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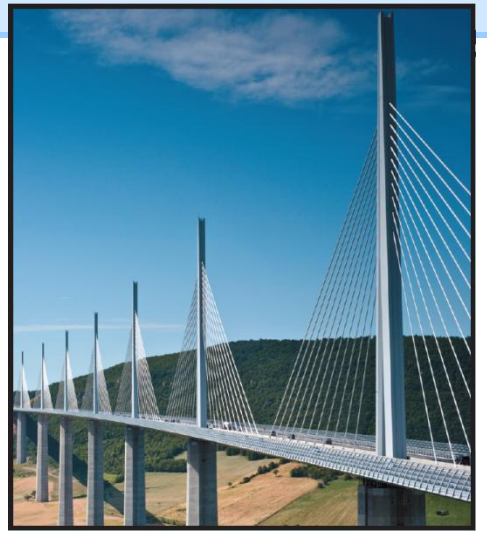
Intermediate Accounting

THIRTEENTH EDITION

CHAPTER 16

DILUTIVE SECURITIES AND EARNINGS PER SHARE

Intermediate Accounting
13th Edition
Kieso, Weygandt, and Warfield



Dilutive Securities and Earnings Per Share

Dilutive Securities and Compensation Plans

- Debt and equity
- Convertible debt
- Convertible preferred stock
- Stock warrants
- Accounting for compensation

Computing Earnings Per Share

- Simple capital structure
- Complex capital structure

Computing Earnings Per Share

Earnings per share indicates the income earned by each share of common stock.

- Companies report earnings per share only for common stock.
- When income statement contains intermediate components of income, companies should disclose earnings per share for each component.

Earnings per share:	
Income from continuing operations	$4.00
Loss from discontinued operations, net of tax	0.60
Income before extraordinary item	3.40
Extraordinary gain, net of tax	1.00
Net income	$4.40

Illustration 16-7

LO 6 Compute earnings per share in a simple capital structure.

Earnings Per Share-Simple Capital Structure

- **Simple Structure**--Only common stock; no potentially dilutive securities.
- **Complex Structure**--Potentially dilutive securities are present.
- **"Dilutive"** means the ability to influence the EPS in a downward direction.

LO 6 Compute earnings per share in a simple capital structure.

Earnings Per Share-Simple Capital Structure

Preferred Stock Dividends

Subtracts the current year preferred stock dividend from net income to arrive at income available to common stockholders.

Illustration 16-8

$$\text{Earnings per Share} = \frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Weighted-Average Number of Shares Outstanding}}$$

Preferred dividends are subtracted on cumulative preferred stock, whether declared or not.

LO 6 Compute earnings per share in a simple capital structure.

Earnings Per Share-Simple Capital Structure

Weighted-Average Number of Shares

Companies must weight the shares by the fraction of the period they are outstanding.

Stock dividends or **stock splits:** companies need to restate the shares outstanding before the stock dividend or split.

LO 6 Compute earnings per share in a simple capital structure.

Earnings Per Share-Simple Capital Structure

E16-16: On January 1, 2010, Chang Corp. had 480,000 shares of common stock outstanding. During 2010, it had the following transactions that affected the common stock account.

February 1	Issued 120,000 Shares
March 1	Issued a 20% stock dividend
May 1	Acquired 100,000 share of treasury stock
June 1	Issued a 3-for-1 stock split
October 1	Reissued 60,000 shares of treasury stock

Instructions Determine the weighted-average number of shares outstanding as of December 31, 2010.

LO 6 Compute earnings per share in a simple capital structure.

Earnings Per Share-Simple Capital Structure

Weighted-Average Number of Shares

Date	Change in Shares	Shares Outstanding		Fraction of Year		20% Dividend		3/1 Split	Weighted Average Shares
Jan. 1		480,000	x	1/12	x	120%	x	3	144,000
Feb. 1	120,000	600,000	x	1/12	x	120%	x	3	180,000
Mar. 1	120,000	720,000	x	2/12			x	3	360,000
May 1	(100,000)	620,000	x	1/12			x	3	155,000
June 1	3/1 split	1,860,000	x	4/12			x		620,000
Oct. 1	60,000	1,920,000	x	3/12			x		480,000
									1,939,000

LO 6 Compute earnings per share in a simple capital structure.

