NO. 1200-200 | DECEMBER 15, 2003

Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Earnings per Share

an amendment of FASB Statement No. 128

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Major Projects and Technical Activities
File Reference No. 1200-200

Comment Deadline: April 13, 2004

Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be *received* in writing by April 13, 2004. Interested parties should submit their comments by email to **director@fasb.org,** File Reference 1200-200. Those without email may send their comments to the "MP&T Director—File Reference 1200-200" at the address at the bottom of this page. Responses should *not* be sent by fax.

Any individual or organization may obtain one copy of this Exposure Draft without charge until April 13, 2004, on written request only. Please ask for our Product Code No. E174. For information on applicable prices for additional copies and copies requested after April 13, 2004, contact:

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Notice for Recipients
of This Exposure Draft

This proposed Statement would amend the computational guidance in FASB Statement No. 128, *Earnings per Share,* for calculating the number of incremental shares included in diluted shares when applying the treasury stock method. Also, this proposed Statement would eliminate the provisions of Statement 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. In addition, this proposed Statement would require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted-average number of ordinary shares outstanding used in computing basic earnings per share from the date when conversion becomes mandatory.

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement. Comments are requested from those who agree with the provisions of this proposed Statement as well as from those who do not.

Comments are most helpful if they identify the specific paragraph or group of paragraphs to which they relate and clearly explain the problem or question. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning.

Summary

This proposed Statement would amend the computational guidance of FASB Statement No. 128, *Earnings per Share*. When applying the treasury stock method for year-to-date diluted earnings per share (EPS), Statement 128 requires that the number of incremental shares included in the denominator be determined by computing a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS computation. Under this proposed Statement, the number of incremental shares included in year-to-date diluted EPS would be computed using the average market price of common shares for the year-to-date period. This proposed Statement also would eliminate the provisions of Statement 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. Also, this proposed Statement would require that shares to be issued upon conversion of a mandatorily convertible security be included in the computation of basic EPS from the date that conversion becomes mandatory.

Reasons for Issuing This Proposed Statement

In 1991, the FASB issued a plan for international activities (which was updated in 1995) that proposed steps to increase the range and intensity of its international activities. An objective of that plan was to make financial statements more useful for investors and creditors by increasing the international comparability of accounting standards concurrent with improving the quality of accounting standards. Statement 128 and IAS 33, *Earnings per Share*, were issued as a result of the first technical project undertaken jointly by the FASB and the International Accounting Standards Committee (IASC) (the predecessor of the International Accounting Standards Board [IASB]).

In October 2002, the FASB and the IASB undertook a joint project to achieve more comparability in cross-border financial reporting through convergence to a single set of high-quality accounting standards. Each Board reviewed its pronouncements for areas of its generally accepted accounting principles (GAAP) that could be improved by converging with the other Board's GAAP. Since the issuance of Statement 128 and IAS 33, the IASB reexamined IAS 33 and proposed changes to enhance its computational guidance. Therefore, EPS was identified as an area in which the FASB and the IASB could improve accounting by converging their standards. This proposed Statement would reaffirm the Board's conclusion in Statement 128 that ". . . financial statements could be improved by simplifying the existing computational guidance, . . . and increasing the comparability of EPS data on an international basis" (paragraph 75). The Board also noted that under the IASB approach, the denominator used for year-to-date computations of EPS will not be affected by the frequency of interim reporting.

How the Changes in This Proposed Statement Would Improve Financial Reporting

By converging with the IASB's method of calculating year-to-date EPS and by clarifying guidance on mandatorily convertible securities in a way that would be consistent with IAS 33, this proposed Statement would enhance the comparability of financial statements prepared under U.S. GAAP and those prepared under the proposed

International Financial Reporting Standard. This is in accordance with the Board's goal of promoting the international convergence of accounting standards concurrent with improving the quality of financial reporting.

