Financial Reporting Insights

EARNINGS PER SHARE

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OVERVIEW

Earnings per share (EPS) is a measurement of an entity's profitability on a per-share basis and is one of the leading metrics used by investors. FASB Accounting Standards Codification (ASC) Topic 260, *Earnings Per Share*, addresses the calculation, presentation, and disclosure requirements for EPS by entities that have either issued common stock that trades in a public market, or made a filing, or are in the process of filing, with a regulatory agency in preparation for a sale of common stock in a public market. The two required measures of EPS are basic EPS and diluted EPS. The objective of basic EPS is to measure the performance of an entity over the reporting period, whereas the objective of diluted EPS is to measure the performance of an entity over the reporting period while giving effect to all dilutive potential common shares outstanding during the period.

This white paper highlights the scope of the EPS requirements, the concepts of basic and diluted EPS, and the presentation and disclosure requirements for EPS. For further guidance on identifying participating and dilutive securities, as well as the methods for calculating EPS, refer to ASC 260.

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1. Introduction

Earnings per share (EPS) is a measurement of an entity's profitability on a per-share basis and is one of the leading metrics used by investors. The primary source of authoritative guidance under U.S. generally accepted accounting principles (GAAP) on EPS is Accounting Standards Codification (ASC) Topic 260, *Earnings Per Share*, which addresses the calculation, presentation, and disclosure requirements for EPS. Under ASC 260, presentation of EPS is required by all entities that have either issued common stock that trades in a public market, or made a filing, or are in the process of filing, with a regulatory agency in preparation for a sale of common stock in a public market. The two metrics of EPS are:

Basic EPS — The objective of basic EPS is to measure the performance of an entity over the reporting period

- Presented when an entity has common shares outstanding
- Calculated as net income available to common shareholders for the period divided by the weighted-average number of common shares outstanding

Diluted EPS — The objective of diluted EPS is to measure the performance of an entity over the reporting period while giving effect to all dilutive potential common shares outstanding during the period

- Presented when an entity has both common shares and dilutive potential common shares outstanding
- Calculated as net income available to common shareholders for the period divided by the weighted-average number of common shares outstanding and dilutive potential common stock

This white paper highlights the scope of the EPS requirements, the concepts of basic and diluted EPS, and the presentation and disclosure requirements for EPS. This white paper is intended to provide a summary of EPS concepts and requirements. Accordingly, it may not provide all the guidance necessary to perform all the required aspects of the basic and diluted EPS calculations. For further guidance on identifying participating and dilutive securities, as well as the methods for calculating EPS, refer to ASC 260.

This whitepaper assumes entities have adopted ASU 2020-06, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*.

1.1 Scope

ASC 260 requires all entities that have issued common stock or potential common stock (e.g., securities such as options, warrants, convertible securities, or contingent stock agreements) present EPS if those securities trade in a public market. A public market can be either on a stock exchange (either domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. ASC 260 also applies to entities that have made a filing or are in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market. The Master Glossary of the ASC defines common stock as "a stock that is subordinate to all other stock of the issuer." ASC 260 applies to an equity interest meeting the definition of common stock regardless of whether such stock is labeled as common stock.

ASC 260 does not apply to:

- An entity that has only publicly-traded debt securities, unless those securities are, or may be, converted into common stock
- Investment companies within the scope of ASC 946

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- Financial statements of wholly owned subsidiaries; however, ASC 260 would apply to the separately issued financial statements of a subsidiary that has publicly-traded common stock held by noncontrolling interests

Any entity can voluntarily choose to present EPS. If an entity elects to voluntarily present EPS, that entity must follow the provisions of ASC 260.

The following table addresses different situations and securities and considers whether presentation of EPS under ASC 260 is required.

Description	Yes, presentation of EPS is required under ASC 260	No, presentation is not required (can be voluntarily provided)	Comments
Common stock traded on the NASDAQ or NYSE	X		Common stock would be considered publicly traded regardless of trading volume.
Common stock traded on OTC Pink Market	X		The OTC Pink Market is considered a public market because it is generally accessible by the public and publishes underlying financial information.
Rule 144A securities		X	Securities that can only be purchased by certain investors, such as 144A securities, are not considered to be traded in a public market.
Entity is in the process of filing with a regulatory agency in preparation for sale of common stock in a public market	X		To be considered “in process,” the entity needs to be actively taking steps to file, including drafting a prospectus or preparing financial statements for inclusion in a filing.
Entity is an Investment Company within the scope of ASC 946		X	Investment Companies are excluded from the scope of ASC 260 pursuant to paragraph 260-10-15-3.
Publicly traded debt, convertible into common stock	X		The debt is traded in a public market and the debt securities are convertible to common stock.
Publicly traded debt, not convertible into common stock		X	While the debt is publicly traded, unless there is common stock or potential common stock that is publicly traded, EPS is not required.

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2. Basic EPS

ASC 260-10-45-10

Basic EPS shall be computed by dividing income available to common stockholders (the numerator) by the weighted-average number of common shares outstanding (the denominator) during the period. Shares issued during the period and shares reacquired during the period shall be weighted for the portion of the period that they were outstanding. See Example 1 (paragraph 260-10-55-38) for an illustration of this guidance.

An entity's EPS is equal to income for the period (such as a quarter or a year) divided by the weighted-average number of common shares outstanding for the same period. Basic EPS is a simpler calculation than diluted EPS as it only includes outstanding shares of common stock in the calculation.

$$\text{Basic EPS} = \frac{\text{Income Available to Common Stockholders (Numerator)}}{\text{Weighted-Average Number of Common Shares Outstanding (Denominator)}}$$

2.1 The numerator: Income available to common stockholders

The numerator in the calculation of basic EPS is income available to common stockholders.

ASC Master Glossary

Income Available to Common Stockholders

Income (or loss) from continuing operations or net income (or net loss) adjusted for preferred stock dividends.

ASC 260-10-45-11

Income available to common stockholders shall be computed by deducting both the dividends declared in the period on preferred stock (whether or not paid) and the dividends accumulated for the period on cumulative preferred stock (whether or not earned) from income from continuing operations (if that amount appears in the income statement) and also from net income. If there is a loss from continuing operations or a net loss, the amount of the loss shall be increased by those preferred dividends. An adjustment to net income or loss for preferred stock dividends is required for all preferred stock dividends, regardless of the form of payment. Preferred dividends that are cumulative only if earned shall be deducted only to the extent that they are earned.

ASC 260-10-45-11A

For purposes of computing EPS in consolidated financial statements (both basic and diluted), if one or more less-than-wholly-owned subsidiaries are included in the consolidated group, income from continuing operations and net income shall exclude the income attributable to the noncontrolling interest in subsidiaries. Example 7 (see paragraph 260-10-55-64) provides an example of calculating EPS when there is a noncontrolling interest in a subsidiary in the consolidated group.

ASC 260-10-45-12

Preferred stock dividends that an issuer has paid or intends to pay in its own common shares shall be deducted from net income (or added to the amount of a net loss) in computing income available to common stockholders. In certain cases, the dividends may be payable in common shares or cash at the issuer's option. The adjustment to net income (or net loss) for preferred

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stock dividends payable in common stock in computing income available to common stockholders is consistent with the treatment of common stock issued for goods or services.

ASC 260-10-45-12B

For a freestanding equity-classified financial instrument and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) with a down round feature, an entity shall deduct the value of the effect of a down round feature (as recognized in accordance with paragraph 260-10-25-1 and measured in accordance with paragraphs 260-10-30-1 through 30-2) in computing income available to common stockholders when that feature has been triggered (that is, upon the occurrence of the triggering event that results in a reduction of the strike price).

ASC 260-10-45-15

For a modification or an exchange of a freestanding equity-classified written call option described in paragraph 815-40-35-17(d), an entity shall deduct the effect of the modification or exchange (as measured in accordance with paragraph 815-40-35-16) in computing income available to common stockholders when the modification or exchange is executed by the issuer and the holder or unilaterally by the issuer (see paragraph 815-40-15-7H).

Income available to common stockholders is based on income (or loss) adjusted for preferred stock dividends. There may also be additional adjustments required.

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Below is a listing of some of the items that may result in an adjustment to income available to common stockholders, followed by additional guidance on some of the common adjustments.

Preferred stock

- Dividends declared in the period on preferred stock (whether or not paid)
- Dividends accumulated during the period on cumulative preferred stock (whether or not earned) unless the preferred dividends are cumulative only if earned (in which case they are included in the adjustment only to the extent earned)
- Accretions on redeemable, non-common stock
- Periodic amortization of the discount resulting from the issuance of increasing rate preferred stock

Noncontrolling interests

- Income (loss) attributable to the noncontrolling interest in subsidiaries

Redeemable securities

- Adjustments to the redemption amount for redeemable preferred stock
- When a class of common stock is redeemable at other than fair value, increases or decreases in the carrying amount of the redeemable security using a method akin to the two-class method (see Section 2.1.1)

Participating securities

- Dividends on participating preferred stock
- Undistributed net income attributable to participating preferred stock
- Dividends paid on common stock options
- Undistributed net income allocated to other participating securities (see Section 2.1.1)

Modifications of preferred stock

- A modification or an exchange of preferred stock or a freestanding equity-classified written call option (such as a warrant) if treated as a deemed dividend
- Certain modifications of common stock if resulting in a deemed dividend

Redemptions and conversions of securities

- Certain common stock repurchases in excess of fair value
- Induced conversions of preferred stock
- Redemptions or extinguishments of preferred stock at amounts other than the carrying amount

Other

- Deemed dividends resulting from the triggering of a down round feature (i.e., a reduction in the exercise or conversion price upon a triggering event) in equity-classified freestanding financial instruments and equity-classified convertible preferred stock
- Discontinued operations

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In adjusting income available to common stockholders, the items referred to above will generally decrease income from continuing operations and net income (or increase a loss from continuing operations and net loss).

Additional Considerations

Income available to common shareholder is adjusted for certain items. One such item is periodic accretions on redeemable stock, other than common stock, calculated in accordance with ASC 480-10-S99-2/Topic 3.C of the SEC Staff Accounting Bulletin (SAB) Codification (also see our guide, *Accounting for debt and equity instruments in financing transactions*). ASC 480-10-S99-3A provides that increases or decreases in the carrying amount of a redeemable common stock should not affect income applicable to common shareholders. Rather, to the extent that a common shareholder has a contractual right to receive at share redemption (other than upon ordinary liquidation events) an amount that is other than the fair value of such shares, then that common shareholder has, in substance, received a preferential distribution. ASC 260 requires entities with capital structures that include a class of common stock with different dividend rates from those of another class of common stock but without prior or senior rights should apply the two-class method of calculating EPS (see Section 2.1.1). Therefore, when a class of common stock is redeemable at other than fair value, increases or decreases in the carrying amount of the redeemable security should be reflected in EPS using a method akin to the two-class method. For common stock redeemable at fair value, the SEC Staff would not expect the use of a method akin to the two-class method, as a redemption at fair value does not amount to a preferential distribution.

Additionally, a financial instrument may contain a feature that reduces the strike price if the issuer sells shares of its stock for an amount less than the currently stated strike price of the issued financial instrument or issues an equity-linked financial instrument with a strike price below the currently stated strike price of the issued financial instrument (i.e., a down round feature). For a freestanding equity-classified financial instrument with a down round feature and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) with a down round feature, the value of the effect of a down round feature is deducted from the computation of income available to common stockholders when that feature is triggered (i.e., upon the occurrence of the triggering event that results in a reduction of the strike price). For further guidance on the accounting upon triggering a down round feature, refer to our guide, *Accounting for debt and equity instruments in financing transactions.*

For a modification or an exchange of a freestanding equity-classified written call option (e.g., a warrant) that is not related to a financing transaction pursuant to an equity issuance, debt origination, or debt modification, and not otherwise within the scope of any other ASC Topics (e.g., ASC 718), the effect of the modification or exchange (as measured in accordance with ASC 815-40-35-16) should be deducted in computing income available to common stockholders when the modification or exchange is executed by the issuer and the holder or unilaterally by the issuer.

For additional guidance on determining the amount of the adjustments to income available to common shareholders, refer to ASC 260, including ASC 260-10-S55 and ASC 260-10-S99, which references and includes guidance issued by the SEC staff on calculating the effect on EPS for various events and transactions, including:

- Preferred stock dividends and accretion of carrying amount of preferred stock
- Redemption or induced conversion of preferred stock or a portion of a class of preferred stock
- Subsequent increases or decreases in the carrying amount of redeemable securities
- Nominal issuances and initial public offerings

Per ASC 220-10-S99-5, the SEC expects income available to common stockholders to be reported on the face of the income statement when it is materially different on a quantitative basis from reported net

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income or loss (generally if the amount differs from net income or loss by more than 10%) or when it is indicative of significant trends or other qualitative considerations.

2.1.1 Participating securities and the two-class method

ASC Master Glossary

Participating Security

A security that may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. The form of such participation does not have to be a dividend—that is, any form of participation in undistributed earnings would constitute participation by that security, regardless of whether the payment to the security holder was referred to as a dividend.

