CHAPTER 17
UNDERSTANDING INCOME STATEMENTS

1. (A) $1.19 $1.18

Explanation

2004 Basic EPS:

$$\text{Basic EPS} = \frac{2,400,000 - 14,000}{2,000,000}$$

$$= \$1.19$$

2004 Diluted EPS:

$$\text{Diluted EPS} = \frac{(2,400,000 - 14,000) + (49,500)(1 - 0.40)}{(2,000,000) + (45,000)} = \$1.18$$

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

2. (B) Income tax expense.

Explanation

For a financial services company, interest income, interest expense, and financing expenses are likely considered operating activities. For both financial and nonfinancial companies, income tax expense is a non-operating item that is reported within "income from continuing operations" as opposed to "operating profit" as with the other answer choices. Therefore, of the three choices, income tax expense is least likely to be considered an operating item.

(Study Session 6, Module 17.3, LOS 17.f)

Related Material

SchweserNotes - Book 2

3. (A) adjusted by adding back convertible preferred stock dividends.

Explanation

If convertible preferred stock is dilutive, the preferred dividends that would not have been paid if the preferred stock is converted must be added back to the numerator. Note that any nonconvertible preferred stock dividends are still subtracted from net income in the numerator.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

4. (C) zero salvage value to positive salvage value.

Explanation

Changes in accounting principle require retrospective presentation. A change in the salvage value of an asset is a change in accounting estimate, which does not apply retrospectively.

(Study Session 6, Module 17.3, LOS 17.e)

Related Material

SchweserNotes - Book 2

5. (A) Yes No

Explanation

Comprehensive income includes all transactions that affect shareholders' equity except transactions with shareholders. Thus, any transaction that affects net income would also affect comprehensive income. Since the inventory write-down is included in net income, it is part of comprehensive income. The acquisition of treasury stock is a transaction with shareholders; thus, it is not a part of comprehensive income.

(Study Session 6, Module 17.5, LOS 17.k)

Related Material

SchweserNotes - Book 2

6. (B) performance obligation.

Explanation

Performance obligations within a contract are defined as promises to transfer distinct goods or services.

(Study Session 6, Module 17.2, LOS 17.b)

Related Material

SchweserNotes - Book 2

7. (A) $2.01.

Explanation

Quad's basic EPS (net income / weighted average common shares outstanding) was $892,000 / 400,000 = $2.23.

Diluted EPS is calculated under the assumption that the convertible bonds are converted into common stock, the bond interest net of tax is restored to net income, and the additional common shares are added to the denominator of the equation. Quad's diluted EPS was [$892,000 + (2,000 × $1,000 × 0.06) (1 — 0.40)] / [400,000 + (2,000 × 40)] = $2.01. Since diluted EPS is less than basic EPS, we know that the bonds are dilutive and should be considered in calculating diluted EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

8. (C) $2.36.

Explanation

Diluted EPS = adjusted earnings after conversion (EAC) / weighted average plus potential common shares outstanding.

Step 1: Calculate Adjusted EAC

Adjusted Eac:		Net income-preferred dividends
	+	dividends on convertible preferred Stock
	+	after-tax interest on convertible debt
	=	adjusted earning Available for common shares

preferred dividends = convertible preferred dividends = (0.08)(90)(500) = 3,600
convertible debt interest = (60,000)(0.06)(1 - 0.40) = 2,160
adjusted EAC = (30,000 – 3,600 + 3,600 + 2,160) = **$32,160**

Step 2: Calculate Weighted average plus potential common shares outstanding.

Weighted Average common shares			=	5,000
Shares from conversion of convertible preferred stock	=	(500×4)	=	2,000
Shares from conversion of convertible bonds	=	(60×110)	=	6,600
Weighted ave. plus potential common shares outst.			=	**13,600**

Step 3: Calculate Diluted EPS

Diluted EPS = 32,160 / 13,600 **= $2.36.**

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

9. (A) $0.261.