Proposed Statement of Financial Accounting Standards

Earnings per Share

an amendment of FASB Statement No. 128

December 15, 2003

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an amendment of FASB Statement No. 128

December 15, 2003

INTRODUCTION

1. FASB Statement No. 128, *Earnings per Share*, specifies the calculation of earnings per share (EPS). This Statement amends the computational guidance of Statement 128 for calculating the number of incremental shares included in diluted shares when applying the treasury stock method. This Statement also eliminates the provision of Statement 128 that allows issuing entities to overcome the presumption that certain contracts that may be settled in cash or shares will be settled in shares. Lastly, this Statement requires that shares to be issued upon conversion of a mandatorily convertible security be included in the computation of basic EPS from the date that conversion becomes mandatory.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendments to Statement 128

2. Statement 128 is amended as follows:

a. The following is added at the end of paragraph 10:

> Shares that will be issued upon conversion of a mandatorily convertible security shall be included in the weighted-average number of shares outstanding used in computing basic EPS from the date that conversion becomes mandatory using the if-converted method described in paragraph 26 of this Statement.

b. Paragraph 29 is amended as follows:

(1) In the second sentence, *presumed* is replaced by *assumed*.

(2) The last sentence is deleted.

c. Paragraph 46 is replaced by the following:

> The number of incremental shares included in quarterly and year-to-date diluted EPS shall be computed using the average market price of common shares for the quarterly and year-to-date periods, respectively. For example, an entity with a calendar year-end would compute the number of incremental shares used for its third quarter diluted EPS using the average market price of common shares during the quarter ended September 30, 20X1. The number of incremental shares used to calculate year-to-date diluted EPS at the end of the third quarter would be

determined using the average market price of common shares for the year-to-date period ending September 30, 20X1.

d. Illustration 1, in paragraph 148, is amended as follows:

(1) Under the caption *Average market price of common stock*, the following sentence is added after *The average market price of common stock from July 1 to September 1, 20X1 was $71*:

The average market price of common stock from January 1, 20X1, to September 1, 20X1, was $66.125.

(2) Under *Full Year 20X1*, *Diluted EPS Computation*, the information under the subheadings *Weighted-average shares* and *Dilutive potential common shares* is replaced by the following:

Weighted-average shares		3,991,666
Plus: Incremental shares from assumed conversions		
Warrants	30,876[a]	
Convertible preferred stock	308,333[b]	
4% convertible debentures	50,000[c]	
Dilutive potential common shares		389,209
Adjusted weighted-average shares		4,380,875

[a][(66.125 – 60) / 66.125] × 500,000 = 46,314 × 8/12 = 30,876 shares
[b](600,000 shares × 5/12) + (100,000 shares × 7/12)
[c]200,000 shares × 3/12

e. Illustration 2, in paragraph 151, is amended as follows:

(1) Under the subheading *Effect of Dilutive Securities*: *Warrants*, the number *30,768* is replaced by *30,876.*

(2) Under the subheading *Diluted EPS*: *Income available to common stockholders + assumed conversions*, the number *4,380,767* is replaced by *4,380,875.*

f. Illustration 8, in paragraph 157, under *The facts are assumed as follows:* the sentence *There are no circumstances in these two examples that would overcome the presumption that the rights are payable in stock (refer to paragraph 29),* is deleted.

g. Paragraph 172 is amended as follows:

(1) Under *Effect of Statement 128* on EITF Issue No. 85-18—"Earnings-per-Share Effect of Equity Commitment Notes," *presumed to be settled in stock and reflected in the computation of diluted EPS unless past experience or a stated policy provides a reasonable basis to believe otherwise* is replaced by *assumed to be settled in stock and reflected in the computation of diluted EPS.*

(2) Under *Effect of Statement 128* on EITF Issue No. 90-19—"Convertible Bonds with Issuer Option to Settle for Cash upon Conversion," *presumed to be settled in stock and reflected in the computation of diluted EPS unless past experience or a stated policy provides a reasonable basis to believe otherwise* is replaced by *assumed to be settled in stock and reflected in the computation of diluted EPS.*

(3) Under *Effect of Statement 128* on EITF Issue No. 94-7—"Accounting for Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," *presumed to be settled in stock and reflected in the computation of diluted EPS unless past experience or a stated policy provides a reasonable basis to believe otherwise* is replaced by *assumed to be settled in stock and reflected in the computation of diluted EPS.*

Effective Date and Transition

3. This Statement shall be effective for financial statements for both interim and annual periods beginning after December 15, 2004. After the effective date, all prior-period EPS data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of this Statement.

The provisions of this Statement need not be applied to immaterial items.