A participating security is a security that may participate in undistributed earnings along with common stock. It does not matter if that participation is conditioned upon the occurrence of a specified event or not. Also, the form of participation does not have to be a dividend; any form of participation in undistributed earnings that would otherwise be available to common shareholders would constitute participation by that security. The following securities, for example, are considered to be participating securities:

- Securities that may participate in dividends with common stock according to a predetermined formula (the right to dividends must be based on objective criteria, not an arbitrary amount at the discretion of the board)
- Potential common shares, (i.e., securities or other contracts that may entitle their holders to obtain common stock such as options, warrants, forwards or other contracts to issue common stock), if they meet the definition of a participating security in their current form (that is, prior to exercise or settlement), such as by participating in dividends if declared
- Debt instruments that receive a dividend based on a formula of earnings
- A class of common stock with different dividend rates from those of another class of common stock but without prior or senior rights

However, pursuant to ASC 260-10-45-62 (see guidance below), dividends to the holder of a convertible security issued as a reduction to the conversion price or an increase in the conversion ratio of the security do not represent participation rights. The guidance in ASC 260-10-45-62 also applies to dividend equivalents and other similar-type contracts that issue common stock when the exercise price is adjusted.

Fully vested share-based compensation awards under ASC 718 that include a right to receive dividends declared on the common stock of the issuer are participating securities. ASC 260-10-45-61A clarifies that instruments granted in share-based payment transactions may also be participating securities prior to vesting. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and should be included in the computation of EPS pursuant to the two-class method. In regard to share-based payments:

- The holder of a share-based payment award that includes nonforfeitable rights to dividends or dividend equivalents receives a noncontingent transfer of value each time an entity declares a dividend or dividend equivalent during the contractual period of the share-based payment award. As a result, the award meets the definition of a participating security in its current form (i.e., prior to the requisite service having been rendered for an employee award or the nonemployee's vesting conditions having been met). In contrast, the right to receive dividends or dividend equivalents that the holder will forfeit if the award does not vest does not constitute a participation right. Such an award does not meet the definition of a participating security in its current form (i.e., prior to the

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requisite service having been rendered for an employee award or the nonemployee's vesting conditions having been met), consistent with the other guidance in ASC 260-10-45-60 through 45-68.

- Dividends or dividend equivalents transferred to the holder of a share-based payment award in the form of a reduction in the exercise price of the award (e.g., reduction in the exercise price of an equity share option) do not represent participation rights because the award does not include a nonforfeitable right to participate in undistributed earnings absent the exercise of the award. That is, a right to dividends or dividend equivalents in the form of a reduction in the exercise price of a share-based payment award is a contingent transfer of value to the holder of a share-based payment award.

ASC 260-10-45-61

Fully vested share-based compensation subject to the provisions of Topic 718, including fully vested options and fully vested stock, that contain a right to receive dividends declared on the common stock of the issuer, are subject to the guidance in paragraph 260-10-45-60A.

ASC 260-10-45-61A

Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method under the requirements of paragraph 260-10-45-60A.

ASC 260-10-45-62

Dividends or dividend equivalents transferred to the holder of a convertible security in the form of a reduction to the conversion price or an increase in the conversion ratio of the security do not represent participation rights. This guidance applies similarly to other contracts (securities) to issue an entity’s common stock if these contracts (securities) provide for an adjustment to the exercise price that is tied to the declaration of dividends by the issuer. The scope of the guidance in this paragraph excludes forward contracts to issue an entity's own equity shares.

It is important to understand the definition of a participating security and to be able to recognize such a security, as the existence of a participating security affects the calculation of EPS. Entities must exclude from income available to common stockholders any claim on undistributed earnings from a participating security—irrespective of whether the securities are convertible, non-convertible or potential common stock securities—in basic EPS using the two-class method. The two-class method is an earnings allocation formula as if all earnings for the period were distributed in accordance with the terms of the participating securities. Only the earnings that would be distributed to the common shareholders are presented in basic and diluted EPS. ASC 260-10-45 describes the application of the two-class method:

ASC 260-10-45-60A

All securities that meet the definition of a participating security, irrespective of whether the securities are convertible, nonconvertible, or potential common stock securities, shall be included in the computation of basic EPS using the two-class method.

ASC 260-10-45-60B

Under the two-class method:

a. Income from continuing operations (or net income) shall be reduced by the amount of dividends declared in the current period for each class of stock and by the contractual amount of dividends (or interest on participating income bonds) that must be paid for the current period (for example, unpaid cumulative dividends). Dividends declared in the current

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period do not include dividends declared in respect of prior-year unpaid cumulative dividends. Preferred dividends that are cumulative only if earned are deducted only to the extent that they are earned.

b. The remaining earnings shall be allocated to common stock and participating securities to the extent that each security may share in earnings as if all of the earnings for the period had been distributed. The total earnings allocated to each security shall be determined by adding together the amount allocated for dividends and the amount allocated for a participation feature.

c. The total earnings allocated to each security shall be divided by the number of outstanding shares of the security to which the earnings are allocated to determine the EPS for the security.

d. Basic and diluted EPS data shall be presented for each class of common stock.

For the diluted EPS computation, outstanding common shares shall include all potential common shares assumed issued. Example 6 (see paragraph 260-10-55-62) illustrates the two-class method.

ASC 260-10-45-65

Undistributed earnings for a period shall be allocated to a participating security based on the contractual participation rights of the security to share in those current earnings as if all of the earnings for the period had been distributed. If the terms of the participating security do not specify objectively determinable, nondiscretionary participation rights, then undistributed earnings would not be allocated based on arbitrary assumptions. For example, if an entity could avoid distribution of earnings to a participating security, even if all of the earnings for the year were distributed, then no allocation of that period's earnings to the participating security would be made. Paragraphs 260-10-55-24 through 55-31 provide additional guidance on participating securities and undistributed earnings.

ASC 260-10-45-66

Under the two-class method the remaining earnings shall be allocated to common stock and participating securities to the extent that each security may share in earnings as if all of the earnings for the period had been distributed. This allocation is required despite its pro forma nature and that it may not reflect the economic probabilities of actual distributions to the participating security holders.

ASC 260-10-45-67

An entity would allocate losses to a nonconvertible participating security in periods of net loss if, based on the contractual terms of the participating security, the security had not only the right to participate in the earnings of the issuer, but also a contractual obligation to share in the losses of the issuing entity on a basis that was objectively determinable. Determination of whether a participating security holder has an obligation to share in the losses of the issuing entity in a given period shall be made on a period-by-period basis, based on the contractual rights and obligations of the participating security. The holder of a participating security would have a contractual obligation to share in the losses of the issuing entity if either of the following conditions is present:

a. The holder is obligated to fund the losses of the issuing entity (that is, the holder is obligated to transfer assets to the issuer in excess of the holder's initial investment in the participating security without any corresponding increase in the holder's investment interest).

b. The contractual principal or mandatory redemption amount of the participating security is reduced as a result of losses incurred by the issuing entity.

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ASC 260-10-45-68

A convertible participating security should be included in the computation of basic EPS in periods of net loss if, based on its contractual terms, the convertible participating security has the contractual obligation to share in the losses of the issuing entity on a basis that is objectively determinable. The guidance in this paragraph also applies to the inclusion of convertible participating securities in basic EPS, irrespective of the differences that may exist between convertible and nonconvertible securities. That is, an entity should not automatically exclude a convertible participating security from the computation of basic EPS if an entity has a net loss from continuing operations. Determination of whether a participating security holder has an obligation to share in the losses of the issuing entity in a given period shall be made on a period-by-period basis, based on the contractual rights and obligations of the participating security.

ASC 260-10-45-68B

Paragraph 718-10-55-45 requires that nonrefundable dividends or dividend equivalents paid on awards for which the requisite service is not (or is not expected to be) rendered be recognized as additional compensation cost and that dividends or dividend equivalents paid on awards for which the requisite service is (or is expected to be) rendered be charged to retained earnings. As a result, an entity shall not include dividends or dividend equivalents that are accounted for as compensation cost in the earnings allocation in computing EPS. To do so would include the dividend as a reduction of earnings available to common shareholders from both compensation cost and distributed earnings. *Undistributed* earnings shall be allocated to all share-based payment awards outstanding during the period, including those for which the requisite service is not expected to be rendered (or is not rendered because of forfeiture during the period, if an entity elects to account for forfeitures when they occur in accordance with paragraph 718-10-35-3). An entity's estimate of the number of awards for which the requisite service is not expected to be rendered (or no estimate, if the entity has elected to account for forfeitures when they occur in accordance with paragraph 718-10-35-3) for the purpose of determining EPS under this Topic shall be consistent with the estimate used for the purposes of recognizing compensation cost under Topic 718. Paragraph 718-10-35-3 requires that an entity apply a change in the estimate of the number of awards for which the requisite service is not expected to be rendered in the period that the change in estimate occurs. This change in estimate will affect net income in the current period; however, a current-period change in an entity's expected forfeiture rate would not affect prior-period EPS calculations. See Example 9 for an illustration of this guidance.

2.1.1.1 Undistributed earnings and losses

Allocating undistributed earnings

The following examples of allocating undistributed earnings are provided within ASC 260-10-55-25 through 55-30:

Example 2-1: Allocation of undistributed earnings

The following scenarios were adapted from ASC 260-10-55-25 through 55-30.

Scenario A: A participating security that provides the holder with the ability to participate in all dividends declared with the holders of common stock on a 1:1 per-share basis.

Evaluation: The undistributed earnings should be allocated between the common stock and the participating security on a 1:1 per-share basis.

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Scenario B: A participating security that provides the holder with the ability to participate with the holders of common stock in dividends declared contingent upon the occurrence of a specified event, the occurrence of which is subject to management discretion or is not objectively determinable (e.g., liquidation of the entity or management determination of an "extraordinary" dividend).

Evaluation: The terms of the participating security in this scenario do not specify objectively determinable, nondiscretionary participation rights; therefore, undistributed earnings would not be allocated to the participating security.

Scenario C: A participating security that provides the holder with the ability to participate with the holders of common stock in earnings for a period in which a specified event occurs, regardless of whether a dividend is paid during the period (e.g., achievement of a target market price of a security or achievement of a certain earnings level).

Evaluation: Undistributed earnings would be allocated to common stock and the participating security based on the assumption that all of the earnings for the period are distributed. Undistributed earnings would be allocated to the participating security if the contingent condition would have been satisfied at the reporting date, irrespective of whether an actual distribution was made for the period.

Scenario D: A participating security that provides the holder with the ability to participate in extraordinary dividends. The classification of dividends as extraordinary is predetermined by a formula, for example, any dividend per common share in excess of 5% of the current market price of the stock is defined as extraordinary.

Evaluation: Undistributed earnings would be allocated to common stock and the participating security based on the assumption that all of the earnings for the period are distributed. If earnings for a given period exceed the specified threshold above which the participating security would participate (i.e., earnings for the period are in excess of 5% of the current market price of the stock), undistributed earnings would be allocated to the participating security according to its terms.

Scenario E: A participating security that provides the holder with the ability to participate in extraordinary dividends. The classification of dividends as extraordinary is within the sole discretion of the board of directors.

Evaluation: Undistributed earnings would be allocated only to common stock. Because the classification of dividends as extraordinary is within the sole discretion of the board of directors, undistributed earnings would not be allocated to the participating security as the participation in the undistributed earnings would not be objectively determinable.

Scenario F: A participating security that provides the holder with the ability to participate in all dividends up to a specified threshold. For example, the security participates in dividends per common share up to 5% of the current market price of the stock.

Evaluation: Undistributed earnings would be allocated to common stock and the participating security based on the assumption that all of the earnings for the period are distributed. In this example, undistributed earnings would be allocated to common stock and to the participating security up to 5% of the current market price of the common stock, as the amount of the threshold for participation by the participating security is objectively determinable. The remaining undistributed earnings for the period would be allocated to common stock.

Allocating losses

Net losses should be allocated to the securities if the contractual terms of the participating security require the holder of the security to share in the losses. This would be evidenced if either of the following conditions from ASC 260-10-45-67 is present:

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- The holder is obligated to fund the losses of the issuing entity. This would be the case if the holder is obligated to transfer assets to the issuer in excess of the holder's initial investment in the participating security without any corresponding increase in the holder's investment interest.
- The contractual principal or mandatory redemption of the participating security is reduced as a result of losses incurred by the issuing entity.

The determination of whether a participating security holder has an obligation to share in the losses should be made on a period-by-period basis, based on the participating security's contractual rights and obligations. In addition, if a convertible participating security meets the above evidence, it should be included in the computation of basic EPS in periods of net loss.

EPS presentation considerations for participating securities

The total earnings allocated to each security is then divided by the number of outstanding shares of the security to determine the EPS for the security. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common shareholders but does not require the presentation of basic and diluted EPS for securities other than common stock. While ASC 260 only requires basic and diluted EPS data be presented for each class of common stock, the presentation of basic and diluted EPS for a participating security other than common stock is not precluded.

2.1.1.2 Illustrative examples of the two-class method

Once it is determined that participating securities exist, entities should follow the guidance on participating securities and the two-class method in ASC 260-10-45-59A through 45-70, and reference ASC 260-10-55-71 for an illustration (included below) of how to include participating securities in the computation of basic EPS using the two-class method.

Example 2-2: Participating securities and the two-class method

[The following example *is Example 9: Participating Securities and the Two-Class Method* from ASC 260-10-55-71 through 55-76D.]

Participating securities should be included in the computation of basic earnings per share using the two-class method. The following Cases illustrate the guidance in paragraphs 260-10-45-59A through 45-70 for the application of the two-class method of computing basic earnings per share when:

a. An entity has participating convertible preferred stock (Case A).

b. An entity has participating convertible bonds (Case B).

c. An entity has participating warrants (Case C).

d. An entity has participating share-based payment awards (Case D).