Explanation

To compute Gerrard's basic earnings per share (EPS) ((net income - preferred dividends) / weighted average common shares outstanding), the weighted average common shares outstanding must be computed. 700,000 shares were outstanding from January 1, and 200,000 shares were issued on March 1, so the weighted average is 700,000 + (200,000 × 10 / 12) = 866,667. Basic EPS was $330,000 - (2,000 × $500 × 0.08)) / 866,667 = $0.289.

If the convertible preferred shares were converted to common stock, 2,000 x 200 = 400,000 additional common shares would have been issued and dividends on the preferred stock would not have been paid. Diluted EPS was $330,000 / (866,667 + 400,000) = $0.261.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

10. (A) All of Valuable's potentially dilutive securities are antidilutive.

Explanation

If all of Valuable's potentially dilutive securities were antidilutive, then EPS would equal diluted EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

11. (A) $2.96.

Explanation

Doors basic earnings per share (EPS) was ($372,000 / 100,000 =) $3.72. If the bonds were converted, interest payments would not have been made. Net income is increased by the interest paid on the bonds net of taxes:

$372,000 + (($1000 × 2,000 × 0.06) × (1 – 0.40)) = $444,000.

Diluted EPS was $444,000 / (100,000 + (2,000 × 25)) = $2.96.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

12. (C) Operating Operating

Explanation

Interest received from customers and interest received from investments are a part of normal operations of a financial institution. Thus, the First National Bank will report the interest income from both sources as components of operating income.

(Study Session 6, Module 17.3, LOS 17.f)

Related Material

SchweserNotes - Book 2

13. (A) $3.75.

Explanation

Basic EPS = ($120,000 - 40,000 - 5,000) / 20,000 shares = $3.75.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

14. (C) 321.

Explanation

Proceeds from the exercise of the options would be:

(802) ($6) = $4,812

The number of shares that could be repurchased with the proceeds at the average price is: 4,812 / 10 = 481.2

The additional number of shares the company would need to issue to fulfill the stock options is: 802 - 481 = 321
(Study Session 6, Module 17.4, LOS 17.h)
Related Material
SchweserNotes - Book 2

15. (B) **Costs of producing inventory.**
Explanation
Inventory costs are expensed when items are sold under the matching principle. As an extreme example, if no sales are made, no costs of inventory production are expensed for the period. Period costs are expensed during the period. Under the accrual method, interest accrued during the period is expensed, regardless of whether it has been paid during the period.
For Further Reference:
(Study Session 6, Module 17.3, LOS 17.d)
CFA® Program Curriculum, Volume 3, page 18
Related Material
SchweserNotes - Book 2

16. (C) **$923,077 -$76,923**
Explanation
During the first year, the revenue was 700,000 / 1,300,000 x 2,000,000 = 1,076,923
The total revenue for both years = $2,000,000
The second year revenue was 2,000,000 – 1,076,923 = $923,077
The second year income = revenues - costs = 923,077 – 1,000,000 = $-76,923
(Study Session 6, Module 17.2, LOS 17.c)
Related Material
SchweserNotes - Book 2

17. (B) **in the same order the units are produced.**
Explanation
The FIFO cost flow method best approximates the physical flow of goods if customers typically purchase units in the order the units are produced, such as goods with a limited shelf life. Last-in-first-out (LIFO) best approximates the flow of goods if customers purchase units from the top of a stack, as with raw materials such as coal or gravel. If customers choose individual units selectively from among all the units for sale, the flow of goods may be unclear and the average cost method may describe it best.
(Study Session 6, Module 17.3, LOS 17.d)
Related Material
SchweserNotes - Book 2

18. (A) 3%, $100 par value convertible preferred.

Explanation

A simple capital structure contains no potentially dilutive securities such as stock options, warrants, or convertible preferred stock.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

19. (B) Unrealized gains and losses on trading securities.

Explanation

Unrealized gains and losses from trading securities are reflected in the income statement and affect owners' equity. However, unrealized gains and losses from available-for-sale securities are included in other comprehensive income. Transactions included in other comprehensive income affect equity but not net income. Dividends paid to shareholders reduce owners' equity but not net income.