Earnings Per Share-Complex Capital Structure

Complex Capital Structure exists when a business has

- convertible securities,
- options, warrants, or other rights

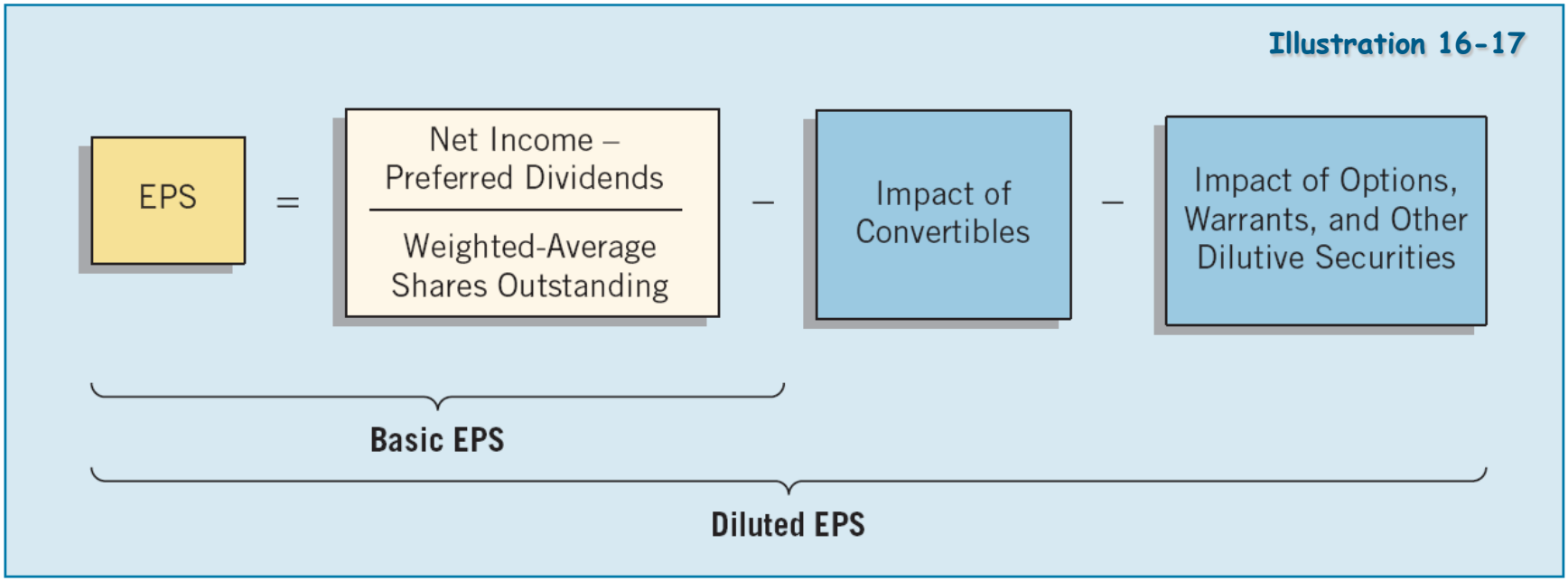
that upon conversion or exercise could **dilute** earnings per share.

Company reports both basic and diluted earnings per share.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

Diluted EPS includes the effect of all potential dilutive common shares that were outstanding during the period.



Companies will not report diluted EPS if the securities in their capital structure are antidilutive.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

Diluted EPS – Convertible Securities

Measure the dilutive effects of potential conversion on EPS using the **if-converted method**.

This method for a convertible bond assumes:

(1) the conversion at the beginning of the period (or at the time of issuance of the security, if issued during the period), and

(2) the elimination of related interest, net of tax.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-22 (Convertible Bonds): In 2010 Buraka Enterprises issued, at par, 75, $1,000, 8% bonds, each convertible into 100 shares of common stock. Buraka had revenues of $17,500 and expenses other than interest and taxes of $8,400 for 2011. (Assume that the tax rate is 40%.) Throughout 2011, 2,000 shares of common stock were outstanding; none of the bonds was converted or redeemed.

Instructions

(a) Compute diluted earnings per share for 2011.

(b) Assume same facts as those for Part (a), except the 75 bonds were issued on September 1, 2011 (rather than in 2010), and none have been converted or redeemed.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-22 (a) Compute diluted earnings per share for 2011.

Calculation of Net Income

Revenues	$17,500
Expenses	8,400
Bond interest expense (75 x $1,000 x 8%)	6,000
Income before taxes	3,100
Income tax expense (40%)	1,240
Net income	$ 1,860

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-22 (a) Compute diluted earnings per share for 2011.

When calculating **Diluted** EPS, begin with **Basis** EPS.

Basic EPS

$$\frac{\text{Net income} = \$1{,}860}{\text{Weighted average shares} = 2{,}000} = \$.93$$

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-22 (a) Compute diluted earnings per share for 2011.

When calculating **Diluted** EPS, begin with **Basis** EPS.