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

A2. In September 2002, the FASB and the International Accounting Standards Board (IASB) (collectively the Boards) made a commitment to converge the accounting standards of their respective jurisdictions through a long-term convergence plan. As part of that plan, the Boards jointly undertook a short-term project to eliminate certain differences between the accounting pronouncements of the IASB and the accounting pronouncements in effect in the United States. Both Boards agreed to limit the scope of the short-term project to issues for which (a) the Boards' respective accounting pronouncements were divergent; (b) convergence to a high-quality solution would appear to be achievable in the short-term, usually by selecting between the existing standards of either the FASB or the IASB; and (c) the issue was not within the scope of other projects on the current agendas of either Board. The Boards hope that before the European Commission's 2005 target date for adoption of international financial reporting standards (IFRS) by all European Union listed companies, the short-term convergence project will simplify cross-border financial reporting by reducing the number of items required for reconciliation of U.S. generally accepted accounting principles (GAAP) and IFRS.

Earnings per Share

A3. In 1991, the FASB issued a plan for international activities (which was updated in 1995) that proposed steps to increase the range and intensity of its international activities. An objective of that plan was to make financial statements more useful for investors and creditors by increasing the international comparability of accounting standards concurrent with improving the quality of accounting standards. Statement 128 and IAS 33, *Earnings per Share*, were issued as a result of the first joint technical project undertaken by the FASB and the International Accounting Standards Committee (IASC) (the predecessor of the IASB).

A4. Since the issuance of Statement 128 and IAS 33, the IASB has reexamined IAS 33 and made changes to enhance the computational guidance for EPS. The Boards identified EPS computation as an issue suitable for the joint short-term convergence project in part because EPS is widely used as an indicator of corporate performance. By converging with IASB guidance, the Board reaffirms its conclusion in Statement 128 that ". . . financial statements could be improved by simplifying the existing computational guidance, . . . and increasing the comparability of EPS data on an international basis" (paragraph 75).

A5. The Board also reaffirmed its position in paragraph 106 of Statement 128 that "application of the treasury stock method in EPS computations represents a practical approach to reflecting the dilutive effect that would result from the issuance of common stock under option and warrant agreements at an effective price below the current market price," noting that both the IASB approach and the U.S. GAAP approach to EPS calculation represent practical approaches and that neither is grounded in any demonstrably superior theory. The Board did note that under the IASB approach, the denominator used for year-to-date computations of EPS would not be affected by the frequency of interim reporting.

A6. The FASB decided to converge with the IASB approach to calculating incremental shares included in year-to-date diluted EPS to provide better comparability between U.S. GAAP and IFRS. The Board recognizes that existing differences between U.S. GAAP and IFRS result in different calculations of earnings, a critical component of EPS. However, it noted that both Boards are working together to minimize those differences.

A7. Statement 128 requires that, for purposes of computing diluted EPS, an entity must presume that a contract that could be settled in cash or shares would be settled in shares if share settlement is more dilutive. However, the presumption that the contract would be settled in common shares could be overcome if past experience or a stated policy provided a reasonable basis to believe that the contract would be paid partially or wholly in cash.[1] Under the IASB approach, the presumption that such contracts will settle in common shares if that settlement would be more dilutive may not be rebutted. The Board decided that the IASB's provisions would result in more consistent EPS calculation. Thus, the Board decided to converge with the IASB provisions that the presumption that contracts that could be settled in either cash or shares would be settled in shares cannot be overcome.

A8. The IASB also decided to require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted-average number of ordinary shares outstanding used in computing basic EPS from the date the security becomes mandatorily convertible. The FASB noted that U.S. GAAP contains no guidance on the effect of mandatorily convertible securities on the calculation of basic EPS. The Board concluded that including such guidance in U.S. GAAP would reduce diversity in practice and eliminate a potential reconciling item between U.S. GAAP and IFRS. Thus, the Board decided to converge with the IASB's guidance on the effect of mandatorily convertible securities on the calculation of basic EPS.

Effective Date and Transition

A9. The Board decided that the provisions of this Statement should be effective for fiscal years beginning after December 15, 2004, so that entities based in the European Union

[1]As discussed in EITF Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share," the presumption was rebuttable only if the decision of whether to issue cash or shares could be made by the issuing entity.

that report under U.S. GAAP would have time to implement its provisions prior to the 2005 target date for reporting under IFRS.