For Further Reference:

(Study Session 6, Module 17.5, LOS 17.1)

CFA® Program Curriculum, Volume 3, page 49

Related Material

SchweserNotes - Book 2

20. (C) 197,500.

Explanation

The January 1 balance is adjusted retroactively for the reverse stock split and 320,000 / 2 = 160,000 shares are treated as outstanding from January 1. Issuance of stock is included from the date of issuance. The weighted average shares are computed by multiplying the share amounts by the number of months the shares were outstanding, then adding these amounts and dividing the sum by 12.

January 1:	initial shares	160,000 x 12	=	1,920,000
July 1:	Smith acquisition	60,000 x 6	=	360,000
October 1:	cash issuance	30,000 x 3	=	90,000
Total:				**2,370,000**

Oregon's weighted average shares = 2,370,000 / 12 = 197,500.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

21. (C) $0.782.

Explanation

Nichols basic EPS (net income / weighted average common shares outstanding) was: $978,000 / 1,250,000 = $0.782.

Because the exercise price of the warrants is higher than the average share price, the warrants are antidilutive and are excluded from diluted EPS. Because there were no other potentially dilutive securities, Nichols' diluted EPS in 20X6 is the same as basic EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

22. (C) Only one should be recognized.

Explanation

Interest earned on the CD is recognized as interest income. The gain on the sale of treasury stock is not reported on the income statement but is reflected on the statement of changes in stockholders' equity and on the balance sheet. The sale proceeds simply increase equity and increase cash.

(Study Session 6, Module 17.1, LOS 17.a)

Related Material

SchweserNotes - Book 2

23. (A) $2.00.

Explanation

Interest is already deducted from earnings.

$$\frac{300,000-(0.10)(\$100)(10,000)}{110,000-(6/12)(20,000)}=\$2.00$$

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

24. (B) increase by approximately 2 days.

Explanation

cash conversion cycle (CCC) = days of sales outstanding + days of inventory on hand - number of days of payables

$$\text{number of days of payables} = \frac{365}{\text{Payables turnover}} = \frac{365}{11} = 33.18 \text{ days;}$$

$$= \frac{365}{10} = 36.5 \text{ days}$$

Since the payables payment period increases by 3.32 days and receivables days increases by 5, CCC increases by 1.68 days.

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.h)
CFA® Program Curriculum, Volume 3, page 197
Related Material
SchweserNotes - Book 2

25. (B) **interest expense per dollar of sales declined.**

Explanation

On a common size income statement, all amounts are stated as a percentage of sales. Interest expense per dollar of sales has declined from 0.15 to 0.06. The other interpretations listed are not necessarily correct. COGS increased as a percentage of sales, but if sales decreased, COGS may have decreased as well. The company's effective tax rate (income tax expense / pretax income) can be calculated from a common-size income statement. Here the effective tax rate was 33% in both years.
(Study Session 6, Module 17.5, LOS 17.j)
Related Material
SchweserNotes - Book 2

26. (B) **convertible bonds.**

Explanation

Simple capital structures do not include any potentially dilutive securities (a security that could decrease earnings per share if exercised). Convertible bonds are potentially dilutive.
(Study Session 6, Module 17.4, LOS 17.g)
Related Material
SchweserNotes - Book 2

27. (C) **$7.45 $5.66**

Explanation

Basic EPS = net income - pref div / wt. ave. shares of common
[850,00 – (3 x 10,000)] / 110,000 = $7.45
Diluted EPS = [(net income - preferred dividends) + convertible preferred dividends + (convertible debt interest)(1 - t)] / [(weighted average shares) + (shares from conversion of cony. pfd shares) + (shares from conversion of cony. debt) + (shares issuable from stock options)]
[(850,000 - (3 x 10,000)) + 30,000 + (80,000)(1 - 0.3)] / [(110,000) + (20,000) + (30,000)] = $5.66.
(Study Session 6, Module 17.4, LOS 17.h)
Related Material
SchweserNotes - Book 2

28. (C) $2,500,000.