The application of the two-class method in each of Cases A, B, and C presents an EPS calculation for both the common stock and the participating security. This presentation is for illustrative purposes only. The presentation of EPS is only required for each class of common stock (as clarified by this Example). However, the presentation of basic and diluted EPS for a participating security other than common stock is not precluded. Cases A, B, and C share both of the following assumptions:

a. 10,000 shares of Class A common stock

b. Reported net income of $65,000 for 20X1.

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Case A: Participating Convertible Preferred Stock

Assume that Entity A had 5,000 shares of preferred stock outstanding during 20X1. Each share of preferred stock is convertible into two shares of Class A common stock. The preferred stock is entitled to a noncumulative annual dividend of $5 per share. After Class A has been paid a dividend of $2 per share, the preferred stock then participates in any additional dividends on a 40:60 per share ratio with Class A. For 20X1, the Class A shareholders have been paid $26,000 (or $2.60 per share), and the preferred shareholders have been paid $27,000 (or $5.40 per share). Basic EPS under the two-class method for 20X1 would be computed as follows.

Net Income		$65,000
Less dividends paid:		
Class A common	$26,000	
Preferred stock	27,000	53,000
Undistributed 20X1 earnings		$12,000

Allocation of undistributed earnings:

To preferred:

0.4 (5,000) / [0.4(5,000) + 0.6(10,000)] x $12,000 = $3,000

$3,000 / 5,000 shares = $0.60 per share

To common:

0.6 (10,000) / [0.4(5,000) + 0.6(10,000)] x $12,000 = $9,000

$9,000 / 10,000 shares = $0.90 per share

Basic earnings per share amounts:		
	Preferred	**Class A**
Distributed earnings	$5.40	$2.60
Undistributed earnings	0.60	0.90
Total	$6.00	$3.50

Case B: Participating Convertible Debt Instrument

Assume that on January 1, 20X1, Entity A issues 1,000 30-year convertible bonds with an aggregate par value of $1,000,000. Each bond is convertible into 8 shares of Class A common stock and carries a coupon rate of 3 percent. After Class A has been paid a dividend of $2 per share, the bondholders then participate in any additional dividends on a 40:60 per share ratio with Class A shareholders. The bondholders receive common stock dividends based on the number of shares of common stock that the bonds are convertible into. The bondholders do not have any voting rights prior to conversion into common stock. For 20X1, the Class A shareholders have been paid $20,000 (or $2.00 per share). Basic EPS under the two-class method for 20X1 would be computed as follows.

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Net Income		$65,000
Less dividends paid:		
Class A common	$20,000	20,000
Undistributed 20X1 earnings		$45,000

Allocation of undistributed earnings:

To convertible bonds:

0.4 (8,000) / [0.4(8,000) + 0.6(10,000)] x $45,000 = $15,652

$15,652 / 8,000 shares = $1.96 per share

To common:

0.6 (10,000) / [0.4(8,000) + 0.6(10,000)] x $45,000 = $29,348

$29,348 / 10,000 shares = $2.93 per share

Basic earnings per share amounts:		
	Convertible Bonds	**Class A**
Distributed earnings	$0	$2.00
Undistributed earnings	1.96	2.93
Total	$1.96	$4.93

Case C: Participating Warrants

Assume that Entity A had warrants to purchase 5,000 shares of common stock outstanding during 20X1. Each warrant entitles the holder to purchase 1 share of common stock at $10 (fair value at date of grant) per share. In addition, the warrant holders receive dividends on the underlying common stock to the extent they are declared. For 20X1, common shareholders have been paid $26,000 (or $2.60 per share), and the warrant holders have been paid $13,000 (or, also, $2.60 per share). Basic EPS under the two-class method for 20X1 would be computed as follows:

Net Income		$65,000
Less dividends paid:		
Common stock	$26,000	
Warrants	13,000	39,000
Undistributed 20X1 earnings		$26,000

Allocation of undistributed earnings:

To warrants:

0.5 (5,000) / [0.5(5,000) + 0.5(10,000)] x $26,000 = $8,667

$8,667 / 5,000 shares = $1.73 per share

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To common:

0.5 (10,000) / [0.5(5,000) + 0.5(10,000)] x $26,000 = $17,333

$17,333 / 10,000 shares = $1.73 per share

Or, to simplify, since the common shareholders and the warrant holders share in dividends on a one-to-one basis, undistributed earnings could also be calculated as follows:

$26,000 ÷ 15,000 shares = $1.73 per common share and warrant.

Basic earnings per share amounts:		
	Common	**Warrants**
Distributed earnings	$2.60	$2.60
Undistributed earnings	1.73	1.73
Total	$4.33	$4.33

Case D: Participating Share-Based Payment Awards

Assume that Entity A had 25,000 shares of common stock and 5,000 unvested share-based payment awards outstanding during 20X8 and reported net income of $100,000. The share-based payment awards participate in any dividends on a 1:1 per-share ratio with common stock, and the dividends are nonforfeitable by the holder of the share-based payment awards. Entity A's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3.

As of the beginning of 20X8, Entity A estimated that the requisite service will not be provided for 200 of the 5,000 share-based payment awards outstanding. At the end of 20X8, Entity A adjusts its estimate to reflect an increased expected forfeiture rate and now expects that the requisite service will not be provided for 300 awards. It recognizes the cumulative effect of this change in compensation cost in the current period.

Entity A paid a $1.50 per-share dividend at the end of 20X8. Net income includes an expense of $450 related to dividends paid to the awards for which the requisite service is not expected to be rendered in accordance with paragraph 718-10-55-45. Basic EPS under the two-class method for 20X8 would be computed as follows:

Net income		$100,000
Less dividends paid:		
Common stock	$37,500	
Unvested share-based payment awards	$7,050 (a)	
		$44,550
Undistributed earnings		$55,450

(a) Reflects the dividends paid to unvested share-based payment awards ($7,500 = $5,000 unvested share-based payment awards x $1.50 dividend per share) less the dividends paid to awards for which the requisite service is not expected to be rendered ($450 = 300 share-based payment awards for which the requisite service is not expected to be rendered x $1.50 dividend per share). Dividends paid on awards for which the requisite service is not expected to be rendered are already recognized in net income as additional compensation cost.

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Allocation of undistributed earnings:

To unvested share-based payment awards:

5,000 / (5,000 + 25,000) x $55,450 = $9,242

$9,242 / 5,000 total unvested share-based payment awards = $1.85 per share

To common:

25,000 / (5,000 + 25,000) x $55,450 = $46,208

$46,208 / 25,000 shares of common stock = $1.85 per share

Or, to simplify, because the common shareholders and the share-based payment award holders share in dividends on a 1:1 basis, undistributed earnings could also be calculated as follows:

$55,450 / 30,000 shares(b) = $1.85 per common share and share-based payment award

(b) 25,000 shares of common stock + 5,000 total unvested share-based payment awards

Basic earnings per share amounts:

	Unvested Share-Based Payment Awards	Common Stock
Distributed earnings	$1.41 (c)	$1.50
Undistributed earnings	1.85	1.85
	$3.26	$3.35

(c) $7.050 of distributed earnings allocated to the unvested share-based payment awards divided by 5,000 total unvested share-based payment awards. Although all unvested share-based payment awards received a payment of $1.50 per share, totaling $7,500, only dividends to awards for which the requisite service is expected to be rendered are considered distributed earnings as that term is used in paragraph 260-10-45-60B(a). Dividends paid on awards for which the requisite service is not expected to be rendered are recognized in net income as additional compensation cost.

Note that in this illustrative example, application of the two-class method presents an EPS calculation for both the common stock and the participating security, that is, the unvested share-based payment awards. This presentation is for illustrative purposes only. The presentation of EPS is only required for each class of common stock. However, the presentation of basic and diluted EPS for a participating security other than common stock is not precluded. The disclosure in the notes to financial statements of actual distributions to unvested share-based payment awards, rather than the amount presented as distributed earnings, also is not precluded to reconcile earnings per common share and per unvested share-based payment awards. For example, Entity A in the example above may disclose that actual distributions to unvested share-based payment awards were $7,500 and that $450 of those distributions was included in net income as compensation cost related to awards for which the requisite service is not expected to be rendered. Disclosure on a per-share basis also is not precluded.

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2.1.2 Master Limited Partnerships and the two-class method

ASC 260-10-05-3

Publicly traded master limited partnerships often issue multiple classes of securities that may participate in partnership distributions according to a formula specified in the partnership agreement. A typical master limited partnership consists of publicly traded common units held by limited partners, a general partner interest, and incentive distribution rights. Depending on the structure of the master limited partnership, the incentive distribution rights may be a separate class of nonvoting limited partner interest that the general partner initially holds but generally may transfer or sell apart from its overall interest. Alternatively, the incentive distribution rights may be embedded in the general partner interest such that they cannot be detached and transferred apart from the general partner's overall interest.

ASC 260-10-05-4

Generally, the partnership agreement obligates the general partner to distribute 100 percent of the partnership's available cash (as defined in the partnership agreement) at the end of each reporting period to the general partner and limited partners via a distribution waterfall (that is, a schedule that prescribes distributions to the general partner and limited partners at each threshold) within a contractually determined period of time following the end of a reporting period. When certain thresholds are met, the distribution waterfall further allocates available cash to the holder of the separate class of nonvoting limited partner interest (the incentive distribution right holder) or, when the incentive distribution right is embedded in the general partner interest, to the general partner. The net income (or loss) of the partnership is allocated to the capital accounts of the general partner and limited partners based on their respective sharing of income or losses specified in the partnership agreement, but only after taking into account any priority income allocations resulting from incentive distributions.

As a result of the capital structure of master limited partnerships (MLPs), the partnership is required to apply the two-class method (Section 2.1.1) when computing earnings per unit (EPU). When applying the two-class method to the interests of the general partner (GP) and limited partners (LPs) in an MLP, questions have been raised about the impact of incentive distribution rights (IDRs) on the computation of EPU.

ASC 260-10-45-71 through 45-73 addresses how current-period earnings of an MLP should be allocated to the GP, LPs and, when applicable, IDRs when applying the two-class method. An MLP may issue IDRs that are a separate class of nonvoting LP interest that the GP initially holds or IDRs that are embedded in the GP interest and therefore cannot be detached or transferred apart from the GP's overall interest. IDRs that are a separate class of non-voting limited partner interest generally may be transferred or sold apart from the GP interest.

The guidance in ASC 260-10-45-71 through 45-73 applies to all MLPs that are required to make incentive distributions when certain thresholds have been met (regardless of whether the IDRs are a separate LP interest or embedded in the GP interest) and have accounted for the incentive distributions as equity distributions, not as compensation costs. This guidance does not address the determination of whether the incentive distribution is an equity distribution or compensation expense.

ASC 260-10-45-72

Incentive distribution rights that are a separate class of limited partner interest are participating securities because they have a right to participate in earnings with common equity holders. Therefore, current-period earnings shall be allocated to the general partner, limited partner, and incentive distribution right holder using the two-class method to calculate earnings per unit.

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> **ASC 260-10-45-73**
>
> Incentive distribution rights that are embedded in the general partner interest are not separate participating securities. However, because the general partner and limited partner interests are separate classes of equity, the two-class method shall be applied in computing earnings per unit for the general partner and limited partner interests.

2.1.2.1 Incentive distribution rights (IDRs)

If IDRs are a separate class of limited partner interest, when calculating EPU under the two-class method for an MLP, net income (or loss) should be decreased or increased by distributions to the GP, LPs, and IDR holder for the period presented. The undistributed earnings, if any, should be allocated to the GP, LPs, and IDR holder according to the contractual terms of the partnership agreement. The distribution waterfall (a schedule that details the distributions to the various interest holders at each threshold) for available cash specified in the partnership agreement contractually mandates how the earnings are to be distributed for the period presented.

The undistributed earnings should be allocated to the IDR holder based on the contractual participation rights of the IDR to share in the current period earnings. Therefore, if the partnership agreement includes a “specified threshold,” undistributed earnings should not be allocated to the IDR holder once the specified threshold has been met. According to ASC 260-10-55-105, in determining whether a specified threshold exists, an MLP should evaluate whether distributions to the IDR holder would be contractually limited to available cash as defined in the partnership agreement. For example, if the partnership agreement contractually limits distributions to the IDR holder to available cash as defined in the partnership agreement and all available cash for the period presented has been distributed, then the MLP would not allocate undistributed earnings to the IDR holder. However, if the partnership agreement is silent or does not explicitly limit distributions to the IDR holder to available cash, then the MLP would allocate undistributed earnings utilizing the distribution waterfall for available cash specified in the partnership agreement.

ASC 260-10-55-106 requires that any excess of distributions over earnings should be allocated to the GP and LPs based on their respective sharing of losses specified in the partnership agreement (that is, the provisions for allocation of losses to the partners’ capital accounts for the period presented). If the IDR holders do not share in losses, the excess of distribution over earnings amount would not be allocated to the IDR holders. However, if the IDR holders have a contractual obligation to share in the losses of the MLP on a basis that is objectively determinable, the excess of distributions over earnings should be allocated to the GP, LPs, and IDR holders based on their respective sharing of losses specified in the partnership agreement for the period presented.

2.1.2.2 Embedded IDRs

If the IDRs are embedded in the GP interest, they are not separate participating securities. However, because the GP and LP interests are separate classes of equity, the two-class method should be applied in computing EPU for the GP and LP interests.