Diluted EPS

$$\frac{\$1{,}860 + \$6{,}000\ (1 - .40)}{2{,}000 + 7{,}500} = \frac{\$5{,}460}{9{,}500} = \$.57$$

Basic EPS = .93

Effect on EPS = .48

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-22 (b) Assume bonds were issued on Sept. 1, 2011 .

Calculation of Net Income

Revenues	$ 17,500
Expenses	8,400
Bond interest expense (75 x $1,000 x 8% x 4/12)	2,000
Income before taxes	7,100
Income taxes (40%)	2,840
Net income	$ 4,260

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-22 (b) Assume bonds were issued on Sept. 1, 2011 .

When calculating **Diluted** EPS, begin with **Basis** EPS.

Diluted EPS

$$\frac{\$4{,}260 + \$2{,}000\ (1 - .40)}{2{,}000 + 7{,}500 \times 4/12\ \text{yr.}} = \frac{\$5{,}460}{4{,}500} = \$1.21$$

Basic EPS = 2.13

Effect on EPS = .48

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

P16-8 (Variation-Convertible Preferred Stock): Prior to 2010, Barkley Company issued 40,000 shares of 6% convertible, cumulative preferred stock, $100 par value. Each share is convertible into 5 shares of common stock. Net income for 2010 was $1,200,000. There were 600,000 common shares outstanding during 2010. There were no changes during 2010 in the number of common or preferred shares outstanding.

Instructions

(a) Compute diluted earnings per share for 2010.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

P16-8 (a) Compute diluted earnings per share for 2010.

When calculating **Diluted** EPS, begin with **Basis** EPS.

Basic EPS

$$\frac{\text{Net income } \$1{,}200{,}000 - \text{Pfd. Div. } \$240{,}000^{*}}{\text{Weighted average shares} = 600{,}000} = \$1.60$$

* 40,000 shares x $100 par x 6% = $240,000 dividend

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

P16-8 (a) Compute diluted earnings per share for 2010.

When calculating **Diluted** EPS, begin with **Basis** EPS.

Diluted EPS

$$\frac{\$1{,}200{,}000 - \$240{,}000 + \$240{,}000}{600{,}000 + 200{,}000^{*}} = \frac{\$1{,}200{,}000}{800{,}000} = \$1.50$$

Basic EPS = 1.60

Effect on EPS = 1.20

*(40,000 x 5)

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

P16-8 (a) Compute diluted earnings per share for 2010 assuming each share of preferred is convertible into 3 shares of common stock.

Diluted EPS

$$\frac{\$1{,}200{,}000 - \$240{,}000 + \$240{,}000}{600{,}000 + 120{,}000^{*}} = \frac{\$1{,}200{,}000}{720{,}000} = \$1.67$$

Basic EPS = 1.60

Effect on EPS = 2.00

*(40,000 x 3)

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

P16-8 (a) Compute diluted earnings per share for 2010 assuming each share of preferred is convertible into 3 shares of common stock.

Diluted EPS **Basic = Diluted EPS**

$$\frac{\$1{,}200{,}000 - \$240{,}000 + \$240{,}000}{600{,}000 + 120{,}000^{*}} = \frac{\$1{,}200{,}000}{720{,}000} = \$1.67$$

Basic EPS = 1.60

Effect on EPS = 2.00

Antidilutive

*(40,000 x 3)

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

Diluted EPS – Options and Warrants

Measure the dilutive effects of potential conversion using the **treasury-stock method**.

This method assumes:

(1) company exercises the options or warrants at the beginning of the year (or date of issue if later), and

(2) that it uses those proceeds to purchase common stock for the treasury.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-26 (EPS with Options): Zambrano Company's net income for 2010 is $40,000. The only potentially dilutive securities outstanding were 1,000 options issued during 2009, each exercisable for one share at $8. None has been exercised, and 10,000 shares of common were outstanding during 2010. The average market price of the stock during 2010 was $20.

Instructions

(a) Compute diluted earnings per share.

(b) Assume the 1,000 options were issued on October 1, 2010 (rather than in 2009). The average market price during the last 3 months of 2010 was $20.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-26 (a) Compute diluted earnings per share for 2010.

Treasury-Stock Method

Proceeds if shares issued (1,000 x $8)		$8,000
Purchase price for treasury shares	÷	$20
Shares assumed purchased		400
Shares assumed issued		1,000
Incremental share increase		600

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-26 (a) Compute diluted earnings per share for 2010.

When calculating **Diluted** EPS, begin with **Basis** EPS.