A10. As part of its short-term convergence project, the Board is reexamining its provisions for accounting changes. The Board issued a proposed Statement on accounting changes concurrent with issuance of the Exposure Draft for this Statement. That proposed Statement would deem retrospective application impracticable if (a) the effects of retrospective application are not determinable, (b) retrospective application requires assumptions about management's intent in a prior period, or (c) retrospective application requires significant estimates as of a prior period for which it is not possible to objectively distinguish between information that would have been available at the time the affected transactions or events would have been recognized in the financial statements and information that arose subsequent thereto. The Board intends to begin its short-term convergence redeliberations with the proposed Statement on accounting changes. The Board concluded that retrospective application of the provisions of this Statement is appropriate because none of the circumstances that would deem retrospective application impracticable are applicable.

Benefits and Costs

A11. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—and other users of financial information benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

A12. The Board does not expect that the cost of any of the changes made by this Statement will be significant, and it notes that converging with the IASB's EPS calculation will reduce costs for entities that prepare cross-border financial statements. In addition to reducing costs associated with preparing cross-border financial statement reconciliations, this Statement brings the FASB and the IASB closer to a common metric for evaluating an entity's financial performance.

Appendix B

ILLUSTRATION 1 OF APPENDIX C OF STATEMENT 128 AS AMENDED

B1. This appendix shows Illustration 1 of Appendix C of Statement 128 as amended by this Statement. [Added text is underlined and deleted text is struck out.]

Illustration 1—Computation of Basic and Diluted Earnings per Share and Income Statement Presentation

B2. This example illustrates the quarterly and annual computations of basic and diluted EPS in the year 20X1 for Corporation A, which has a complex capital structure. The control number used in this illustration (and in Illustration 2) is income before extraordinary item and accounting change because Corporation A has no discontinued operations. Paragraph B3 illustrates the presentation of basic and diluted EPS on the face of the income statement. The facts assumed are as follows:

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

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

<u>The average market price of common stock from January 1, 20X1, to September 1, 20X1, was $66.125.</u>

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.

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 the Corporation.

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.

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.

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.

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

Year 20X1	**Income (Loss) before Extraordinary Item and Accounting Change**[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)	3,750,000[c]
Full year	$7,500,000	$ 9,750,000

[a]This is the control number (before adjusting for preferred dividends). Refer to paragraph 15.
[b]Corporation A had a $2 million extraordinary loss (net of tax) in the third quarter.
[c]Corporation A had a $4.25 million cumulative effect of an accounting change (net of tax) in the fourth 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 × \$0.05

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	0[c]	
Convertible preferred stock	600,000	
4% convertible debentures	200,000	
Dilutive potential common shares		800,000
Adjusted weighted-average 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 × $0.05
[b]($10,000,000 × 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).

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 × $0.05

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-average 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 × $0.05

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

[c] (600,000 shares × 2/3) + (100,000 shares × 1/3)

Third Quarter 20X1

Basic EPS Computation

Income before extraordinary item	$ 500,000
Less: Preferred stock dividends	(5,000)
Income available to common stockholders	495,000
Extraordinary item	(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 before extraordinary item	**$ 0.12**
Extraordinary item	**$(0.47)**
Net loss	**$(0.35)**

The equation for computing basic EPS is:

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

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
Extraordinary item		(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-average shares		4,418,309

Diluted EPS

Income before extraordinary item	**$ 0.11**
Extraordinary item	**$(0.45)**
Net loss	**$(0.34)**

The equation for computing diluted EPS is:

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

Note: The incremental shares from assumed conversions are included in computing the diluted per-share amounts for the extraordinary item and net loss even though they are antidilutive. This is because the control number (income before extraordinary item, adjusted for preferred dividends) was income, not a loss. (Refer to paragraphs 15 and 16.)

[a] [($71 – $60) ÷ $71] × 500,000 = 77,465 shares; 77,465 × 2/3 = 51,643 shares

Fourth Quarter 20X1

Basic and Diluted EPS Computation

Loss before accounting change	$ (500,000)
Plus: Preferred stock dividends	(5,000)
Loss available to common stockholders	(505,000)
Accounting change	4,250,000
Net income available to common stockholder	$3,745,000

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

Loss before accounting change	**$(0.11)**
Accounting change	**$ 0.92**
Net income	**$ 0.81**

The equation for computing basic (and diluted) EPS is:

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

Note: The incremental shares from assumed conversions are not included in computing the diluted per-share amounts for the accounting change and net income because the control number (loss before accounting change, adjusted for preferred dividends) was a loss, not income. (Refer to paragraphs 15 and 16.)

