



## On the Radar

### Earnings per Share

EPS is one of the most prominent financial ratios analyzed by financial statement users. The objective of EPS is to measure the performance of an entity over a financial reporting period. EPS must be presented by entities that (1) have common stock that trades in a public market or (2) file with a regulatory agency for the sale of common stock in a public market. ASC 260 addresses the calculation, presentation, and disclosure of EPS.

Entities that present EPS must provide two metrics:

#### Basic EPS

Income available to common stockholders divided by outstanding common shares

#### Diluted EPS

Basic EPS adjusted to reflect the effect of outstanding potential common shares

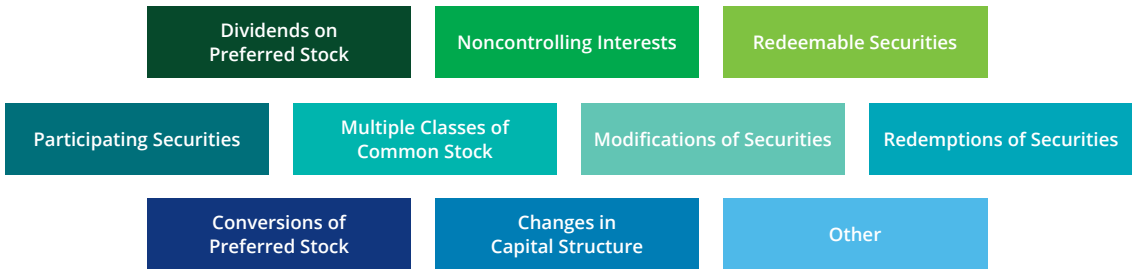
Many entities also disclose non-GAAP EPS amounts (e.g., diluted EPS adjusted to exclude certain charges or gains). SEC registrants may generally disclose non-GAAP EPS amounts as long as they comply with SEC Regulation S-K, Item 10(a), as interpreted by the SEC staff. Such disclosures must be meaningful, reconciled to GAAP EPS, and not shown with more prominence than GAAP EPS.

**The SEC staff closely scrutinizes non-GAAP measures that are included in press releases, Form 8-K filings, and other filings under the Securities Act and Exchange Act and will challenge non-GAAP EPS amounts that do not comply with SEC Regulation S-K, Item 10(a). For example, the disclosure of EBIT or EBITDA per share or per-share amounts that are liquidity measures is prohibited.**

### Basic EPS

The calculation of basic EPS is straightforward for entities with simple capital structures. Basic EPS equals net income or loss divided by the weighted-average number of shares of common stock outstanding during the period. Outstanding common stock includes issued common shares that are not subject to any vesting conditions and shares issuable for little or no consideration. Outstanding common stock does not include shares held in treasury or contingently issuable shares.

Certain complexities that can arise when basic EPS is calculated are discussed in the sections below.<sup>1</sup>



### Dividends on Preferred Stock

Dividends on preferred stock reduce net income (or increase net loss) to arrive at income (or loss) available to common stockholders, which is the numerator in the calculation of basic EPS. Such dividends include (1) dividends that accumulate on cumulative preferred stock; (2) dividends that are declared on noncumulative preferred stock; (3) the accretion of dividends on convertible preferred stock with an increasing rate; (4) undistributed earnings attributable to participating preferred stock; and (5) “deemed” dividends such as exercise price adjustments triggered by down-round features and measurement adjustments on redeemable preferred stock.

### Noncontrolling Interests

The numerator in the calculation of basic EPS reflects only net income or loss of the parent; therefore, income or loss attributable to noncontrolling interests (NCIs) must be excluded. Accordingly, an entity must calculate basic EPS at the subsidiary level and use that amount in calculating the parent’s EPS.

### Redeemable Securities

SEC registrants are required to present redeemable securities, such as redeemable preferred stock, common stock, share-based payment arrangements, and NCIs, within temporary equity. In addition, an entity may be required to remeasure the carrying amount of such securities to their redemption amount. Such measurement adjustments are treated as “deemed dividends” that may result in an adjustment to the numerator in the calculation of basic EPS.

### Participating Securities

The ASC master glossary defines a participating security as 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.” Participating securities may include debt instruments, preferred stock instruments, contracts on an

<sup>1</sup> Because diluted EPS is calculated on the basis of basic EPS, these matters also affect the calculation of diluted EPS. However, certain considerations that apply to diluted EPS are not relevant to the calculation of basic EPS.

entity's own equity, share-based payment arrangements, and NCIs. An entity with participating securities must allocate a portion of undistributed net income to such securities in accordance with the two-class method of calculating EPS. Such allocation will result in a reduction of basic EPS because the common stockholders are not entitled to share in all of the entity's earnings.