Diluted EPS

$$\frac{\$40{,}000 + 0}{10{,}000 + 600} = \frac{\$40{,}000}{10{,}600} = \$3.77$$

Basic EPS = 4.00

Options

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-26 (b) Compute diluted earnings per share assuming the 1,000 options were issued on October 1, 2010.

Treasury-Stock Method

Proceeds if shares issued (1,000 x $8)		$	8,000
Purchase price for treasury shares	÷	$	20
Shares assumed purchased			400
Shares assumed issued			1,000
Incremental share increase			600
Weight for 3 months assumed outstanding	×		3/12
Weighted incremental share increase			150

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

E16-26 (b) Compute diluted earnings per share assuming the 1,000 options were issued on October 1, 2010.

Diluted EPS

$$\frac{\$40{,}000}{10{,}000 + 150} = \frac{\$40{,}000}{10{,}150} = \$3.94$$

Basic EPS = 4.00

Options

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

Contingent Issue Agreement

Contingent shares are issued as a result of the:

1. passage of time or
2. attainment of a certain earnings or market price level.

Antidilution Revisited

Ignore antidilutive securities in all calculations and in computing diluted earnings per share.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

EPS Presentation and Disclosure

A company should show per share amounts for:

- income from continuing operations,
- income before extraordinary items, and
- net income.

Per share amounts for a discontinued operation or an extraordinary item should be presented on the face of the income statement or in the notes.

LO 7 Compute earnings per share in a complex capital structure.

Earnings Per Share-Complex Capital Structure

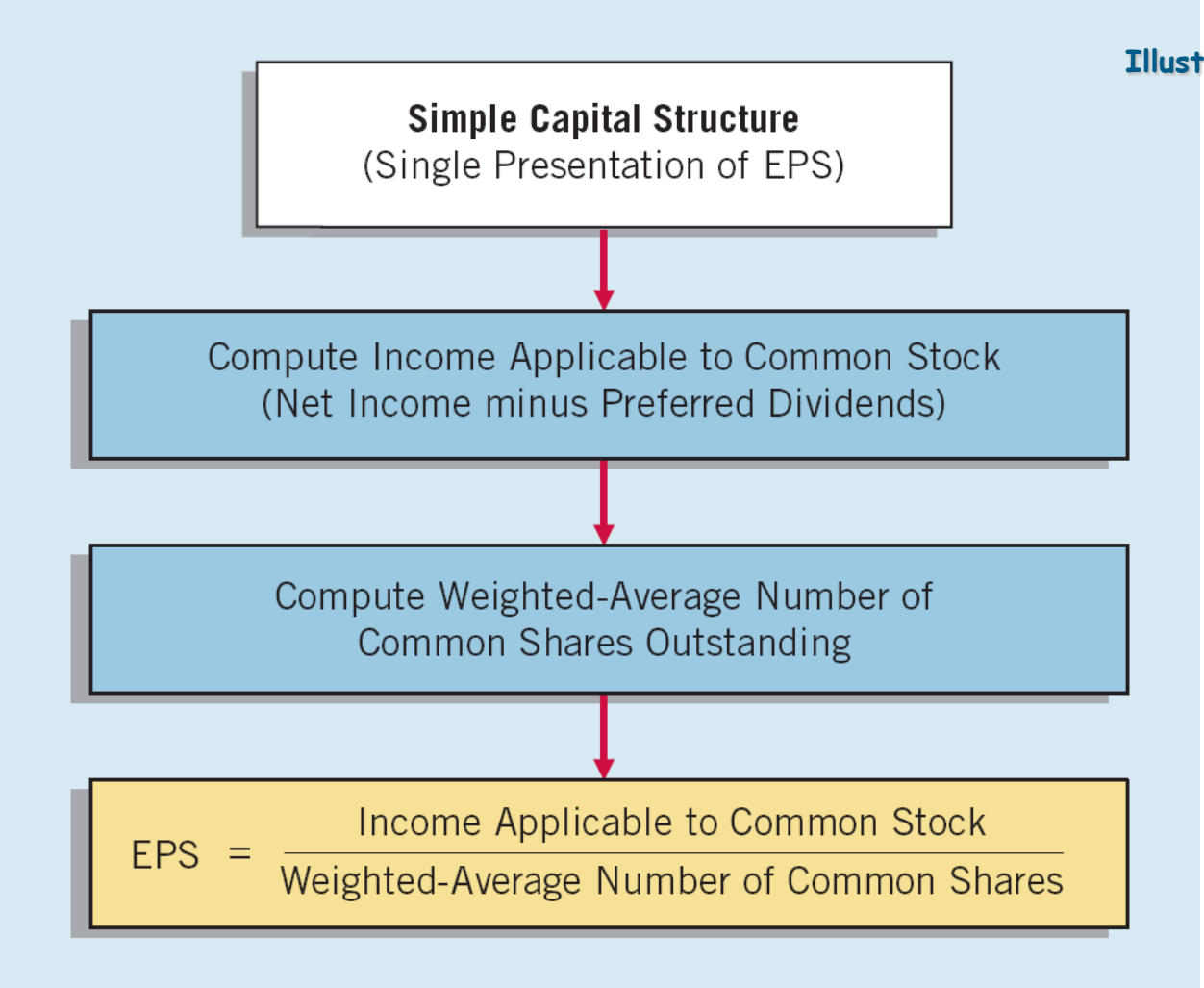
Complex capital structures and dual presentation of EPS require the following additional disclosures in note form.