Explanation

Percentage of completion = 25%(2.2 / 8.8)

Revenue to be recognized in Year 1 = 0.25 × 10 million = 2.5 million

(Study Session 6, Module 17.2, LOS 17.c)

Related Material

SchweserNotes - Book 2

29. (C) Only one is operating.

Explanation

Since Pinto is a nonfinancial firm, dividends received would be considered a nonoperating component. An increase in cost of goods sold would be considered a part of normal operations.

(Study Session 6, Module 17.3, LOS 17.f)

Related Material

SchweserNotes - Book 2

30. (C) 325.

Explanation

(1,039 options)($11) = $11,429

$11,429 / $16 per share

1039 – 714 = 325 shares or [(16 – 11) / 1611,039 = 325.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

31. (A) 1.6 million.

Explanation

The weighted average number of common shares outstanding is the number of shares outstanding during the year weighted by the portion of the year they were outstanding. For the QRK Company, the weighted number of shares outstanding is the original one million shares plus 150,000 shares for the end-of-March issue (= 200,000 x 9/12), plus 250,000 shares for the end-of-June issue (= 500,000 x 6/12), plus 200,000 shares for the end-of-September issue (= 800,000 x 3/12), or 1.6 million shares.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

32. (A) 248.

Explanation

(992) ($9) = $8928

$8928 / 12 = 744

992 – 744 = 248 new shares or [(12 - 9) / 12]992 = 248

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

33. (A) If diluted and basic EPS are equal, the firm must report both basic and diluted EPS.

Explanation

A firm with any potentially dilutive securities outstanding must report both basic and diluted EPS, even if the two are equal. If convertible preferred stock is dilutive to earnings per share, the preferred dividend is added back to the numerator as if the preferred has been converted to common shares. If diluted EPS is less than basic EPS then the convertible preferred is said to be dilutive.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

34. (B) $2.04.

Explanation

Lawson's basic EPS ((net income - preferred dividends) / weighted average common shares outstanding) is ($1,060,000 - (2,000 x $1,000 x 0.08)) / 420,000 = $2.14. To calculate diluted EPS the convertible preferred shares are presumed to have been converted, the preferred dividends paid are added back to the numerator of the EPS equation, and the additional common shares are added to the denominator of the equation. Lawson's diluted EPS is $1,060,000 / (420,000 + 100,000) = $2.04.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

35. (C) simple capital structure.

Explanation

A simple capital structure is one that contains no securities that have the potential to dilute a firm's earnings per share. For example, convertible bonds, convertible preferred stock, options, and warrants have the potential to dilute earnings per share upon conversion or exercise.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

36. (B) expenses are incurred.

Explanation

Accrual accounting is based on the matching principle, under which revenues are recognized in the same period that the expenses are incurred to generate those revenues.

(Study Session 6, Module 17.3, LOS 17.d)

Related Material

SchweserNotes - Book 2

37. (B) 5,000.

Explanation

1/1 5,500 shares issued (includes 10% stock dividend on 6/1) × 12 = 66,000
7/1 1,000 shares repurchased × 6 months = 6,000
66,000 - 6,000 = 60,000 shares
60,000 shares / 12 months = 5,000 average shares
(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

38. (B) $4.75.

Explanation

EPS = earnings available to common shareholders divided by the weighted average number of common shares outstanding. Earnings available to common shareholders is net income minus preferred dividends, or $4,750,000
(= $5 million - 250,000) for AKB.
(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

39. (A) $5.25.

Explanation

Moulding's basic EPS (net income / weighted average common shares outstanding) was $13,820,000 / 2,600,000 = $5.32.