When calculating EPU under the two-class method for an MLP when the IDRs are embedded in the GP interest, ASC 260-10-55-107 states that net income (or loss) should be reduced (or increased) by distributions to the GP (including the distribution rights of the embedded IDRs) and LPs for the period presented. Undistributed earnings, if any, should be allocated to the GP (including the distribution rights of the embedded IDRs) and LPs according to the contractual terms of the partnership agreement. The distribution waterfall for available cash specified in the partnership agreement contractually mandates how the earnings will be distributed for the period presented.

The undistributed earnings should be allocated to the GP (with respect to the distribution rights of an embedded IDR) based on the contractual participation rights of the IDR to share in the current period

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earnings. Therefore, if the partnership agreement includes a “specified threshold,” an MLP should not allocate undistributed earnings to the GP (with respect to the distribution rights of an embedded IDR) once the specified threshold has been met. In determining whether a specified threshold exists, an MLP should evaluate whether distributions to the GP (with respect to the distribution rights of an embedded IDR) would be contractually limited to available cash as defined in the partnership agreement. ASC 260-10-55-109 provides an example, which states that if the partnership agreement contractually limits distributions to the GP (with respect to the distribution rights of an embedded IDR) to available cash as defined in the partnership agreement and all available cash for the period presented has been distributed, then the MLP would not allocate undistributed earnings to the GP (with respect to the distribution rights of an embedded IDR). However, if the partnership agreement is silent or does not explicitly limit distributions to the GP (with respect to the distribution rights of an embedded IDR) to available cash, then the MLP would allocate undistributed earnings to the GP (with respect to the distribution rights of an embedded IDR) according to the distribution waterfall for available cash specified in the partnership agreement. The excess of distributions over earnings should be allocated to the GP and LPs based on their respective sharing of losses specified in the partnership agreement for the period presented.

2.2 The denominator: Weighted-average number of common shares

The denominator in the calculation of basic EPS is the weighted-average number of common shares. The ASC Master Glossary defines weighted-average number of common shares outstanding, in part, as “[t]he number of shares determined by relating the portion of time within a reporting period that common shares have been outstanding to the total time in that period.”

ASC 260-10-45-12C

Contractual agreements (usually associated with purchase business combinations) sometimes provide for the issuance of additional common shares contingent upon certain conditions being met. Consistent with the objective that basic EPS should represent a measure of the performance of an entity over a specific reporting period, contingently issuable shares should be included in basic EPS only when there is no circumstance under which those shares would not be issued and basic EPS should not be restated for changed circumstances.

ASC 260-10-45-13

Shares issuable for little or no cash consideration upon the satisfaction of certain conditions (contingently issuable shares) shall be considered outstanding common shares and included in the computation of basic EPS as of the date that all necessary conditions have been satisfied (in essence, when issuance of the shares is no longer contingent). Outstanding common shares that are contingently returnable (that is, subject to recall) shall be treated in the same manner as contingently issuable shares. Thus, contingently issuable shares include shares that meet any of the following criteria:

a. They will be issued in the future upon the satisfaction of specified conditions.

b. They have been placed in escrow and all or part must be returned if specified conditions are not met.

c. They have been issued but the holder must return all or part if specified conditions are not met.

ASC 260-10-55-2

The weighted-average number of shares is an arithmetical mean average of shares outstanding and assumed to be outstanding for EPS computations. The most precise average would be the sum of the shares determined on a daily basis divided by the number of days in the period. Less-precise averaging methods may be used, however, as long as they produce reasonable

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results. Methods that introduce artificial weighting, such as the Rule of 78 method, are not acceptable for computing a weighted-average number of shares for EPS computations.

The weighted-average number of common shares is determined by relating the portion of time within a reporting period that common shares have been outstanding to the total time in that period. When computing EPS for an interim period, the denominator is based on the weighted-average shares outstanding during the interim period, not on an annualized weighted-average basis. Generally, year-to-date basic EPS calculations are based on the sum of the individual quarterly calculations.

Common shares outstanding include issued common stock that is not subject to any vesting or forfeiture provisions and may include common stock issuable for little to no consideration. Shares issuable for little or no cash consideration upon the satisfaction of certain conditions are considered outstanding common shares and included in the weighted-average number of common shares used in the denominator in the computation of basic EPS commencing on the date that all necessary conditions have been satisfied (i.e., the shares are no longer contingent). This would be the case even if the shares are not yet legally issued. Outstanding common shares that are contingently returnable are treated in the same manner as contingently issuable shares and would be excluded from common shares outstanding until such time as any contingencies expire or forfeiture provisions lapse. Contingently issuable shares include shares that will be issued once specified conditions are satisfied, have been placed in escrow and must be returned if specified conditions are not met or have been issued but must be returned if specified conditions are not met.

The following table discusses select securities and their potential impact on the weighted-average shares outstanding calculation used in basic EPS. Some of these securities that are excluded from the calculation of basic EPS may need to be considered for inclusion in the calculation of diluted EPS (see Chapter 3):

Description	Impact on weighted-average shares outstanding for purposes of calculating basis EPS
Contingent shares	Excluded until such time as contingencies are resolved or the shares are no longer returnable
Restricted stock/nonvested shares issued as share-based payments	Excluded until such time as vested or no longer forfeitable (e.g., when the employee is retirement eligible)
Escrowed shares forfeitable if certain conditions are not met	Excluded until such time as contingencies are resolved or no longer forfeitable
Employee stock options	Excluded until exercised
Mandatorily convertible preferred stock	Excluded unless considered participating securities as defined in ASC 260
Mandatorily convertible debt	Excluded unless considered participating securities as defined in ASC 260
Mandatorily redeemable common stock	Excluded if accounted for as a liability under ASC 480
Shares issuable for little or no consideration upon meeting certain	Excluded until the conditions have been met

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Description	Impact on weighted-average shares outstanding for purposes of calculating basis EPS
conditions, including penny warrants	
Common stock subscriptions	Excluded unless they are entitled to dividends, then the portion of the subscription price paid is included
Common stock issued for a note receivable	Excluded until the note is repaid
Forwards to repurchase common stock	Excluded if the repurchase is mandatory, otherwise excluded upon exercise of the repurchase
Treasury shares	Excluded, as they are not considered outstanding shares
Own shares held by employee benefit plan	Excluded unless they qualify as plan assets

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3. Diluted EPS

3.1 Overview

Like basic EPS, diluted EPS is a measure of an entity's profitability on a per-share basis. However, unlike basic EPS, the calculation of diluted EPS includes other kinds of securities that can be settled or converted into common shares, such as employee stock options, restricted stock issued as share-based payments, convertible preferred stock, and convertible debt. This results in a larger number of shares (i.e., denominator) and, if net income is not affected, a lower EPS amount.

ASC Master Glossary

Diluted Earnings Per Share

The amount of earnings for the period available to each share of common stock outstanding during the reporting period and to each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the reporting period.

Dilution

A reduction in EPS resulting from the assumption that convertible securities were converted, that options or warrants were exercised, or that other shares were issued upon the satisfaction of certain conditions.

Potential Common Stock

A security or other contract that may entitle its holder to obtain common stock during the reporting period or after the end of the reporting period.

ASC 260-10-45-16

The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In computing the dilutive effect of convertible securities, the numerator is adjusted in accordance with the guidance in paragraph 260-10-45-40. Adjustments also may be necessary for certain contracts that provide the issuer or holder with a choice between settlement methods. See Example 1 (paragraph 260-10-55-38) for an illustration of this guidance.

ASC 260-10-45-17

The computation of diluted EPS shall not assume conversion, exercise, or contingent issuance of securities that would have an antidilutive effect on EPS. Shares issued on actual conversion, exercise, or satisfaction of certain conditions for which the underlying potential common shares were antidilutive shall be included in the computation as outstanding common shares from the date of conversion, exercise, or satisfaction of those conditions, respectively. In determining whether potential common shares are dilutive or antidilutive, each issue or series of issues of potential common shares shall be considered separately rather than in the aggregate.

ASC 260-10-45-18

Convertible securities may be dilutive on their own but antidilutive when included with other potential common shares in computing diluted EPS. To reflect maximum potential dilution, each issue or series of issues of potential common shares shall be considered in sequence from the most dilutive to the least dilutive. That is, dilutive potential common shares with the lowest earnings per incremental share shall be included in diluted EPS before those with a higher earnings per incremental share. Example 4 (see paragraph 260-10-55-57) illustrates that provision. Options and warrants generally will be included first because use of the treasury

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stock method does not affect the numerator of the computation. An entity that reports a discontinued operation in a period shall use income from continuing operations (adjusted for preferred dividends as described in paragraph 260-10-45-11) as the control number in determining whether those potential common shares are dilutive or antidilutive. That is, the same number of potential common shares used in computing the diluted per-share amount for income from continuing operations shall be used in computing all other reported diluted per-share amounts even if those amounts will be antidilutive to their respective basic per-share amounts. (See paragraph 260-10-45-3.) The control number excludes income from continuing operations attributable to the noncontrolling interest in a subsidiary in accordance with paragraph 260-10-45-11A. Example 14 (see paragraph 260-10-55-90) provides an illustration of this guidance.

ASC 260-10-45-19

Including potential common shares in the denominator of a diluted per-share computation for continuing operations always will result in an antidilutive per-share amount when an entity has a loss from continuing operations or a loss from continuing operations available to common stockholders (that is, after any preferred dividend deductions). Although including those potential common shares in the other diluted per-share computations may be dilutive to their comparable basic per-share amounts, no potential common shares shall be included in the computation of any diluted per-share amount when a loss from continuing operations exists, even if the entity reports net income.

ASC 260-10-45-20

The control number for determining whether including potential common shares in the diluted EPS computation would be antidilutive should be income from continuing operations (or a similar line item above net income if it appears on the income statement). As a result, if there is a loss from continuing operations, diluted EPS would be computed in the same manner as basic EPS is computed, even if an entity has net income after adjusting for a discontinued operation. Similarly, if an entity has income from continuing operations but its preferred dividend adjustment made in computing income available to common stockholders in accordance with paragraph 260-10-45-11 results in a loss from continuing operations available to common stockholders, diluted EPS would be computed in the same manner as basic EPS.

ASC 260-10-45-21

Diluted EPS shall be based on the most advantageous conversion rate or exercise price from the standpoint of the security holder. Previously reported diluted EPS data shall not be retroactively adjusted for subsequent conversions or subsequent changes in the market price of the common stock.

ASC 260-10-55-3

The number of incremental shares included in quarterly diluted EPS shall be computed using the average market prices during the three months included in the reporting period. For year-to-date diluted EPS, the number of incremental shares to be included in the denominator shall be determined by computing a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS computation. Example 1 (see paragraph 260-10-55-38) provides an illustration of that provision.

While computed in a manner similar to basic EPS, diluted EPS may include adjustments to the numerator as well as the denominator. Diluted EPS assumes that all dilutive potential common shares (i.e., those that reduce EPS or increase loss per share) were outstanding common shares during the period and that net income (the numerator) was calculated on this basis.

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Potential common shares are not included if their inclusion would be antidilutive (i.e., an increase in EPS amounts or a decrease in loss per share amounts). Shares issued on actual conversion, exercise or satisfaction of certain conditions for which the underlying potential common shares were antidilutive are included in the computation as outstanding common shares only from the date of conversion, exercise or satisfaction of those conditions. Convertible securities may be dilutive on their own but become antidilutive when included with other potential common shares in the diluted EPS calculation. To reflect maximum potential dilution, each issue or series of issues of potential common shares should be considered from the most dilutive to the least dilutive. Said another way, dilutive potential common shares with the lowest earnings per incremental share are included in diluted EPS before potential common shares with a higher earnings per incremental share. Options and warrants are generally included first because the numerator of the computation is not impacted by use of the treasury stock method. ASC 260-10-55-57 through 55-59 illustrates the antidilution sequencing.

The "control number" for determining whether including potential common shares in the diluted EPS computation would be antidilutive is income from continuing operations. (The "control number" excludes income from continuing operations attributable to noncontrolling interest in subsidiaries). Thus, an entity that reports a discontinued operation in a period must use income from continuing operations, not net income, as the "control number" in determining whether those potential common shares are dilutive or antidilutive. Consequently, if there is a loss from continuing operations, diluted EPS is computed in the same manner as basic EPS, even if the entity reports net income after adjusting for the discontinued operation. Similarly, if the entity has income from continuing operations but its preferred dividend and other adjustments made in computing income available to common stockholders for basic EPS purposes result in a loss from continuing operations available to common stockholders, diluted EPS would be computed in the same manner as basic EPS. Although including potential common shares in the other diluted per-share computations may be dilutive to their comparable basic per share amounts (e.g., a discontinued operation), no potential common shares are to be included in the computation of any diluted per-share amount when a loss from continuing operations exists, even if net income is reported.

The potential dilutive effect on EPS is computed using the treasury stock method (Section 3.3.2), the reverse treasury stock method (Section 3.3.3), the if-converted method (Section 3.3.4), or the contingently issuable method (Section 3.3.5). Which method is used in calculating the dilutive effect on EPS will depend on the nature of the potentially dilutive security. Each of these methods and the securities to which they apply is described in ASC 260-10-45 and Section 3.3 of this paper.