Full Year 20X1

Basic EPS Computation

Income before extraordinary item and accounting change	$7,500,000
Less: Preferred stock dividends	(45,000)
Income available to common stockholders	7,455,000
Extraordinary item	(2,000,000)
Accounting change	4,250,000
Net income available to common stockholders	$9,705,000

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 before extraordinary item and accounting change	**$ 1.87**
Extraordinary item	**$(0.50)**
Accounting change	**$ 1.06**
Net income	**$ 2.43**

The equation for computing basic EPS is:

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

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
Extraordinary item		(2,000,000)
Accounting change		4,250,000
Net income available to common stockholders + assumed conversions		$ 9,810,000

Weighted-average shares		3,991,666
Plus: Incremental shares from assumed conversions		
Warrants	30,876 ~~30, 768~~ [a]	
Convertible preferred stock	308,333[b]	
4% convertible debentures	50,000[c]	
Dilutive potential common shares	~~389,101~~	389,209
Adjusted weighted-average shares	~~4,380,767~~	4,380,875

Diluted EPS

Income before extraordinary item and accounting change	**$ 1.73**
Extraordinary item	**$(0.46)**
Accounting change	**$ 0.97**
Net income	**$ 2.24**

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 shares x 3/12) + (51, 643 shares x 3/12)~~ [(66.125 – 60) / 66.125] × 500,000 = 46,314 × 8/12 = 30,876 shares

[b] (600,000 shares × 5/12) + (100,000 shares × 7/12)

[c] 200,000 shares × 3/12

~~B3.~~B3. The following illustrates how Corporation A might present its EPS data on its income statement. Note that the per-share amounts for the extraordinary item and the accounting change are not required to be shown on the face of the income statement.

	For the Year Ended 20X1
Earnings per common share	
Income before extraordinary item and accounting change	$ 1.87
Extraordinary item	(0.50)
Cumulative effect of a change in accounting principle	1.06
Net income	$ 2.43
Earnings per common share—assuming dilution	
Income before extraordinary item and accounting change	$ 1.73
Extraordinary item	(0.46)
Cumulative effect of a change in accounting principle	0.97
Net income	$ 2.24

B4. The following table includes the quarterly and annual EPS data for Corporation A. The purpose of this table is to illustrate that the sum of the four quarters' EPS data will not necessarily equal the annual EPS data. This Statement does not require disclosure of this information.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Basic EPS					
Income (loss) before extraordinary item and accounting change	$0.89	$1.19	$ 0.12	$(0.11)	$ 1.87
Extraordinary item	—	—	(0.47)	—	(0.50)
Accounting change	—	—	—	0.92	1.06
Net income (loss)	$0.89	$1.19	$(0.35)	$ 0.81	$ 2.43
Diluted EPS					
Income (loss) before extraordinary item and accounting change	$0.74	$1.05	$ 0.11	$(0.11)	$ 1.73
Extraordinary item	—	—	(0.45)	—	(0.46)
Accounting change	—	—	—	0.92	0.97
Net income (loss)	$0.74	$1.05	$(0.34)	$ 0.81	$ 2.24

Appendix C

IMPACT ON EITF ISSUES

C1. This appendix addresses the impact of this Statement on the consensuses reached on EITF Issues relating to earnings per share. This appendix does not address the impact of this Statement on other authoritative accounting literature included in categories (b), (c), and (d) in the GAAP hierarchy discussed in AICPA Statement on Auditing Standards No. 69, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles" in the Independent Auditor's Report.*