1. Description of pertinent rights and privileges of the various securities outstanding.
2. A reconciliation of the numerators and denominators of the basic and diluted per share computations, including individual income and share amount effects of all securities that affect EPS.
3. The effect given preferred dividends in determining income available to common stockholders in computing basic EPS.
4. Securities that could potentially dilute basic EPS in the future that were excluded in the computation because they would be antidilutive.
5. Effect of conversions subsequent to year-end, but before issuing statements.

LO 7 Compute earnings per share in a complex capital structure.

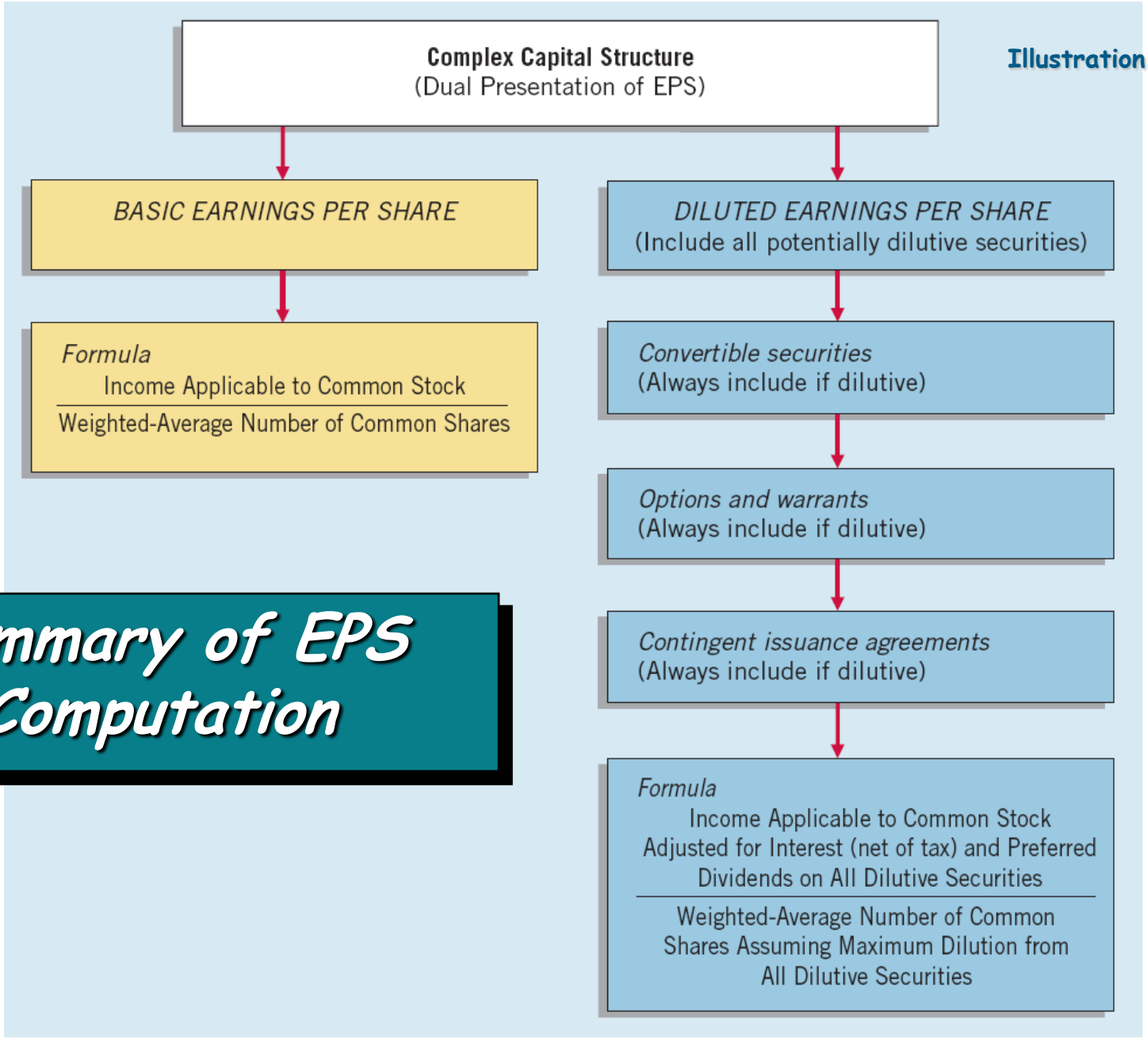
Summary of EPS Computation

Illustration 16-27



LO 7 Compute earnings per share in a complex capital structure.