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The following graphic represents the process for computing diluted EPS:

Step 1: Calculate basic EPS
Start with the calculation of basic EPS for the period

Step 2: Identify dilutive securities
Identify dilutive securities by applying the antidilution sequencing guidance in ASC 260-10-45-18 and as illustrated in ASC 260-10-55-57 through 55-59. Based on the nature of the security, the potential dilutive effect on EPS is computed using either the treasury stock method, the reverse treasury stock method, the if-converted method or the contingently issuable method.

Step 3: Adjust the numerator
Income available to common stockholders (the numerator) should be adjusted to reflect the basis used for identified dilutive securities. For example, adjustment would be required for dilutive securities classified as assets or liabilities that are assumed share-settled for purposes of calculating diluted EPS (see ASC 260-10-45-46).

Step 4: Adjust the denominator
Adjust the number of common shares to include dilutive potential common shares on a weighted average basis. Dilutive potential common shares may include securities such as stock options, warrants, convertible debt, convertible preferred stock, restricted stock and earn-out provisions.

3.2 Step One: Calculate basic EPS

The starting point for calculating diluted EPS is the basic EPS calculation. Refer to Chapter 2 for guidance on calculating basic EPS.

3.3 Step Two: Identify dilutive securities and calculate the dilutive effect

Following the calculation of basic EPS, entities must identify their population of dilutive securities and calculate their dilutive effect. The dilutive securities adjustment will factor into determining the denominator of the dilutive EPS calculation (see Step Four at Section 3.5).

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3.3.1 Identify dilutive securities

Common dilutive securities and the method used to calculate their dilutive effect for purposes of the dilutive EPS calculation include the following:

Security	Dilutive calculation method
Options	Treasury stock method or contingently issuable method for options with performance or market conditions
Warrants	Treasury stock method
Nonvested stock	Treasury stock method
Stock purchase contracts	Treasury stock method
Stock issued for a note receivable	Treasury stock method
Partially paid stock subscriptions	Treasury stock method
Forward purchase contracts, if effect is dilutive	Reverse treasury stock method
Convertible preferred stock	If-converted method
Convertible debt	If-converted method
Contingently issuable shares	Contingently issuable method
Contracts that can be settled in cash or stock	Underlying presumption is that the contract will be settled in shares unless historical practice or a written policy state otherwise

3.3.2 Treasury stock method

The treasury stock method should be used to determine the dilutive impact of instruments such as stock options, warrants, nonvested stock, etc. The dilutive effect is the number of incremental shares that will be added to the denominator in the diluted EPS calculation. Under the treasury stock method, the dilutive effect is calculated as follows:

1. Assume the outstanding options and warrants are exercised at the beginning of the reporting period (or at time of issuance, if later) and common shares are issued at that time.
2. The proceeds that would have been received from the exercise of the instruments are assumed to be used to repurchase common stock at the average market price during the period (a simple average of weekly or monthly prices, based on closing prices, is usually adequate).

   For share-based awards issued to grantees under a share-based payment arrangement in exchange for goods and services, the assumed proceeds is the sum of the:

   a. Amount, if any, the option holder must pay upon exercise of the award
   b. Amount of cost attributed to share-based payment awards (within the scope of ASC 718) not yet recognized (also referred to as unrecognized compensation cost as of the end of the reporting period)
      i. According to ASC 260-10-45-29, “This amount includes share-based payment awards that are not contingent upon satisfying certain conditions as described in paragraph 260-10-45-32 and contingently issuable shares that have been determined to be included in the computation of diluted EPS as described in paragraphs 260-10-45-48 through 45-57.”

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3. The Incremental shares (i.e., the difference between the number of shares assumed issued and the number of shares assumed to have been repurchased) are included in the denominator of the diluted EPS calculation.

   Refer to ASC 260-10-45-22 through 45-37, 55-93 through 55-94, 55-2 through 55-10, and 55-38 through 55-70 for further guidance, including illustrations of various computations.

3.3.3 Reverse treasury stock method

Options and warrants have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options or warrants (i.e., they are "in the money").

Options held by the entity on its own stock (e.g., purchased put and purchased call options) are to be excluded from the computation of diluted EPS because their inclusion would always be antidilutive.

Contracts that require the entity to repurchase its own stock (e.g., written put options and forward purchase contracts) are to be included in the calculation of diluted EPS if the effect of their inclusion is dilutive. When those contracts are "in the money" during the reporting period (i.e., the exercise price is above the average market price during the reporting period), they are dilutive. The potential dilutive effect on EPS is computed using the reverse treasury stock method. The dilutive effect is the number of incremental shares that will be added to the denominator in the diluted EPS calculation. Under the reverse treasury stock method, the dilutive effect is calculated as follows:

1. The issuance of a sufficient number of common shares is assumed to have occurred at the beginning of the reporting period at the average market price during that period in order to raise proceeds sufficient to satisfy the contract.
2. The proceeds from the above issuance are assumed to be used to settle the contract and to buy back the shares pursuant to the contract.
3. The incremental shares are calculated as the difference between the number of shares assumed issued and the number of shares received from satisfying the contract. Those incremental shares are included in the denominator of the diluted EPS calculation.

Refer to ASC 260-10-45-22 through 45-37, 55-93 through 55-94 and 55-38 through 55-70 for further guidance, including illustrations of various computations.

3.3.4 If-converted method

Convertible securities are securities that are convertible into another security based on a conversion rate (e.g., convertible preferred stock that is convertible into common stock on a two-for-one basis or two shares of common for each share of preferred). The dilutive effect of convertible securities is included in diluted EPS by use of the if-converted method. Under the if-converted method, the dilutive effect is calculated as follows:

1. If an entity has convertible preferred stock outstanding, the preferred dividends, if any, that are applicable to that stock are added back to the numerator (such amount is the same amount that was deducted in computing basic EPS).
2. If an entity has outstanding convertible debt:
   a. The interest associated with the convertible debt is added back to the numerator. For convertible debt where the principal is required to be paid in cash, the interest charged is not to be added back to the numerator.
   b. To the extent nondiscretionary adjustments based on income made during the period (e.g., profit-sharing or royalty expenses) would have been computed differently had the interest on the convertible debt never been recognized, the numerator is adjusted accordingly.

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c. The numerator is also adjusted for the tax impact of items a and b.

3. The entity should assume that the conversion of the convertible preferred stock or convertible debt is to have occurred at the beginning of the reporting period or at time of issuance, whichever is later, and the resulting common shares are included in the denominator. The average market price shall be used for purposes of calculating the denominator for diluted EPS when the number of shares that may be issued is variable, except for contingently issuable shares within the scope of the guidance in ASC 260-10-45-48 through 45-57. ASC 260-10-55-4 through 55-5 provides implementation guidance on determining an average market price.

In applying the if-converted method, an entity should not assume conversion of a security if the effect is antidilutive. Convertible preferred stock is antidilutive whenever the current period dividend declared or accumulated dividend per common share obtainable upon conversion is greater than basic EPS. Convertible debt is antidilutive whenever the interest and nondiscretionary adjustments, net of tax, per common share obtainable upon conversion exceeds basic EPS.

Refer to ASC 260-10-45-40 through 45-42, 55-8, 55-10 (included below), 55-38 through 55-70 and 55-84C to 55-84E for further guidance, including illustrations of various computations.

ASC 260-10-45-40

The dilutive effect of convertible securities shall be reflected in diluted EPS by application of the if-converted method. Under that method:

a. If an entity has convertible preferred stock outstanding, the preferred dividends applicable to convertible preferred stock shall be added back to the numerator. The amount of preferred dividends added back will be the amount of preferred dividends for convertible preferred stock deducted from income from continuing operations (and from net income) in computing income available to common stockholders pursuant to paragraph 260-10-45-11.

b. If an entity has convertible debt outstanding:

   1. Interest charges applicable to the convertible debt shall be added back to the numerator. For convertible debt for which the principal is required to be paid in cash, the interest charges shall not be added back to the numerator.

   2. To the extent nondiscretionary adjustments based on income made during the period would have been computed differently had the interest on convertible debt never been recognized, the numerator shall be appropriately adjusted. Nondiscretionary adjustments include any expenses or charges that are determined based on the income (loss) for the period, such as profit-sharing and royalty agreements.

   3. The numerator shall be adjusted for the income tax effect of (b)(1) and (b)(2).

c. The convertible preferred stock or convertible debt shall be assumed to have been converted at the beginning of the period (or at time of issuance, if later), and the resulting common shares shall be included in the denominator. See paragraph 260-10-45-21A if the incremental shares are variable (such as when calculating a conversion premium).

ASC 260-10-45-41

In applying the if-converted method, conversion shall not be assumed for purposes of computing diluted EPS if the effect would be antidilutive. Convertible preferred stock is antidilutive whenever the amount of the dividend declared in or accumulated for the current period per common share obtainable on conversion exceeds basic EPS. Similarly, convertible

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debt is antidilutive whenever its interest (net of tax and nondiscretionary adjustments) per common share obtainable on conversion exceeds basic EPS.

ASC 260-10-45-42

Dilutive securities that are issued during a period and dilutive convertible securities for which conversion options lapse, for which preferred stock is redeemed, or for which related debt is extinguished during a period, shall be included in the denominator of diluted EPS for the period that they were outstanding. Likewise, dilutive convertible securities converted during a period shall be included in the denominator for the period prior to actual conversion. The common shares issued upon actual conversion shall be included in the denominator for the period after the date of conversion. Consequently, shares assumed issued shall be weighted for the period the convertible securities were outstanding, and common shares actually issued shall be weighted for the period the shares were outstanding.

ASC 260-10-55-8

When several conversion alternatives exist, the computation shall give effect to the alternative that is most advantageous to the holder of the convertible security. Similar treatment shall be given to preferred stock that has similar provisions or to other securities that have conversion options that permit the investor to pay cash for a more favorable conversion rate.

ASC 260-10-55-11

Convertible securities that permit or require the payment of cash by the holder of the security at conversion are considered the equivalent of warrants. In computing diluted EPS, the proceeds assumed to be received shall be assumed to be applied to purchase common stock under the treasury stock method and the convertible security shall be assumed to be converted under the if-converted method. See Example 11 (paragraph 260-10-55-78) for guidance on the effects of contingently convertible instruments on diluted EPS.

3.3.5 Contingently issuable method

Shares whose issuance is dependent upon meeting certain specified conditions are considered outstanding and included in the calculation of diluted EPS under the following circumstances:

- If all the required conditions have been met by the end of the reporting period (i.e., the events have occurred), the resulting shares are included as of the beginning of the reporting period during which the conditions were satisfied (or as of the date of the contingent stock agreement, if later).
- If all the required conditions have not been met by the end of the reporting period, then the number of contingently issuable shares included for purposes of calculating diluted EPS is based on the number of shares, if any, that would be issuable if the end of the reporting period were the end of the contingency period.

Refer to ASC 260-10-45-48 through 45-57 (included below), and 55-53 through 55-56 for further guidance, including an illustrative computation.

ASC 260-10-45-48

Shares whose issuance is contingent upon the satisfaction of certain conditions shall be considered outstanding and included in the computation of diluted EPS as follows:

a. If all necessary conditions have been satisfied by the end of the period (the events have occurred), those shares shall be included as of the beginning of the period in which the conditions were satisfied (or as of the date of the contingent stock agreement, if later).

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b. If all necessary conditions have not been satisfied by the end of the period, the number of contingently issuable shares included in diluted EPS shall be based on the number of shares, if any, that would be issuable if the end of the reporting period were the end of the contingency period (for example, the number of shares that would be issuable based on current period earnings or period-end market price) and if the result would be dilutive. Those contingently issuable shares shall be included in the denominator of diluted EPS as of the beginning of the period (or as of the date of the contingent stock agreement, if later).

ASC 260-10-45-49

For year-to-date computations, contingent shares shall be included on a weighted-average basis. That is, contingent shares shall be weighted for the interim periods in which they were included in the computation of diluted EPS.

ASC 260-10-45-50

Paragraphs 260-10-45-51 through 45-54 provide general guidelines that shall be applied in determining the EPS impact of different types of contingencies that may be included in contingent stock agreements.

ASC 260-10-45-51

If attainment or maintenance of a specified amount of earnings is the condition and if that amount has been attained, the additional shares shall be considered to be outstanding for the purpose of computing diluted EPS if the effect is dilutive. The diluted EPS computation shall include those shares that would be issued under the conditions of the contract based on the assumption that the current amount of earnings will remain unchanged until the end of the agreement, but only if the effect would be dilutive. Because the amount of earnings may change in a future period, basic EPS shall not include such contingently issuable shares because all necessary conditions have not been satisfied. Example 3 (see paragraph 260-10-10-55-53) illustrates that provision.

ASC 260-10-45-52

The number of shares contingently issuable may depend on the market price of the stock at a future date. In that case, computations of diluted EPS shall reflect the number of shares that would be issued based on the current market price at the end of the period being reported on if the effect is dilutive. If the condition is based on an average of market prices over some period of time, the average for that period shall be used. Because the market price may change in a future period, basic EPS shall not include such contingently issuable shares because all necessary conditions have not been satisfied.

ASC 260-10-45-53

In some cases, the number of shares contingently issuable may depend on both future earnings and future prices of the shares. In that case, the determination of the number of shares included in diluted EPS shall be based on both conditions, that is, earnings to date and current market price—as they exist at the end of each reporting period. If both conditions are not met at the end of the reporting period, no contingently issuable shares shall be included in diluted EPS.

