45	$ 450,000
Treasury stock	$450,000 / $40	11,250
Per Share Effect of options	0/(10,000 - 9,000)	$ 0.00
Diluted Earnings Per Share	$800,000 / (100,000 + 10,000- 11,250)	$ 8.10

The stock options are antidilutive; therefore, only a basic earnings per share presentation is required.

C. Multiple Dilutive Securities

1. Ranking--the per share effect of convertible securities, stock options and stock warrants, and other rights on earnings per share is computed and is used to rank the convertible securities, stock options and stock warrants, and other rights from the most dilutive to the least dilutive.

2. Computation--earnings per share is computed by adding the convertible securities, stock options and stock warrants, and other rights one at a time to the earnings per share computation in order of their ranking of their per share effects until a convertible security, a stock option or a stock warrant, or an other right is antidilutive or until all convertible securities, stock options or stock warrants, or other rights are included in the computation

3. Illustrations

a. A corporation reported net income of $425,000 during the current year; the corporation had a weighted average number of common shares outstanding of 50,000 during the current year; the corporation had 4,000 shares of 7.5% cumulative, convertible preferred stock with a par value of $100 outstanding during the current year; the preferred stock was issued at par; each share of preferred stock is convertible into 2 shares of common stock; the corporation had $300,000 of 8% convertible bonds with a par value of $1,000 outstanding during the current year; the bonds were issued at par value; each bond is convertible into 40 shares of common stock; the corporation had 10,000 stock options outstanding during the current year; the option price is $20; the average market price of the common stock is $25 per share, and the closing market price of the common stock is $30 per share. Ignore taxes.

Basic Earnings Per Share	($425,000 - 7.5% x $100 x 4,000) / 50,000	$ 7.90
Proceeds from exercise- options	10,000 x $20	$ 200,000
Treasury stock	$200,000 / $25	8,000
Per Share Effects:		
Preferred Stock	7.5% x $100 x 4,000 / (2 x 4,000)	$ 3.75
Bonds	8% x $1,000 x 300 / (40 x 300)	$ 2.00
options	0/(10,000 - 8,000)	$ 0.00
Diluted Earnings Per Share:		
Options	($425,000 - 7.5% x $100 x 4,000) / (50,000 +10,000 - 8,000)	$ 7.60
Bonds	($425,000 - 7.5% x $100 x 4,000 + 8% x $1,000 x 300)/ (50,000 + 10,000 - 8,000 + 40 x 300	$ 6.55
Preferred Stock	($425,000 + 8% x $1,000 x 300) / (50,000 + 10,000 - 8,000 + 40 x 300 + 2 x 4,000)	$ 6.24

b. A corporation reported net income of $425,000 during the current year; the corporation had a weighted average number of common shares outstanding of 100,000 during the current year; the corporation had 4,000 shares of 7.5% cumulative, convertible preferred stock with a par value of $100 outstanding during the current year; the preferred stock was issued at par; each share of preferred stock is convertible into 2 shares of common stock; the corporation had $300,000 of 8% convertible bonds with a par value of $1,000 outstanding during the current year; the bonds were issued at par value; each bond is convertible into 40 shares of common stock; the corporation had 10,000 stock options outstanding during the current year; the option price is $20; the average market price of the common stock is $25 per share, and the closing market price of the common stock is $30 per share. Ignore taxes.

Basic Earnings Per Share	($425,000 - 7.5% x $100 x 4,000) / 100,000	$ 3.95
Proceeds from exercise- options	10,000 x $20	$ 200,000
Treasury stock	$200,000 / $25	8,000
Per Share Effects:		
Preferred Stock	7.5% x $100 x 4,000 / (2 x 4,000)	$ 3.75
Bonds	8% x $1,000 x 300 / (40 x 300)	$ 2.00
options	0/(10,000 - 8,000)	$ 0.00
Diluted Earnings Per Share:		
Options	($425,000 - 7.5% x $100 x 4,000) / (100,000 +10,000 - 8,000)	$ 3.87
Bonds	($425,000 - 7.5% x $100 x 4,000 + 8% x $1,000 x 300)/ (100,000 + 10,000 - 8,000 + 40 x 300)	$ 3.68

The preferred stock is antidilutive; therefore, the preferred stock is excluded from the computation of diluted earnings per share.

D. Reporting

1. Special Transactions--when the earnings of the period include special transactions, earnings per share amounts (where applicable) should be presented for discontinued operations and for extraordinary items either on the face of the income statement or in the notes to the financial statements.

2. Comparative Financial Statements--earnings per share amounts should be presented for all periods presented

a. Stock Dividends or Stock Splits--if a stock dividend or stock split occurs either during the current period or after the end of the current period but before the financial statements are issued, the earnings per share amounts presented for all prior periods should be restated to reflect the effects of the stock dividend or stock split

b. Prior Period Adjustments--if the results of operations of prior periods have been restated as a result of a prior period adjustment or a change in accounting principle,

the earnings per share amounts presented for the prior periods should be restated to reflect the effect of the prior period adjustment or the change in accounting principle, and the effects of the restatement should be disclosed in the year of restatement

c. Diluted Earnings Per Share--if diluted earnings per share is reported for at least one period, diluted earnings per share should be reported for all periods presented, even if diluted earnings per share is the same as basic earnings per share

3. Complex Capital Structure--if a corporation has a complex capital structure, the notes to the financial statements should disclose the following:

a. Description of pertinent rights and privileges of the various securities outstanding

b. A reconciliation of the numerators and denominators of the basic earnings per share and diluted earnings per share computations including the individual income and share effects of all securities that affect earnings per share

c. The effect given preferred dividends in determining income available to common stockholders in computing basic earnings per share

d. Securities that could potentially dilute basic earnings per share in the future that were not included in the computation of diluted earnings per share because they would be antidilutive

e. Effects of conversion subsequent to year end