Using the treasury stock method to compute diluted EPS, if the options were exercised, cash inflow would be 10,000 × 10 × $40 = $4,000,000. Based on the average share price of $58.00, the number of Moulding shares that can be purchased with the cash flow is $4,000,000 / $58 = 68,966. The number of shares that would have been created is 100,000 – 68,966 = 31,034. Diluted EPS was $13,820,000 / (2,600,000 + 31,034) = $5.25.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

40. (A) 132,000 139,000

Explanation

Calculating Basic Shares:

Jan 1 100,000 shares outstanding

May 1 30,000 shares issued

July 1 10% stock dividend issued

The 10% stock dividend is retroactive therefore:

110,000 shares × 12 months = 1,320,000

33,000 shares × 8 months = 264,000

Total share-month = 1,584,000

Average shares = (1,584,000 / 12) = 132,000

Calculating diluted shares:

(1,000 bonds) × (21 shares each) × (4 months) = 84,000 total share-month 84,000 / 12 = 7,000 Average shares

Total diluted shares = 7,000 (from convertible bonds) + 132,000 (from stock) = 139,000

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

41. (A) $117.75.

Explanation

To compute Jupiter's basic earnings per share (EPS) use the formula: (net income - preferred dividends) / weighted average common shares outstanding. Weighted average common shares outstanding.

= [(115,000 x 12) + (60,000 x 9) - (45,000 x 3)] / 12

= 148,750.

Basic EPS = $18,300,000 / 148,750 = $123.02.

Using the treasury stock method, if the warrants were exercised cash inflow would be 200 x $100 x 100 = $2,000,000. The number of Jupiter shares that can be purchased with this cash at the average share price is $2,000,000 / $150 = 13,333. The net number of shares that would have been created is 20,000 – 13,333 = 6,667.

Diluted EPS = $18,300,000 / (148,750 + 6,667) = $117.75. Since diluted EPS is less than basic EPS, the warrants are dilutive.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

42. (A) Diluted EPS must be less than or equal to basic EPS.

Explanation

Antidilutive securities are securities that would increase EPS if exercised or converted to common stock.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

43. (B) $1.00.

Explanation

Number of average shares:

1/1 5,500 shares issued (includes 10% stock dividend on 6/1) x 12 = 66,000

7/1 1,000 shares repurchased x 6 months = 6,000

66,000 - 6,000 = 60,000

60,000 shares / 12 months = 5,000 average shares

Preferred dividends = ($10)($1,000) = $10,000

Basic EPS = [$15,000(N1) - $10,000(preferred dividends)] / 5,000 shares

= $5,000 / 5,000 shares = $1/share

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

44. (A) controlling operating expenses.

Explanation

The improvement in net profit margin from 15% to 17% appears to result mainly from the firm reducing selling and administrative expense from 16% of sales to 9% of sales, thus decreasing operating expenses from 66% to 62% of sales. Gross margin is decreasing over this period because cost of goods sold is increasing as a percentage of sales. While financial leverage cannot be determined directly from the income statement, the fact that interest expense is a constant percentage of sales suggests financial leverage is stable.

(Study Session 6, Module 17.5, LOS 17.j)

Related Material

SchweserNotes - Book 2

45. (C) Both of these items are included in comprehensive income.

Explanation

Both items are included in comprehensive income. Comprehensive income includes all items that affect owners' equity except transactions with the company's owners. Any items that are included in net income are also included in comprehensive income. The gain on sale is reported in net income. The foreign currency translation loss is taken directly to owners' equity (i.e., not reported in the income statement).

(Study Session 6, Module 17.5, LOS 17.k)

Related Material

SchweserNotes - Book 2

46. (A) 1,440,000.

Explanation

The January 1 balance is adjusted retroactively for the stock split and (720,000 x 2 = 1,440,000) shares are treated as outstanding from January.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

47. (A) Test for impairment but do not amortize.

Explanation

Under IFRS and U.S. GAAP, intangible assets with indefinite lives (e.g., goodwill) are not amortized but are tested for impairment at least annually.

(Study Session 6, Module 17.3, LOS 17.d)

Related Material

SchweserNotes - Book 2

48. (B) $1.00 $0.80

Explanation

$$\text{Basic EPS} = \frac{(\$1,500,000 - \$500,000)}{1,000,000} = \$1.00$$

$$\text{Diluted EPS} = \frac{(\$1,500,000 - \$500,000) + \$1,000,000(1 - 0.4)}{1,000,000 + 1,000,000}$$

$$= \frac{\$1,600,000}{2,000,000} = \$0.80$$

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

49. (B) $16.00.