ASC 260-10-45-54

If the contingency is based on a condition other than earnings or market price (for example, opening a certain number of retail stores), the contingent shares shall be included in the computation of diluted EPS based on the assumption that the current status of the condition will

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remain unchanged until the end of the contingency period. Example 3 (see paragraph 260-10-55-53) illustrates that provision.

ASC 260-10-45-55

Contingently issuable potential common shares (other than those covered by a contingent stock agreement, such as contingently issuable convertible securities) shall be included in diluted EPS as follows:

a. An entity shall determine whether the potential common shares may be assumed to be issuable based on the conditions specified for their issuance pursuant to the contingent share provisions in paragraphs 260-10-45-48 through 45-54.

b. If those potential common shares should be reflected in diluted EPS, an entity shall determine their impact on the computation of diluted EPS by following the provisions for options and warrants in paragraphs 260-10-45-22 through 45-37, the provisions for convertible securities in paragraphs 260-10-45-40 through 45-42, and the provisions for contracts that may be settled in stock or cash in paragraph 260-10-45-45, as appropriate.

ASC 260-10-45-56

Neither interest nor dividends shall be imputed for the additional contingently issuable convertible securities because any imputed amount would be reversed by the if-converted adjustments for assumed conversions.

ASC 260-10-45-57

However, exercise or conversion shall not be assumed for purposes of computing diluted EPS unless exercise or conversion of similar outstanding potential common shares that are not contingently issuable is assumed. See Example 3 (paragraph 260-10-55-53) for an illustration of this guidance.

3.4 Step Three: Adjust the numerator

Following the identification of the dilutive securities and the associated method that will be used to factor those securities into the diluted EPS calculation, the numerator, or income available to common shareholders, may have to be adjusted to reflect the impact of the dilutive securities on net income available to common shareholders.

As mentioned above, convertible securities use the if-converted method to calculate the impact on diluted EPS. Any preferred dividends associated with convertible preferred stock that reduced net income should be added back to the numerator. Interest expense, net of the tax impact, associated with convertible debt is also added back. However, there is one exception. According to ASC 260-10-45-40, for convertible debt for which the principal is required to be paid in cash, the interest charges should not be added back to the numerator. Furthermore, ASC 260-10-45-40 requires that “to the extent nondiscretionary adjustments based on income made during the period would have been computed differently had the interest on convertible debt never been recognized, the numerator shall be appropriately adjusted. Nondiscretionary adjustments include any expenses or charges that are determined based on the income (loss) for the period, such as profit-sharing and royalty agreements.” The nondiscretionary adjustments should also be adjusted for any tax impact. The conversion of the securities for purposes of computing diluted EPS is assumed to occur at the beginning of the period and, as a result, the adjustments to the numerator should also be assumed as of that date.

Income available to common shareholders may also require adjustment if the entity has a contract that is reported as an asset or liability for accounting purposes, but in the calculation of diluted EPS is treated as an equity instrument. Pursuant to ASC 260-10-55-32, for purposes of computing diluted EPS, the

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adjustments to the numerator are only permitted for instruments for which the effect on net income (i.e., the numerator) is different depending on whether the instrument is accounted for as an equity instrument or as an asset or liability. For example, if the asset or liability is remeasured to fair value each reporting period with the change recorded in earnings, the numerator will need to be adjusted to remove the remeasurement impact.

When the if-converted method is used for calculating the impact of securities issued by a parent entity that are convertible into common stock of a subsidiary or an investee entity accounted for under the equity method, the numerator must be adjusted appropriately for any change in the income recorded by the parent (such as dividend income or equity method income) due to the increase in the number of common shares of the subsidiary or equity method investee outstanding as a result of the assumed conversion.

In summary, if an adjustment is being made to the denominator of the diluted EPS calculation, consideration should be given to whether an associated adjustment needs to be made to the numerator.

3.5 Step Four: Adjust the denominator

In Step Four, the number of common shares in the denominator is adjusted to include the dilutive potential common shares on a weighted average basis. The potential common shares or incremental shares are calculated using the appropriate method that was identified in Step Two (see Section 3.3) for the identified dilutive security or securities. The following is an example of how to calculate the dilutive effect of share-based payment transactions using the treasury stock method.

Example 3-1: Application of the treasury stock method to a share-based payment arrangement

[The following example is *Example 8: Application of the Treasury Stock Method to a Share-Based Payment Arrangement* from ASC 260-10-55-69 through 55-70.]

Entity A adopted a share option plan on January 1, 20X7, and granted 900,000 at-the-money share options with an exercise price of $30. All share options vest at the end of three years (cliff vesting). Entity A's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-1D or 718-10-35-3. At the grant date, Entity A assumes an annual forfeiture rate of 3 percent and therefore expects to receive the service for 821,406 [900,000 × (.97 to the third power)] share options. On January 1, 20X7, the fair value of each share option granted is $14.69. Grantees forfeited 15,000 stock options ratably during 20X7.

The average stock price during 20X7 is $44. Net income for the period is $97,385,602. For the year ended December 31, 20X7, there are 25,000,000 weighted-average common shares outstanding. This guidance also applies if the service inception date precedes the grant date.

The following table illustrates computation of basic and diluted EPS for the year ended December 31, 20X7.

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Computation of Basic EPS for the Year Ended December 31, 20X7:		
Net income		$97,385,602
Weighted-average common shares outstanding		25,000,000
Basic earnings per share		$3.90
Computation of assumed proceeds for diluted earnings per share:		
Amount employees would pay if the weighted-average number of options outstanding were exercised using the average exercise price (892,500[b] x $30)		$26,775,000
Average unrecognized compensation cost in 20X7 (see computation)		10,944,050
Assumed proceeds		$37,719,050
Computation of average unrecognized compensation cost in 20X7:		
Beginning of period		
Unrecognized compensation cost (900,000 x $14.69)		$13,221,000
End of the period		
Beginning of period	$13,221,000	
Annual compensation cost recognized during 20X7, based on estimated forfeitures	(4,022,151) [a]	
Annual compensation cost not recognized during the period related to outstanding options at December 31, 20X7, for which the requisite service is not expected to be rendered	(311,399) [c]	
Total compensation cost of actual forfeited options	(220,350) [d]	
Total unrecognized compensation cost, end of the period, based on actual forfeitures		8,667,100
Subtotal		$21,888,100
Average total unrecognized compensation, based on actual forfeitures		$10,944,050
Assumed repurchase of shares:		
Repurchase shares at average market price during the year ($37,719,050 / $44)		857,251
Incremental shares (892,500 – 857,251)		35,249
Computation of Diluted EPS for the Year Ended December 31, 20X7:		
Net income		$97,385,602

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Weighted-average common shares outstanding		25,000,000
Incremental shares		35,249
Total shares outstanding		25,035,249
Diluted earnings per share		$3.89

(a) Pre-tax annual share-based compensation cost is $4,022,151 [(821,406 x $14.69) / 3].

(b) Share options granted at the beginning of the year plus share options outstanding at the end of the year divided by two equals the weighted-average number of share options outstanding in 20X7: [(900,000 + 885,000) / 2] = 892,500. This example assumes that forfeitures occurred ratably throughout 20X7.

(c) 885,000 (options outstanding at December 31, 20X7) – 821,406 (options for which the requisite service is expected to be rendered) = 63,594. 63,594 options x $14.69 (grant-date fair value per option) = $934,196 (total fair value). $934,196 / 3 = $311,399 (annual share-based compensation cost).

(d) 15,000 (forfeited options) x $14.69 (grant-date fair value per option) = $220,350 (total fair value)

3.6 Computation of diluted EPS when there is a year-to-date loss with periods of income

ASC 260-10-55-3A

Computation of year-to-date diluted EPS when an entity has a year-to-date loss from continuing operations including one or more quarters with income from continuing operations and when in-the-money options or warrants were not included in one or more quarterly diluted EPS computations because there was a loss from continuing operations in those quarters is as follows. In computing year-to-date diluted EPS, year-to-date income (or loss) from continuing operations shall be the basis for determining whether or not dilutive potential common shares not included in one or more quarterly computations of diluted EPS shall be included in the year-to-date computation.

ASC 260-10-55-3B

Therefore:

a. When there is a year-to-date loss, potential common shares should never be included in the computation of diluted EPS, because to do so would be antidilutive.

b. When there is year-to-date income, if in-the-money options or warrants were excluded from one or more quarterly diluted EPS computations because the effect was antidilutive (there was a loss from continuing operations in those periods), then those options or warrants should be included in the diluted EPS denominator (on a weighted-average basis) in the year-to-date computation as long as the effect is not antidilutive. Similarly, contingent shares that were excluded from a quarterly computation solely because there was a loss from continuing operations should be included in the year-to-date computation unless the effect is antidilutive.

Example 12 (see paragraph 260-10-55-85) illustrates this guidance.

Generally, year-to-date calculations are based on the sum of the individual quarterly calculations; however, in the computation of diluted EPS, there may be shares that were excluded during the quarterly EPS calculation that should be included in the year-to-date calculations. For example, in-the-money options or warrants when there is a loss in the quarterly period but there is year-to-date income or vice versa. Accordingly, the sum of the four quarters' diluted EPS data will not necessarily equal the annual

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diluted EPS data. As a result, questions may arise on how companies should compute year-to-date diluted EPS when an entity has a year-to-date loss from continuing operations including one or more quarters with income from continuing operations.

ASC 260-10-55-3 states that in applying the treasury stock method in year-to-date computations, "the number of incremental shares to be included in the denominator shall be determined by computing a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS computation." However, ASC 260 includes a prohibition against antidilution. The no-antidilution rule in ASC 260-10-45-17 states that "the computation of diluted EPS shall not assume conversion, exercise, or contingent issuance of securities that would have an antidilutive effect on EPS." A conflict emerges between those two provisions when a period that is longer than three months has an overall loss but includes quarters with income.

The antidilution provision in ASC 260-10-45-17 should take precedence in computing year-to-date diluted EPS. That is, potential common shares should never be included in the computation of diluted EPS if doing so would be antidilutive. This is best illustrated through the following example.

Example 3-2: Year-to-date loss

[The following example *is Case A: Year-to-Date Loss* from ASC 260-10-55-86.]

The following tables illustrate the computation of quarterly and year-to-date EPS.

Quarterly	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Income from continuing operations	$50,000	($150,000)	$50,000	($200,000)
Common shares	100,000	100,000	100,000	100,000
Incremental shares	20,000	0 (a)	20,000	0 (a)
Basic EPS	$0.50	($1.50)	$0.50	($2.00)
Diluted EPS	$0.42	($1.50)	$0.42	($2.00)

(a) Due to a loss for the period, zero incremental shares are included because the effect would be antidilutive.

Year-to-Date	Three Months	Six Months	Nine Months	Full Year
Income from continuing operations	$50,000	($100,000)	($50,000)	($250,000)
Common shares	100,000	100,000	100,000	100,000
Incremental shares	20,000	0 (a)	0 (a)	0 (a)
Basic EPS	$0.50	($1.00)	($0.50)	($2.50)
Diluted EPS	$0.42	($1.00)	($0.50)	($2.50)

(a) Due to a loss for the period, zero incremental shares are included because the effect would be antidilutive.

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3.7 Example computation of basic and diluted EPS

Example 3-3: Computation of basic and diluted EPS

[The following example *is Example 1: Computation of Basic and Diluted EPS and Income Statement Presentation* from ASC 260-10-55-38 through 55-48.]

This Example illustrates the quarterly and annual computations of basic and diluted EPS in the year 20X1 for Entity A, which has a complex capital structure. The control number used in this Example…is income from continuing operations. Paragraph 260-10-55-49 illustrates the presentation of basic and diluted EPS on the face of the income statement. The facts assumed are as follows:

a. Average market price of common stock. The average market prices of common stock for the calendar-year 20X1 were as follows.

First quarter	$59
Second quarter	$70
Third quarter	$72
Fourth quarter	$72

b. The average market price of common stock from July 1 to September 1, 20X1 was $71.

c. Common stock. The number of shares of common stock outstanding at the beginning of 20X1 was 3,300,000. On March 1, 20X1, 100,000 shares of common stock were issued for cash.

d. Convertible debentures. In the last quarter of 20X0, 4 percent convertible debentures with a principal amount of $10,000,000 due in 20 years were sold for cash at $1,000 (par). Interest is payable semiannually on November 1 and May 1. Each $1,000 debenture is convertible into 20 shares of common stock. No debentures were converted in 20X0. The entire issue was converted on April 1, 20X1, because the issue was called by Entity A.

e. Convertible preferred stock. In the second quarter of 20X0, 600,000 shares of convertible preferred stock were issued for assets in a purchase transaction. The quarterly dividend on each share of that convertible preferred stock is $0.05, payable at the end of the quarter. Each share is convertible into one share of common stock. Holders of 500,000 shares of that convertible preferred stock converted their preferred stock into common stock on June 1, 20X1.

f. Warrants. Warrants to buy 500,000 shares of common stock at $60 per share for a period of 5 years were issued on January 1, 20X1. All outstanding warrants were exercised on September 1, 20X1.

g. Options. Options to buy 1,000,000 shares of common stock at $85 per share for a period of 10 years were issued on July 1, 20X1. No options were exercised during 20X1 because the exercise price of the options exceeded the market price of the common stock.

h. Tax rate. The tax rate was 40 percent for 20X1.

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The following table illustrates the income (loss) from continuing operations.