Summary of EPS Computation



LO 7

CONVERGENCE CORNER

DILUTIVE SECURITIES AND EARNINGS PER SHARE

RELEVANT FACTS

- Under U.S. GAAP, all of the proceeds of convertible debt are recorded as long-term debt. Under iGAAP, convertible bonds are "bifurcated"—separated into the equity component (the value of the conversion option) of the bond issue and the debt component.
- Although the calculation of basic and diluted earnings per share is similar between iGAAP and U.S. GAAP, the Boards are working to resolve the few minor differences in EPS reporting.
- Other EPS differences relate to (1) the treasury-stock method and how the proceeds from extinguishment of a liability should be accounted for, and (2) how to compute the weighted-average of contingently issuable shares.

APPENDIX 16A ACCOUNTING FOR STOCK-APPRECIATION RIGHTS

Stock-Appreciation Rights (SARs):

- The company gives an executive the right to receive compensation equal to the share appreciation.
- **Share appreciation** is the excess of the market price of the stock at the date of exercise over a pre-established price.
- The company may pay the share appreciation in cash, shares, or a combination of both.
- The accounting for stock-appreciation rights depends on whether the company classifies the rights as equity or as a liability.

LO 8 Explain the accounting for stock appreciation rights plans.

SARS— Share-Based Equity Awards

Companies classify SARs as equity awards if at the date of exercise, the holder receives shares of stock from the company upon exercise.

- ✓ holder receives shares in an amount equal to the share-price appreciation (the difference between the market price and the pre-established price).
- ✓ At the date of grant, the company determines a fair value for the SAR and then allocates this amount to compensation expense over the service period of the employees.

LO 8 Explain the accounting for stock appreciation rights plans.

SARS— Share-Based Liability Awards

Companies classify SARs as liability awards if at the date of exercise, the holder receives a cash payment. Accounting:

1. Measure the fair value of the award at the grant date and accrue compensation over the service period.
2. Remeasure the fair value each reporting period, until the award is settled; adjust the compensation cost each period for changes in fair value pro-rated for the portion of the service period completed.
3. Once the service period is completed, determine compensation expense each subsequent period by reporting the full change in market price as an adjustment to compensation expense.

LO 8 Explain the accounting for stock appreciation rights plans.

APPENDIX 16A ACCOUNTING FOR STOCK-APPRECIATION RIGHTS

Illustration: American Hotels, Inc. establishes a stock-appreciation rights plan on January 1, 2010. The plan entitles executives to receive cash at the date of exercise for the difference between the market price of the stock and the pre-established price of $10 on 10,000 SARs. The fair value of the SARs on December 31, 2010, is $3, and the service period runs for two years (2010–2011).

Illustration 16A-1 indicates the amount of compensation expense to be recorded each period.

LO 8 Explain the accounting for stock appreciation rights plans.

APPENDIX 16A ACCOUNTING FOR STOCK-APPRECIATION RIGHTS

Illustration 16-A1

STOCK-APPRECIATION RIGHTS
SCHEDULE OF COMPENSATION EXPENSE

(1) Date	(2) Fair Value	(3) Cumulative Compensation Recognizable[a]	(4) Percentage Accrued[b]	(5) Cumulative Compensation Accrued to Date	Expense 2010	Expense 2011	Expense 2012
12/31/10	$3	$30,000	50%	$ 15,000	$15,000		
				55,000		$55,000	
12/31/11	7	70,000	100%	70,000			
				(20,000)			$(20,000)
12/31/12	5	50,000	100%	$ 50,000			

[a]Cumulative compensation for unexercised SARs to be allocated to periods of service.
[b]The percentage accrued is based upon a two-year service period (2010–2011)

American Hotels records compensation expense in the first year as follows.

Compensation Expense	15,000	
Liability under Stock-Appreciation Plan		15,000

LO 8 Explain the accounting for stock appreciation rights plans.