**The determination of whether an instrument is a participating security and the use of the two-class method of calculating EPS are two of the most complicated aspects of applying ASC 260. Entities may need to consult with their accounting advisers to appropriately apply ASC 260.**

## Multiple Classes of Common Stock

Entities that have multiple classes of common stock and master limited partnerships (MLPs) must apply the two-class method of calculating basic EPS to present EPS for each class. An entity has more than one class of common stock if some, but not all, of its common shares are redeemable.

## Modifications of Securities

When an entity modifies preferred stock or a contract on its own equity and the fair value of the instrument increases as a result of the modification, a charge to the numerator in the calculation of EPS may be required if the modification includes a "deemed dividend." A modification of common stock could also affect the numerator in the calculation of basic EPS.

## Redemptions of Securities

ASC 260-10-S99-2 requires entities to adjust the numerator in the calculation of basic EPS for the difference between the fair value of the consideration transferred and the carrying amount of preferred stock that is redeemed or otherwise considered extinguished. The numerator may also need to be adjusted when common stock is repurchased for more than fair value.

## Conversions of Preferred Stock

Certain conversions of preferred stock into common stock affect the numerator in the calculation of basic EPS. ASC 260-10-S99-2 requires an entity to adjust the numerator for the excess value conveyed in an induced conversion of preferred stock. In addition, when preferred stock that contains a separately recognized equity component or embedded conversion option liability is converted into common stock, an entity may be required to recognize an adjustment to the numerator for a "deemed dividend" that occurs upon such conversion.

## Changes in Capital Structure

When stock dividends, stock splits, and certain rights issues exist, entities must retrospectively adjust previously reported basic EPS to reflect the change in outstanding common shares. Other changes in capital structure may be treated similarly or may be reflected only prospectively. Significant judgment is often required when there is a change in an entity's capital structure.

## Other

Other situations that affect the calculation of basic EPS include prior-period adjustments, certain issuances of common stock, accelerated share repurchase agreements, own-share lending arrangements, business combinations, discontinued operations, and equity method investees.