Issue Number	Title	Status	Analysis
85-18	Earnings-per-Share Effect of Equity Commitment Notes	Status Amended	The status of Issue 85-18 notes that by stating that contracts that may be settled in stock or cash should be presumed to be settled in stock and reflected in the computation of diluted EPS unless past experience or a stated policy provides a reasonable basis to believe otherwise, Statement 128 nullifies the first consensus in Issue 85-18. This Statement eliminates the ability to rebut that presumption because past experience or a stated policy provides a reasonable basis to believe otherwise.
90-19	Convertible Bonds with Issuer Option to Settle for Cash upon Conversion	Status Amended	Issue 3 of EITF Issue 90-19 states that for instrument C, described therein, the conversion spread should be included in diluted EPS based on the provisions of paragraph 29 of Statement 128 and EITF Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share." This Statement eliminates the ability to overcome the presumption in paragraph 29 of Statement 128 that a contract that may be settled in stock or cash will be settled in common stock and the resulting potential shares included in diluted EPS if the effect is more dilutive.

Issue Number	Title	Status	Analysis
97-14	Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested	Partially Nullified	The Task Force reached a consensus that employer shares held by the rabbi trust should be treated as treasury stock for EPS purposes and excluded from the denominator in the basic and diluted EPS calculations. However, the obligation under the deferred compensation arrangements should be reflected in the denominator of the EPS computation in accordance with the provisions of Statement 128. Thus, if the obligation may be settled by delivery of cash, shares of employer stock, or diversified assets (other than Plan A), those shares would not be reflected in basic EPS but would be included in the calculation of diluted EPS in accordance with paragraphs 22 and 29 of Statement 128. This Statement eliminates the ability to overcome the presumption in paragraph 29 of Statement 128 that a contract that may be settled in stock or cash will be settled in common stock and the resulting potential shares included in diluted EPS if the effect is more dilutive.
98-12	Application of Issue No. 00-19 to Forward Equity Sales Transactions	Partially Nullified	The Task Force reached a consensus that for the purpose of computing EPS the effect of the forward equity sales transaction on the diluted EPS calculation would be determined using the guidance provided in Statement 128 and the guidance in Topic D-72. This Statement eliminates the ability to overcome the presumption in paragraph 29 of Statement 128 that a contract that may be settled in stock or cash will be settled in common stock and the resulting potential shares included in diluted EPS if the effect is more dilutive. Thus, the EPS calculation assumption (b) in footnote 1 is nullified.

Issue Number	Title	Status	Analysis
00-19	Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock	Partially Nullified	Paragraph 49 states, in accordance with an FASB staff announcement (Topic D-72), that for those contracts that provide the company with a choice of settlement methods, the company should assume that the contract will be settled in shares. However, that presumption may be overcome if past experience or a stated policy provides a reasonable basis to believe that it is probable that the contract will be paid partially or wholly in cash. This Statement eliminates the ability to overcome that presumption. Paragraph 49 then states that in accordance with that same FASB staff announcement, for contracts in which the counterparty controls the means of settlement, past experience or a stated policy is not determinative. Accordingly, in those situations, the more dilutive of cash or share settlement should be used. This Statement reaffirms that position.
D-62	Computing Year-to-Date Diluted Earnings per Share under FASB Statement No. 128	Partially Nullified	The second paragraph of Topic D-62 states, "Paragraph 46 of FASB Statement No. 128, *Earnings per Share,* 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.' Similar guidance is provided for contingent shares in footnote 18 of Statement 128." This Statement changes that computational guidance to require that for year-to-date diluted EPS, the year-to-date weighted average be computed over the entire period, rather than an average of that used in each prior interim period. Thus, the note at the end of Example 2 in Topic D-62 is deleted.

Issue Number	Title	Status	Analysis
D-72	Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share	Partially Nullified Partially Affirmed	Topic D-72 states, "The staff also would like to clarify that the provisions of paragraph 29 of Statement 128 require that for contracts that provide the company with a choice of settlement methods, the company shall assume that the contract will be settled in shares. That presumption may be overcome if past experience or a stated policy provides a reasonable basis to believe that it is probable that the contract will be paid partially or wholly in cash." This Statement eliminates the ability to overcome the presumption in paragraph 29 of Statement 128 that a contract that may be settled in stock or cash will be settled in common stock and the resulting potential shares included in diluted EPS if the effect is more dilutive. Topic D-72 also states, "For contracts in which the counterparty controls the means of settlement, past experience or a stated policy is not determinative. Accordingly, in those situations, the more dilutive of cash or share settlement should be used." This Statement reaffirms the position that past experience or a stated policy cannot be used to rebut that presumption.