APPENDIX 16A ACCOUNTING FOR STOCK-APPRECIATION RIGHTS

In 2012, when it records negative compensation expense, American would debit the account for $20,000. The entry to record the negative compensation expense is as follows.

Liability under Stock-Appreciation Plan	20,000	
Compensation Expense		20,000

At December 31, 2012, the executives receive $50,000. American would remove the liability with the following entry.

Liability under Stock-Appreciation Plan	50,000	
Cash		50,000

LO 8 Explain the accounting for stock appreciation rights plans.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

Balance Sheet for Comprehensive Illustration

Illustration 16-B1

WEBSTER CORPORATION
BALANCE SHEET (PARTIAL)
AT DECEMBER 31, 2010

Long-term debt	
Notes payable, 14%	$ 1,000,000
8% convertible bonds payable	2,500,000
10% convertible bonds payable	2,500,000
Total long-term debt	$ 6,000,000
Stockholders' equity	
10% cumulative, convertible preferred stock, par value $100; 100,000 shares authorized, 25,000 shares issued and outstanding	$ 2,500,000
Common stock, par value $1, 5,000,000 shares authorized, 500,000 shares issued and outstanding	500,000
Additional paid-in capital	2,000,000
Retained earnings	9,000,000
Total stockholders' equity	$14,000,000

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

Balance Sheet for Comprehensive Illustration

Illustration 16-B1

Notes and Assumptions
December 31, 2010

1. Options were granted in July 2008 to purchase 50,000 shares of common stock at $20 per share. The average market price of Webster's common stock during 2010 was $30 per share. All options are still outstanding at the end of 2010.
2. Both the 8 percent and 10 percent convertible bonds were issued in 2009 at face value. Each convertible bond is convertible into 40 shares of common stock. (Each bond has a face value of $1,000.)
3. The 10 percent cumulative, convertible preferred stock was issued at the beginning of 2010 at par. Each share of preferred is convertible into four shares of common stock.
4. The average income tax rate is 40 percent.
5. The 500,000 shares of common stock were outstanding during the entire year.
6. Preferred dividends were not declared in 2010.
7. Net income was $1,750,000 in 2010.
8. No bonds or preferred stock were converted during 2010.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

Computation of Earnings per Share—Simple Capital Structure

Illustration 16-B2

Weighted-average number of common shares outstanding	
Earnings per common share	

Solution on notes page

LO 9 Compute earnings per share in a complex situation.

Diluted Earnings Per Share

Steps for computing diluted earnings per share:

1. Determine, for each dilutive security, the per share effect assuming exercise/conversion.
2. Rank the results from step 1 from smallest to largest earnings effect per share.
3. Beginning with the earnings per share based upon the weighted-average of common shares outstanding, recalculate earnings per share by adding the smallest per share effects from step 2. Continue this process so long as each recalculated earnings per share is smaller than the previous amount.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **first step** is to determine a per share effect for each potentially dilutive security.

Per Share Effect of Options **(Treasury-Stock Method)**, Diluted Earnings per Share

Illustration 16-B3

Number of shares under option	50,000
Option price per share	× $20
Proceeds upon assumed exercise of options	$1,000,000
Average 2010 market price of common	$30
Treasury shares that could be acquired with proceeds ($1,000,000 ÷ $30)	33,333
Excess of shares under option over treasury shares that could be repurchased (50,000 − 33,333)	16,667
Per share effect:	
$\frac{\text{Incremental Numerator Effect}}{\text{Incremental Denominator Effect}} = \frac{\text{None}}{\text{16,667 shares}} =$	$0

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **first step** is to determine a per share effect for each potentially dilutive security.

Per Share Effect of 8% Bonds **(If-Converted Method)**, Diluted Earnings per Share

Illustration 16-B4

Interest expense for year (8% × $2,500,000)	$200,000
Income tax reduction due to interest (40% × $200,000)	80,000
Interest expense avoided (net of tax)	$120,000
Number of common shares issued assuming conversion of bonds (2,500 bonds × 40 shares)	100,000
Per share effect:	
$\frac{\text{Incremental Numerator Effect}}{\text{Incremental Denominator Effect}} = \frac{\$120,000}{100,000 \text{ shares}} =$	$1.20

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **first step** is to determine a per share effect for each potentially dilutive security.

Per Share Effect of 10% Bonds **(If-Converted Method)**, Diluted Earnings per Share

Illustration 16-B5

Interest expense for year (10% × $2,500,000)	$250,000
Income tax reduction due to interest (40% × $250,000)	100,000
Interest expense avoided (net of tax)	$150,000
Number of common shares issued assuming conversion of bonds (2,500 bonds × 40 shares)	100,000
Per share effect:	
$\frac{\text{Incremental Numerator Effect}}{\text{Incremental Denominator Effect}} = \frac{\$150,000}{100,000 \text{ shares}} =$	$1.50

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **first step** is to determine a per share effect for each potentially dilutive security.