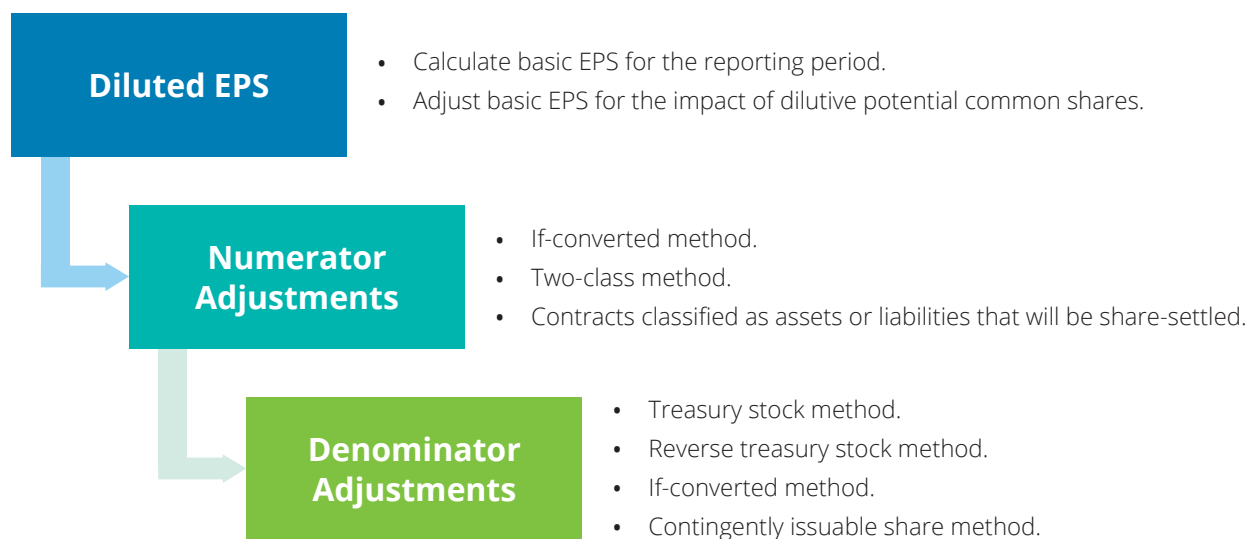
## Diluted EPS

Diluted EPS is a per-share performance measure that includes (1) outstanding common shares and (2) additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In calculating diluted EPS, an entity assumes that all dilutive potential common shares within its capital structure were outstanding during the reporting period and that net income (the numerator) was calculated by using a consistent assumption. To determine whether a potential common share is dilutive, entities must apply the antidilution sequencing guidance in ASC 260, which often proves difficult. The complexity of calculating diluted EPS will vary depending on the nature of an entity's capital structure.

To calculate diluted EPS, an entity makes various adjustments to the numerator and denominator in the calculation of basic EPS to reflect the impact of potential common shares. To do so, the entity uses one of four methods — the treasury stock method, the reverse treasury stock method, the if-converted method, or the contingently issuable share method.

**In calculating diluted EPS, an entity must adjust the numerator for convertible instruments and other contracts whose accounting classification differs from their EPS treatment (e.g., contracts classified as assets or liabilities that are considered share-settled for diluted EPS purposes). Entities with more complex capital structures may also need to apply the two-class method of calculating diluted EPS.**

The graphic below illustrates the types of adjustments to the numerator and denominator that an entity may be required to make when calculating diluted EPS.



## Treasury Stock Method

The treasury stock method is an approach to calculating diluted EPS in which an entity assumes that the proceeds that would be obtained upon the exercise of options, warrants, and similar instruments are used to purchase common stock at the average market price during the period. The excess of the shares issuable over the shares repurchased is added to the denominator. An adjustment to the numerator is also necessary for contracts classified as assets or liabilities since they are considered to be equity-classified for diluted EPS purposes.

## Reverse Treasury Stock Method

The reverse treasury stock method is an approach to calculating diluted EPS in which an entity assumes that the proceeds needed to satisfy an obligation to repurchase common stock (i.e., a put option or forward contract) will be raised by issuing shares at the average market price during the period. The excess of the shares issuable

over the shares repurchased is added to the denominator. An adjustment to the numerator is also necessary because contracts subject to the reverse treasury stock method are classified as assets or liabilities for accounting purposes.

### If-Converted Method

The if-converted method is an approach to calculating diluted EPS in which conversion of convertible securities at the beginning of the reporting period (or at the time of issuance, if later) is assumed. To apply the if-converted method, an entity generally must also adjust the numerator.

### Contingently Issuable Share Method

The contingently issuable share method is an approach to calculating diluted EPS in which an entity assumes that the number of common shares that would be issued, if any, if the reporting period was the end of the contingency period, are issued and outstanding. An adjustment to the numerator is also necessary for contingently issuable share arrangements that are classified as assets or liabilities.

In the guidance in ASC 260 on diluted EPS, it is assumed that the calculation is performed on an interim reporting basis. As a result, ASC 260 contains additional guidance on how to calculate diluted EPS on a year-to-date basis. In performing such calculations, entities must use the numerator and denominator amounts in the individual interim-period calculations.

### Presentation and Disclosure

ASC 260 requires entities to present basic and diluted EPS with equal prominence on the face of the income statement for each period presented. Under ASC 270-10, the same requirement applies to interim periods. Entities with multiple classes of common stock must present basic and diluted EPS for each class on the face of the income statement. Entities that report a discontinued operation must present basic and diluted EPS on the face of the income statement for income (loss) from continuing operations and net income (loss).

**SEC Regulation S-X outlines the format and content required in financial reports filed with the SEC, including the presentation of EPS in annual reports and interim reports filed under the Exchange Act.**

ASC 260 requires entities to provide a number of disclosures about EPS. SEC registrants must also furnish the incremental disclosures required by the SEC's rules and guidance. In some situations, entities must disclose pro forma EPS amounts (i.e., as required by GAAP or the SEC's rules and guidance). SEC Regulation S-X, Article 11, provides guidance on preparing pro forma financial information.

**Entities that disclose per-share measures not required by ASC 260 or other Codification topics, including, but not limited to, non-GAAP EPS amounts, should exercise caution because the SEC staff often challenges the appropriateness or usefulness of such measures.**

Deloitte's Roadmap *Earnings per Share* comprehensively addresses the calculation, presentation, and disclosure of EPS.

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