Explanation

Basic EPS = $\frac{53,000,000 - (0.07 \times 30,000,000)}{3,000,000} = \$16.97$

The options are not dilutive because the exercise price is greater than the average price over the period.

Diluted EPS =

$$\frac{53,000,000 - (0.07 \times 30,000,000) + [10,000,000 \times 0.06 \times (1 - 0.30)]}{3,000,000 + 200,000}$$

= $16.04

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.g)

CFA® Program Curriculum, Volume 3, page 34

CFA® Program Curriculum, Volume 3, page 43

Related Material

SchweserNotes - Book 2

50. (C) operating profit.

Explanation

This difference describes operating profit.

For Further Reference:

(Study Session 6, Module 17.1, LOS 17.a)

CFA® Program Curriculum, Volume 3, page 6

Related Material

SchweserNotes - Book 2

51. (A) $3.30 $2.86

Explanation

Basic EPS = (net income - preferred dividends) / number of common shares

= (200,000 -35,000) / 50,000 = $3.30 per share

The preferred shares are converted into 20,000 common shares, the firm does not pay preferred dividends. Diluted EPS = 200,000 / (50,000 + 20,000) = $2.86 per share. The warrants are out of the money at a stock price of $20.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

52. (A) 250,000.

Explanation

The treasury stock method would allow the 1 million additional shares to be partially offset by the number of shares that could be repurchased with the amount of money received for those shares. In this case, the 1 million shares issued would be offset by (1,000,000 × $42 / $56) or 750,000 shares.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

53. (A) Shares issued after a stock split must be adjusted for the split.

Explanation

Shares issued post-split need not be adjusted for the split as they are already "new" shares. Options with an exercise price greater than the average share price do not affect diluted EPS.

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.g)

CFA® Program Curriculum, Volume 3, page 34

Related Material

SchweserNotes - Book 2

54. (B) $0.50.

Explanation

The preferred shares are convertible into 100,000 x 20 = 2 million common shares. They are dilutive since:

$$\text{Basic EPS} = \frac{\$1,000,000}{1,000,000} = \$1.00$$

$$\text{Diluted EPS} = \frac{\$1,500,000}{3,000,000} = \$0.50 \text{ which is less.}$$

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

55. (B) No Yes

Explanation

Other comprehensive income includes non-owner transactions that affect shareholders' equity and are not recognized in net income. Dividends paid are transactions with the owners of the firm, so dividends paid are not included in other comprehensive income. Foreign currency translation gains and losses are non-owner transactions that are not recognized in net income. Thus, foreign currency translation gains and losses are included in other comprehensive income.

(Study Session 6, Module 17.5, LOS 17.1)

Related Material

SchweserNotes - Book 2

56. (B) Decrease EPS.

Explanation

Dilutive securities such as convertibles and options are found in a complex capital structure and always decrease EPS. Convertibles and options may also be antidilutive, which will increase EPS hence the name antidilutive. The only way to know if a security is dilutive or antidilutive is to compare the basic EPS to diluted EPS. If the diluted EPS is higher than the basic EPS then the security is antidilutive and should not be included when determining diluted EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

57. (B) 220,000.

Explanation

The January 1 balance of common shares outstanding is adjusted retroactively for both stock dividends and stock splits. The weighted average shares outstanding for the year = 100,000 × 2 × 1.1 = 220,000.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

58. (A) Effective tax rate.

Explanation

The effective tax rate is income tax expense as a percentage of pretax income. Items on a common-size income statement are stated as a percentage of revenue (sales). Net profit margin is net income as a percentage of revenue.

(Study Session 6, Module 17.5, LOS 17.i)

Related Material

SchweserNotes - Book 2

59. (A) 484,000.

Explanation

[400,000 shares ×12 months + 40,000 × 12 months + 90,000 × 6 months - (12,000 × 1 months)] divided by 12 = 484,000 shares.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

60. (C) premium bonds.