Year 20X1	Income (Loss) from Continuing Operations[a]	Net Income (Loss)
First quarter	$3,000,000	$3,000,000
Second quarter	4,500,000	4,500,000
Third quarter	500,000	(1,500,000) [b]
Fourth quarter	(500,000)	(500,000)
Full year	$7,500,000	$5,500,000

(a) This is the control number (before adjusting for preferred dividends). See paragraph 260-10-45-18.

(b) Entity A had a $2 million loss on discontinued operations (net of tax) in the third quarter.

The following tables illustrate calculation of basic EPS for the first quarter.

First Quarter 20X1			
Basic EPS Computation			
Net income	$3,000,000		
Less: Preferred stock dividends	(30,000) [a]		
Income available to common stockholders	$2,970,000		
Dates Outstanding	**Shares Outstanding**	**Fraction of Period**	**Weighted-Average Shares**
January 1–February 28	3,300,000	2/3	2,200,000
Issuance of common stock on March 1	100,000		
March 1–March 31	3,400,000	1/3	1,133,333
Weighted-average shares			3,333,333

Basic EPS $0.89

The equation for computing basic EPS is:

$$\frac{\text{Income available to common stockholders}}{\text{Weighted-average shares}}$$

(a) 600,000 shares x $0.05

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The following table illustrates calculation of diluted EPS for the first quarter.

First Quarter 20X1		
Diluted EPS Computation		
Income available to common stockholders		$2,970,000
Plus: Income impact of assumed conversions		
Preferred stock dividends	$30,000 (a)	
Interest on 4% convertible debentures	60,000 (b)	
Effect of assumed conversions		90,000
Income available to common stockholders + assumed conversions		$3,060,000
Weighted-average shares		3,333,333
Plus: Incremental shares from assumed conversions		
Warrants	- (c)	
Convertible preferred stock	600,000	
4% convertible debentures	200,000	
Dilutive potential common shares		800,000
Adjusted weighted-averages shares		4,133,333

Diluted EPS $0.74

The equation for computing diluted EPS is:

$$\frac{\text{Income available to common stockholders + Effect of assumed conversions}}{\text{Weighted-average shares + Dilutive potential common shares}}$$

(a) 600,000 shares x $0.05

(b) ($10,000,000 x 4%) / 4; less taxes at 40%

(c) The warrants were not assumed exercised because they were antidilutive in the period ($60 exercise price > $59 average price)

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The following tables illustrate calculation of basic EPS for the second quarter.

Second Quarter 20X1			
Basic EPS Computation			
Net income	$4,500,000		
Less: Preferred stock dividends	(5,000) [(a)]		
Income available to common stockholders	$4,495,000		
Dates Outstanding	**Shares Outstanding**	**Fraction of Period**	**Weighted-Average Shares**
April 1	3,400,000		
Conversion of 4% debentures on April 1	200,000		
April 1–May 31	3,600,000	2/3	2,400,000
Conversion of preferred stock on June 1	500,000		
June 1–June 30	4,100,000	1/3	1,366,667
Weighted-average shares			3,766,667
Basic EPS $1.19			

The equation for computing basic EPS is:

$$\frac{\text{Income available to common stockholders}}{\text{Weighted-average shares}}$$

(a) 100,000 shares x $0.05

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The following table illustrates calculation of diluted EPS for the second quarter.

Second Quarter 20X1		
Diluted EPS Computation		
Income available to common stockholders		$4,495,000
Plus: Income impact of assumed conversions		
Preferred stock dividends	$5,000 (a)	
Effect of assumed conversions		5,000
Income available to common stockholders + assumed conversions		$4,500,000
Weighted-average shares		3,766,667
Plus: Incremental shares from assumed conversions		
Warrants	71,429 (b)	
Convertible preferred stock	433,333 (c)	
Dilutive potential common shares		504,762
Adjusted weighted-averages shares		4,271,429
Diluted EPS $1.05		

The equation for computing diluted EPS is:

$$\frac{\text{Income available to common stockholders + Effect of assumed conversions}}{\text{Weighted-average shares + Dilutive potential common shares}}$$

(a) 100,000 shares x $0.05

(b) $60 x 500,000 = $30,000,000; $30,000,000 / $70 = 428,571; 500,000 – 428,571 = 71,429 shares OR [($70 - $60) / $70] x 500,000 shares = 71,429 shares

(c) (600,000 shares x 2/3) + (100,000 shares x 1/3)

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The following tables illustrate calculation of basic EPS for the third quarter.

Third Quarter 20X1			
Basic EPS Computation			
Income from continuing operations	$500,000		
Less: Preferred stock dividends	(5,000)		
Income available to common stockholders	$495,000		
Loss on discontinued operations	(2,000,000)		
Net loss available to common stockholders	$(1,505,000)		
Dates Outstanding	**Shares Outstanding**	**Fraction of Period**	**Weighted-Average Shares**
July 1–August 31	4,100,000	2/3	2,733,333
Exercise of warrants on September 1	500,000		
September 1–September 30	4,600,000	1/3	1,533,333
Weighted-average shares			4,266,666
Basic EPS			
Income from continuing operations	**$0.12**		
Loss on discontinued operations	**$(0.47)**		
Net loss	**$(0.35)**		
The equation for computing basic EPS is: $\frac{\text{Income available to common stockholders}}{\text{Weighted-average shares}}$			

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The following tables illustrate calculation of diluted EPS for the third quarter.

Third Quarter 20X1		
Diluted EPS Computation		
Income available to common stockholders		$495,000
Plus: Income impact of assumed conversions		
Preferred stock dividends	$5,000	
Effect of assumed conversions		5,000
Income available to common stockholders + assumed conversions		500,000
Loss on discontinued operations		(2,000,000)
Net loss available to common stockholders + assumed conversions		$(1,500,000)
Weighted-average shares		4,266,666
Plus: Incremental shares from assumed conversions		
Warrants	51,643 (a)	
Convertible preferred stock	100,000	
Dilutive potential common shares		151,643
Adjusted weighted-averages shares		4,418,309
Diluted EPS		
Income from continuing operations	**$0.11**	
Loss on discontinued operations	**$(0.45)**	
Net loss	**$(0.34)**	

The equation for computing diluted EPS is:

$$\frac{\text{Income available to common stockholders + Effect of assumed conversions}}{\text{Weighted-average shares + Dilutive potential common shares}}$$

(a) [($71 - $60) / $71] x 500,000 = 77,456 shares; 77,456 x 2/3 – 51,643 shares

Note that the incremental shares from assumed conversions are included in computing the diluted per-share amounts for the discontinued operation and net loss even though they are antidilutive. This is because the control number (income from continuing operations, adjusted for preferred dividends) was income, not a loss. (See paragraphs 260-10-45-18 through 45-19.)

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The following tables illustrate calculation of basic and diluted EPS for the fourth quarter.

Fourth Quarter 20X1			
Basic and Diluted EPS Computation			
Net loss	$(500,000)		
Plus: Preferred stock dividends	(5,000)		
Net loss available to common stockholders	$(505,000)		
Dates Outstanding	**Shares Outstanding**	**Fraction of Period**	**Weighted-Average Shares**
October 1–December 31	4,600,000	3/3	4,600,000
Weighted-average shares			4,600,000
Basic and Diluted EPS			
Net loss	$(0.11)		
The equation for computing basic (and diluted) EPS is: $\frac{\text{Income available to common stockholders}}{\text{Weighted-average shares}}$			

Note that the incremental shares from assumed conversions are not included in computing the diluted per-share amounts for net loss because the control number (net loss adjusted for preferred dividends) was a loss, not income. (See paragraphs 260-10-45-18 through 45-19.)

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The following tables illustrate calculation of basic EPS for the full year 20X1.

Full Year 20X1			
Basic EPS Computation			
Income from continuing operations	$7,500,000		
Less: Preferred stock dividends	(45,000)		
Income available to common stockholders	$7,455,000		
Loss on discontinued operations	(2,000,000)		
Net income available to common stockholders	$5,455,000		
Dates Outstanding	**Shares Outstanding**	**Fraction of Period**	**Weighted-Average Shares**
January 1–February 28	3,300,000	2/12	550,000
Issuance of common stock on March 1	100,000		
March 1–March 31	3,400,000	1/12	283,333
Conversion of 4% debenture on April 1	200,000		
April 1–May 31	3,600,000	2/12	600,000
Conversion of preferred stock on June 1	500,000		
June 1–August 31	4,100,000	3/12	1,025,000
Exercise of warrants on September 1	500,000		
September 1–December 31	4,600,000	4/12	1,533,333
Weighted-average shares			3,991,666
Basic EPS			
Income from continuing operations	**$1.87**		
Loss on discontinued operations	**$(0.50)**		
Net income	**$1.37**		

The equation for computing basic EPS is:

$$\frac{\text{Income available to common stockholders}}{\text{Weighted-average shares}}$$

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The following tables illustrate calculation of diluted EPS for the full year 20X1.

Full Year 20X1		
Diluted EPS Computation		
Income available to common stockholders		$7,455,000
Plus: Income impact of assumed conversions		
Preferred stock dividends	$45,000	
Interest on 4% convertible debentures	60,000	
Effect of assumed conversions		105,000
Income available to common stockholders + assumed conversions		7,560,000
Loss on discontinued operations		(2,000,000)
Net income available to common stockholders + assumed conversions		$5,560,000
Weighted-average shares		3,991,666
Plus: Incremental shares from assumed conversions		
Warrants	30,768 (a)	
Convertible preferred stock	308,333 (b)	
4% convertible debentures	50,000 (c)	
Dilutive potential common shares		389,101
Adjusted weighted-averages shares		4,380,767
Diluted EPS		
Income from continuing operations	**$1.73**	
Loss on discontinued operations	**$(0.46)**	
Net income	**$1.27**	

The equation for computing diluted EPS is:

$$\frac{\text{Income available to common stockholders + Effect of assumed conversions}}{\text{Weighted-average shares + Dilutive potential common shares}}$$

(a) (71,429 x 3/12) + (51,643 shares x 3/12)

(b) (600,000 shares x 5/12) + (100,000 shares x 7/12)

(c) 200,000 shares x 3/12

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4. Presentation and disclosure

4.1 Presentation

ASC 260-10-45-2

Entities with simple capital structures, that is, those with only common stock outstanding, shall present basic per-share amounts for income from continuing operations and for net income on the face of the income statement. All other entities shall present basic and diluted per-share amounts for income from continuing operations and for net income on the face of the income statement with equal prominence.

ASC 260-10-45-3

An entity that reports a discontinued operation in a period shall present basic and diluted per-share amounts for that line item either on the face of the income statement or in the notes to the financial statements.

ASC 260-10-45-4

The terms *basic EPS* and *diluted EPS* are used to identify EPS data to be presented and are not required to be captions used in the income statement. There are no explicit requirements for the terms to be used in the presentation of basic and diluted EPS; terms such as *earnings per common share* and *earnings per common share—assuming dilution*, respectively, are appropriate.

ASC 260-10-45-5

Per-share amounts not required to be presented by this Subtopic that an entity chooses to disclose shall be computed in accordance with this Subtopic and disclosed only in the notes to financial statements; it shall be noted whether the per-share amounts are pretax or net of tax. (See paragraph 260-10-50-1A.)

ASC 260-10-45-6

Paragraph 230-10-45-3 prohibits reporting an amount of cash flow per share.

ASC 260-10-45-7

EPS data shall be presented for all periods for which an income statement or summary of earnings is presented. If diluted EPS data are reported for at least one period, they shall be reported for all periods presented, even if they are the same amounts as basic EPS. If basic and diluted EPS are the same amount, dual presentation can be accomplished in one line on the income statement.

Under ASC 260, entities with simple capital structures are required to present basic EPS amounts for income from continuing operations and for net income on the face of the income statement. Entities have a simple capital structure when only one class of common stock is outstanding, and the entity has no outstanding securities or contracts that may entitle the holder to obtain common stock either during or after the end of the reporting period. All other entities are required to present basic and diluted EPS amounts for income from continuing operations and for net income on the face of the income statement with equal prominence. EPS is to be disclosed separately on the face of the income statement for all classes of common stock. Multiple classes of common stock may be combined if the amount of EPS are the same for each class. If an entity does not report a discontinued operation, the only EPS amount required to be reported on the face of the income statement is for net income.

An entity that reports a discontinued operation in any period presented must present basic and, if other than a simple capital structure, diluted EPS amounts for that line item, either on the face of the income

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statement or in the notes to financial statements. When space permits, we recommend entities present the required EPS amounts on the face of the income statement.

Any per-share amounts not required to be presented by ASC 260 that an entity may choose to disclose must be computed in accordance with ASC 260 and disclosed only in the notes to financial statements (or elsewhere in a filing, such as in Management's Discussion and Analysis or Selected Financial Data), and the disclosure must indicate whether the per share amounts are pretax or net of tax. ASC 230, *Statement of Cash Flows*, prohibits reporting an amount of cash flow per share.

EPS data must be presented for all periods for which an income statement or summary of earnings is presented. If diluted EPS data are reported for at least one period, they must be reported for all periods presented, even if the same as basic EPS. SEC Regulation S-X requires presentation of EPS in both annual Form 10-K and interim Form 10-Q.

4.1.1 Other presentation matters

4.1.1.1 Stock dividends and stock splits

> **ASC 260-10-55-12**
>
> If the number of common shares outstanding increases as a result of a stock dividend or stock split (see Subtopic 505-20) or decreases as a result of a reverse stock split, the computations of basic and diluted EPS shall be adjusted retroactively for all periods presented to reflect that change in capital structure. If changes in common stock resulting from stock dividends, stock splits, or reverse stock splits occur after the close of the period but before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25), the per-share computations for those and any prior-period financial statements presented shall be based on the new number of shares. If per-share computations reflect such changes in the number of shares, that fact shall be disclosed.