Per Share Effect of 10% Convertible Preferred **(If-Converted Method)**, Diluted Earnings per Share

Illustration 16-B6

Dividend requirement on cumulative preferred (25,000 shares × $10)	$250,000
Income tax effect (dividends not a tax deduction)	none
Dividend requirement avoided	$250,000
Number of common shares issued assuming conversion of preferred (4 × 25,000 shares)	100,000
Per share effect:	
$\frac{\text{Incremental Numerator Effect}}{\text{Incremental Denominator Effect}} = \frac{\$250,000}{100,000 \text{ shares}} =$	$2.50

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **first step** is to determine a per share effect for each potentially dilutive security.

Ranking of per Share Effects **(Smallest to Largest)**, Diluted Earnings per Share

Illustration 16-B7

	Effect per Share
1. Options	$ 0
2. 8% convertible bonds	1.20
3. 10% convertible bonds	1.50
4. 10% convertible preferred	2.50

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **next step** is to determine earnings per share giving effect to the ranking

Recomputation of EPS Using Incremental Effect of Options

Illustration 16-B8

Options	
Income applicable to common stockholders	$1,500,000
Add: Incremental numerator effect of options	none
Total	$1,500,000
Weighted-average number of common shares outstanding	500,000
Add: Incremental denominator effect of options (Illustration 16B-3)	16,667
Total	516,667
Recomputed earnings per share ($1,500,000 ÷ 516,667 shares)	$2.90

The effect of the options is dilutive.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **next step** is to determine earnings per share giving effect to the ranking

Recomputation of EPS Using Incremental Effect of 8% Convertible Bonds

Illustration 16-B9

8% Convertible Bonds	
Numerator from previous calculation	$1,500,000
Add: Interest expense avoided (net of tax)	120,000
Total	$1,620,000
Denominator from previous calculation (shares)	516,667
Add: Number of common shares assumed issued upon conversion of bonds	100,000
Total	616,667
Recomputed earnings per share ($1,620,000 ÷ 616,667 shares)	$2.63

The effect of the 8% convertible bonds is dilutive.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **next step** is to determine earnings per share giving effect to the ranking

Recomputation of EPS Using Incremental Effect of 10% Convertible Bonds

Illustration 16-B10

10% Convertible Bonds	
Numerator from previous calculation	$1,620,000
Add: Interest expense avoided (net of tax)	150,000
Total	$1,770,000
Denominator from previous calculation (shares)	616,667
Add: Number of common shares assumed issued upon conversion of bonds	100,000
Total	716,667
Recomputed earnings per share ($1,770,000 ÷ 716,667 shares)	$2.47

The effect of the 10% convertible bonds is dilutive.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

The **next step** is to determine earnings per share giving effect to the ranking

Recomputation of EPS Using Incremental Effect of 10% Convertible Preferred

Illustration 16-B11

10% Convertible Preferred	
Numerator from previous calculation	$1,770,000
Add: Dividend requirement avoided	250,000
Total	$2,020,000
Denominator from previous calculation (shares)	716,667
Add: Number of common shares assumed issued upon conversion of preferred	100,000
Total	816,667
Recomputed earnings per share ($2,020,000 ÷ 816,667 shares)	$2.47

The effect of the 10% convertible preferred is NOT dilutive.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

Finally, Webster Corporation's disclosure of earnings per share on its income statement.

Illustration 16-B12

Net income	$1,750,000
Basic earnings per common share (Note X)	$3.00
Diluted earnings per common share	$2.47

The effect of the 10% convertible preferred is NOT dilutive.

LO 9 Compute earnings per share in a complex situation.

APPENDIX 16B COMPREHENSIVE EARNINGS PER SHARE EXAMPLE

Assume that Barton Company provides the following information.

Barton Company Data

Illustration 16-B13

Income from continuing operations	$2,400,000
Loss from discontinued operations	3,600,000
Net loss	$1,200,000
Weighted-average shares of common stock outstanding	1,000,000
Potential common stock	200,000

Barton reports basic and dilutive earnings per share as follows.

Basic and Diluted EPS

Illustration 16-B14

Basic earnings per share	
Income from continuing operations	$2.40
Loss from discontinued operations	3.60
Net loss	$1.20
Diluted earnings per share	
Income from continuing operations	$2.00
Loss from discontinued operations	3.00
Net loss	$1.00

LO 9 Compute earnings per share in a complex situation.

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