Explanation

Whether a bond is issued or valued at a premium or discount is not relevant to whether the bond is potentially dilutive to earnings per share. Bonds and preferred stock are only potentially dilutive if they are convertible to common shares. Stock options and warrants are potentially dilutive because they will increase common shares outstanding if they are exercised.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

61. (C) $1.23.

Explanation

Diluted EPS = [NI - preferred dividends + convertible interest (1 - t)] / [weighted average shares + convertible debt shares]

100(1,000)(6%)(1 - 0.4) = $3,600; convertible debt shares = 50(100) = 5,000

$$\frac{\$15,000-\$10,000+\$3,600}{2,000+5,000}=81.23$$

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.g)

CFA® Program Curriculum, Volume 3, page 34

Related Material

SchweserNotes - Book 2

62. (A) $720,000.

Explanation

(1,200 × $1,000 × 12/20) = $720,000

(Study Session 6, Module 17.2, LOS 17.c)

Related Material

SchweserNotes - Book 2

63. (A) 485,000.

Explanation

Only the October 1 transaction affects the weighted average common shares outstanding because the April 1 transaction would not affect the number of shares outstanding and the July 1 transaction involves warrants which would not be included in the basic EPS calculation. The computation for basic EPS is [(500,000 × 12) – (60,000 × 3)] / 12 = 485,000.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

64. (B) No effect Increase

Explanation

Unrealized foreign currency translation gains and losses are not reported in the income statement; thus, retained earnings are unaffected. However, unrealized foreign currency gains and losses are included in comprehensive income. Comprehensive income includes all changes in equity except those that result from transactions with shareholders. So, the translation gain increases stockholders' equity by increasing comprehensive income.

(Study Session 6, Module 17.5, LOS 17.k)

Related Material

SchweserNotes - Book 2

65. (A) 231.

Explanation

(999)(10) = 9,990

9,990 / 13 = 768

999 – 768 = 231

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

66. (A) dividends paid to common shareholders.

Explanation

Basic EPS = earnings available to common shareholders divided by the weighted average number of common shares outstanding. Earnings available to common shareholders equals net income minus preferred dividends.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

67. (B) principles-based.

Explanation

The converged accounting standards concerning revenue recognition, issued in May 2014 by the IASB and FASB, are principles-based.

(Study Session 6, Module 17.2, LOS 17.b)

Related Material

SchweserNotes - Book 2

68. (B) $3.94.

Explanation

Kendall's basic EPS is $830,000 / 200,000 = $4.15. To compute diluted EPS, bond interest paid net of taxes is added to net income, and the number of shares that would be issued in the conversion is added to the denominator. Kendall's diluted EPS = [$830,000 + (1,000 x $1,000 x 0.06) x (1 - 0.4)] / (200,000 + 20,000) = $3.94. Since diluted EPS is less than basic EPS, we know that the bonds are dilutive and should be considered in calculating diluted EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

69. (C) 7,500,000 shares.

Explanation

Stock splits and stock dividends are applied to all shares that existed at the beginning of the period and shares that were issued or repurchased during the period, but prior to the split or dividend. For SSP, the 5 million beginning-of-year shares outstanding are adjusted to 7.5 million shares (5.0 x 3/2) as a result of the 3:2 split.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

70. (B) $14.67.

Explanation

To compute Hampshire's basic EPS ((net income - preferred dividends) / weighted average common shares outstanding), the weighted average common shares must be computed. 100,000 shares were outstanding from January 1, and 30,000 shares were issued on September 1, so the weighted average is 100,000 + (30,000 × 4 / 12) = 110,000. Basic EPS is ($2,800,000 - (10,000 × $1,000 × 0.06)) / 110,000 = $20.00.

If the warrants were exercised, cash inflow would be 10,000 × $150 × 10 = $15,000,000 for 10 × 10,000 = 100,000 shares. Using the treasury stock method, the number of Hampshire shares that can be purchased with the cash inflow (cash inflow / average share price) is $15,000,000 / $250 = 60,000. The number of shares that would be created is 100,000 - 60,000 = 40,000. Diluted EPS is $2,200,000 / (110,000 + 40,000) = $14.67.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

71. (C) 20,266,667.