If the number of common shares outstanding increases as a result of a stock dividend or a stock split, or decreases as a result of a reverse stock split, the calculations of basic and diluted EPS are retroactively adjusted for all of the periods presented in the financial statements. If such a change in capital structure occurs after the date of the financial statements but prior to their issuance, the per-share computations for all periods presented are required to be similarly retroactively adjusted based on the new number of shares. Entities should ensure that appropriate disclosure of the stock dividend or stock split is included in the notes to the financial statements.

The requirements in ASC 260-10-55-12 also apply in situations in which stock dividends are declared, but not paid until after the balance sheet date. In that scenario, the computations of basic and diluted EPS should be retroactivity adjusted for all periods presented when a change in capital structure occurs due to a stock dividend declared, even if such dividends have not been paid as of the balance sheet date. If per-share computations reflect such changes in the number of shares, that fact should be disclosed.

4.1.1.2 Prior-Period Adjustments

> **ASC 260-10-55-15**
>
> If authoritative literature requires that a restatement of the results of operations of a prior period be included in the income statement or summary of earnings, then EPS data given for the prior period or periods shall be restated. The effect of the restatement, expressed in per-share terms, shall be disclosed in the period of restatement.

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ASC 260-10-55-16

Restated EPS data shall be computed as if the restated income or loss had been reported originally in the prior period or periods. Thus, it is possible that common stock assumed to be issued upon exercise, conversion, or issuance of potential common shares in accordance with the provisions of this Subtopic may not be included in the computation of restated EPS amounts. That is, retroactive restatement of income from continuing operations could cause potential common shares originally determined to be dilutive to become antidilutive pursuant to the control number provision in paragraph 260-10-45-18. The reverse also is true. Retroactive restatement also may cause the numerator of the EPS computation to change by an amount that differs from the amount of the retroactive adjustment.

As described in ASC 260-10-55-15 and 55-16, U.S. GAAP requires that a restatement of the results of operations of a prior period be included in the income statement or summary of earnings. In those instances, EPS data given for the prior periods must also be restated, and the effect of the restatement in per-share amounts must be disclosed in the period of restatement.

Restated EPS data is computed as if the restated income or loss had been reported originally in the prior periods. However, an entity cannot simply calculate restated EPS using the restated income or loss figures with the originally calculated EPS denominators. Previously dilutive potential common shares may become antidilutive based on the new “control number” and vice versa. Additionally, adjustments to the numerator may also need to be revisited as a result of the restatement of prior period financial results.

4.1.1.3 Business combinations

ASC 260-10-55-17

When common shares are issued to acquire a business in a business combination, the computations of EPS shall recognize the existence of the new shares only from the acquisition date. In reorganizations, EPS computations shall be based on analysis of the particular transaction and the provisions of this Subtopic.

Per ASC 260-10-55-17, when common shares are issued in a business combination, the computations of EPS should recognize the existence of the new shares only from the acquisition date.

4.1.1.4 Consolidated financial statements and subsidiaries

ASC 260-10-55-20

The effect on consolidated EPS of options, warrants, and convertible securities issued by a subsidiary depends on whether the securities issued by the subsidiary enable their holders to obtain common stock of the subsidiary or common stock of the parent entity. The following general guidelines shall be used for computing consolidated diluted EPS by entities with subsidiaries that have issued common stock or potential common shares to parties other than the parent entity

a. Securities issued by a subsidiary that enable their holders to obtain the subsidiary's common stock shall be included in computing the subsidiary's EPS data. Those per-share earnings of the subsidiary shall then be included in the consolidated EPS computations based on the consolidated group’s holding of the subsidiary's securities. Example 7 (see paragraph 260-10-55-64) illustrates that provision.

b. Securities of a subsidiary that are convertible into its parent entity's common stock shall be considered among the potential common shares of the parent entity for the purpose of

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computing consolidated diluted EPS. Likewise, a subsidiary's options or warrants to purchase common stock of the parent entity shall be considered among the potential common shares of the parent entity in computing consolidated diluted EPS. Example 7 (see paragraph 260-10-55-64) illustrates that provision.

ASC 260-10-55-21

The preceding provisions also apply to investments in common stock of corporate joint ventures and investee companies accounted for under the equity method.

ASC 260-10-55-22

The if-converted method shall be used in determining the EPS impact of securities issued by a parent entity that are convertible into common stock of a subsidiary or an investee entity accounted for under the equity method. That is, the securities shall be assumed to be converted and the numerator (income available to common stockholders) adjusted as necessary in accordance with the provisions in paragraph 260-10-45-40(a) through (b). In addition to those adjustments, the numerator shall be adjusted appropriately for any change in the income recorded by the parent (such as dividend income or equity method income) due to the increase in the number of common shares of the subsidiary or equity method investee outstanding as a result of the assumed conversion. The denominator of the diluted EPS computation would not be affected because the number of shares of parent entity common stock outstanding would not change upon assumed conversion.

For purposes of computing EPS in consolidated financial statements (both basic and diluted), if one or more less-than-wholly-owned subsidiaries are included in the consolidated group, income from continuing operations and net income should exclude the income attributable to the noncontrolling interest in subsidiaries.

The effect on consolidated EPS of options, warrants, and convertible securities issued by a subsidiary depends on whether the securities issued by the subsidiary enable their holders to obtain common stock of the subsidiary entity or common stock of the parent entity. Refer to ASC 260-10-55-20, 55-22, and 55-64 through 55-66 for further guidance and an illustrative computation.

4.1.1.5 Rights issues

ASC 260-10-55-13

A rights issue whose exercise price at issuance is less than the fair value of the stock contains a bonus element that is somewhat similar to a stock dividend. If a rights issue contains a bonus element and the rights issue is offered to all existing stockholders, basic and diluted EPS shall be adjusted retroactively for the bonus element for all periods presented. If the ability to exercise the rights issue is contingent on some event other than the passage of time, the provisions of this paragraph shall not be applicable until that contingency is resolved.

ASC 260-10-55-14

The number of common shares used in computing basic and diluted EPS for all periods prior to the rights issue shall be the number of common shares outstanding immediately prior to the issue multiplied by the following factor: (fair value per share immediately prior to the exercise of the rights) / (theoretical ex-rights fair value per share). Theoretical ex-rights fair value per share shall be computed by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds expected from the exercise of the rights and dividing by the number of shares outstanding after the exercise of the rights. Example 5 (see paragraph 260-10-55-60) illustrates that provision. If the rights themselves are to be publicly traded

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separately from the shares prior to the exercise date, fair value for the purposes of this computation shall be established at the close of the last day on which the shares are traded together with the rights.

A rights issue is defined as "an offer to existing stockholders to purchase additional shares of common stock in accordance with an agreement for a specified amount (which is generally substantially less than the fair value of the shares) for a given period." A rights issue whose exercise price at the issuance date is less than the fair value of the stock contains a bonus element. This bonus element is similar to a stock dividend. If a rights issue contains a bonus element and the rights issue is offered to all existing stockholders, similar to the treatment of a stock dividend, basic and diluted EPS should be adjusted retroactively for the bonus element. The retroactive adjustment should be reflected in all periods presented. Refer to ASC 260-10-55-60 through 55-61 for further guidance, including an illustrative computation.

4.2 Disclosure

ASC 260-10-50-1

For each period for which an income statement is presented, [*after the adoption of ASU 2023-06* – including interim periods] an entity shall disclose all of the following:

a. A reconciliation of the numerators and the denominators of the basic and diluted per-share computations for income from continuing operations. The reconciliation shall include the individual income and share amount effects of all securities that affect earnings per share (EPS). Example 2 (see paragraph 260-10-55-51) illustrates that disclosure. (See paragraph 260-10-45-3.) An entity is encouraged to refer to pertinent information about securities included in the EPS computations that is provided elsewhere in the financial statements as prescribed by Subtopic 505-10.

b. The effect that has been given to preferred dividends in arriving at income available to common stockholders in computing basic EPS.

c. Securities (including those issuable pursuant to contingent stock agreements) that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS because to do so would have been antidilutive for the period(s) presented. Full disclosure of the terms and conditions of these securities is required even if a security is not included in diluted EPS in the current period.

d. [*After the adoption of ASU 2023-06* – The methods used in the diluted EPS computation for each type of dilutive instrument (for example, treasury stock method, if-converted method, two-class method, or reverse treasury stock method).]

ASC 260-10-50-1A

Per-share amounts not required to be presented by this Subtopic that an entity chooses to disclose shall be computed in accordance with this Subtopic and disclosed only in the notes to financial statements; it shall be noted whether the per-share amounts are pretax or net of tax. (See paragraph 260-10-45-5.)

ASC 260-10-50-2

For the latest period for which an income statement is presented, an entity shall provide a description of any transaction that occurs after the end of the most recent period but before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) that would have changed materially the number of common shares or potential common shares outstanding at the end of the period if the transaction had occurred before the end of the period. Examples of those transactions include the issuance or acquisition of common

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shares; the issuance of warrants, options, or convertible securities; the resolution of a contingency pursuant to a contingent stock agreement; and the conversion or exercise of potential common shares outstanding at the end of the period into common shares.

ASC 260-10-50-1 through 50-2 provides the general disclosure requirements related to EPS. Pursuant to this guidance, for each period for which an income statement is presented, the following disclosures are required:

- A reconciliation of the numerators and the denominators of the basic and diluted per-share computations for income from continuing operations, which must include both the individual income and share effects of all securities that affect EPS
- The impact of preferred dividends in arriving at income available to common stockholders in computing basic EPS
- Securities (including those issuable pursuant to contingent stock agreements) that could potentially dilute basic EPS in a future period that were not included in the computation of diluted EPS because their inclusion would have been antidilutive for the periods presented
- Following the adoption of ASU 2023-06, the method used to calculate the dilutive effect for each type of dilutive instrument included in the computation of diluted EPS

For the most recent period for which an income statement is presented, an entity is required to describe any transaction, including the number of securities involved, that occurred after the end of the most recent period but before the financial statements are issued or are available to be issued that would have materially changed the number of common shares or potential common shares outstanding at the end of the period if the transaction had occurred before the end of the period. Examples of those types of transactions include:

- Issuance or acquisition of common shares (other than in connection with a stock dividend, stock split or a reverse stock split)
- Issuance of warrants, options or convertible securities
- Resolution of a contingency included in a contingent stock agreement
- Conversion or exercise of potential common shares outstanding at the end of the period into common shares

When there has been a retroactive adjustment to all per-share data presented because of a stock dividend, stock split or reverse stock split (either during the period or after the close of the period but before the financial statements are issued or are available to be issued) that fact is required to be disclosed.

ASC 260-10-55-51 through 55-52 provide an illustrative example of the reconciliation of the numerators and denominators of the basic and diluted EPS computations.

ASC 260-10-55-51

This Example illustrates the reconciliation of the numerators and denominators of the basic and diluted EPS computations for income from continuing operations and other related disclosures required by paragraph 260-10-50-1 for Entity A in Example 1. [*After the adoption of ASU 2023-06* – This disclosure is required in both interim and annual periods,] Note that Topic 718 has specific disclosure requirements related to share-based compensation arrangements.

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ASC 260-10-55-52

The following table illustrates the computation of basic and diluted EPS for the year ended 20X1.

	For the Year Ended 20X1		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Income from continuing operations	$ 7,500,000		
Less: Preferred stock dividends	(45,000)		
Basic EPS			
Income available to common stockholders	7,455,000	3,991,666	$ 1.87
Effect of Dilutive Securities			
Warrants		30,768	
Convertible preferred stock	45,000	308,333	
4% convertible debentures	60,000	50,000	
Diluted EPS			
Income available to common stockholders + assumed conversions	$ 7,560,000	4,380,767	$ 1.73

[*After the adoption of ASU 2023-06* – Diluted EPS was computed using the treasury stock method for warrants and the if-converted method for convertible instruments.] Options to purchase 1,000,000 shares of common stock at $85 per share were outstanding during the second half of 20X1 but were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares. The options, which expire on June 30, 20Y1, were still outstanding at the end of year 20X1.

4.3 Other EPS impacts

The impact of transactions on the basic and diluted EPS calculations are not all housed within ASC 260. Requirements are included in other sections within the FASB Accounting Standards Codification and ASC 260-10-60 details some of those relationships:

Topic	ASC Reference
Rabbi trust	710-10-45-3 through 45-4
Share-based payment arrangements	718-10-45-1 through 45-2
Employee stock ownership plans	718-40-45 718-40-50

Additional areas noted include (not intended to be all-inclusive):

Topic	ASC Reference
Unusual or infrequently occurring items	220-20-45-1
Initial public offerings	260-10-S99-1

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Topic	ASC Reference
Period includes redemption or induced conversion of preferred stock	260-10-S99-2
Share-collateral transactions	460-10-55-24
Loaned shares or own-share lending arrangements	470-20-45-2A and 470-20-50
Redeemable securities—SEC guidance	480-10-S99-3A
Business combinations—reverse acquisitions	805-40-45-3 through 45-5
Intra-entity transactions	805-50-45-3 805-50-50-2
Research and development arrangements	810-30-45-2
Modifications or exchanges of freestanding equity-classified written call options	815-40-35-17
Reorganizations	852-10-45-16

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