Explanation

Outstanding all year	8,000,000 × 1.2 × 2 × 1.0	19,200,000
Outstanding for 0.75 years	750,000 × 1.2 × 2 × 0.75	1,350,000
Outstanding for 0.25 years	100,000 × 2 × 0.25	50,000
Retired for 2 months	-1,000,000 × 2 × (2/12)	
	Weighted average number of shares for year:	**20,266,667**

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

72. (C) Changes in accounting estimates are now treated the same as changes in accounting principles.

Explanation

Changes in accounting estimates are not treated the same as changes in principles. Changes in principles are treated retrospectively, whereas changes in accounting estimates are accounted for in the current and future periods. Both remaining statements are accurate.

(Study Session 6, Module 17.3, LOS 17.e)

Related Material

SchweserNotes - Book 2

73. (B) average market price of Young common stock increased in 20X5.

Explanation

Average stock price is not a factor in determining whether convertible bonds are dilutive or antidilutive.

If Young redeemed the bonds, they would have no potentially dilutive securities outstanding in 20X5 and diluted EPS, if the company reported it, would equal basic EPS. Basic and diluted EPS would also be equal in 20X5 if the bonds were antidilutive in that year.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

74. (C) 1,016,667.

Explanation

Use the Treasury stock method:

Step 1 : Determine the number of common shares created if the warrants are exercised = 100,000.

Step 2 : Calculate the cash inflow if the warrants are exercised:
(100,000) ($50 per share) = $5,000,000.

Step 3 : Calculate the number of shares that can be purchased with these funds using the average market price ($60 per share):
5,000,000 / 60 = 83,333 shares.

Step 4 : Calculate the net increase in common shares outstanding from the exercise of the warrants:
100,000 – 83,333 = 16,667.

Step 5 : Add the net increase in common shares from the exercise of the warrants to the number of common shares outstanding for the entire year:
1,000,000 + 16,667 = 1,016,667.

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.g)

CFA® Program Curriculum, Volume 3, page 34

Related Material

SchweserNotes - Book 2

75. (B) an operating cash flow but as non-operating income.

Explanation

Under U.S. GAAP, interest received is reported as an operating cash flow. For a non-financial services company, interest received is typically reported as non-operating income.

For Further Reference:

(Study Session 6, Module 17.3, LOS 17.f)

CFA® Program Curriculum, Volume 3, page 33

Related Material

SchweserNotes - Book 2

76. (C) 70,000.

Explanation

The stock split is applied from the beginning of the year. Because the preferred stock is not convertible, it has no impact on the number of common shares for calculating diluted EPS. Beginning shares (40,000 shares × 12 months) + split shares (40,000 shares × 12 months) - reacquired shares (20,000 shares × 6 months) = 840,000, and 840,000 / 12 months = 70,000 shares.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

77. (C) estimates and are applied prospectively.

Explanation

Changes in asset lives and salvage value are changes in accounting estimates and are not considered changes in accounting principle. Changes in accounting estimates are applied prospectively.

(Study Session 6, Module 17.3, LOS 17.e)

Related Material

SchweserNotes - Book 2

78. (C) $4.12 $3.06

Explanation

Basic EPS = Net income - preferred dividends / Weighted average shares of common Preferred dividends:

- 6.25% convertible preferred stock:
  (0.0625)($100)(2,315) = $14,469
- 8% convertible preferred stock:
  (0.08)($100)(2,572) = $20,576
- Preferred dividends = $14,469 + $20,576 = $35,045.

Basic EPS = ($200,000 - $35,045) / 40,045 = 164,955/40,045 = $4.12

Diluted EPS:

First, check each of the potentially dilutive securities for dilution.

- 6.125% convertible bonds:
  (Convertible debt interest) (1 - tax rate) / Common shares if converted
  = (0.06125)($1,000)(100)(1 - 0.4) / (33)(100)
  = $1.1136
  Because this is less than basic EPS, these convertible bonds are dilutive.
- 6.25% convertible preferred stock:
  Preferred dividend / Common shares if converted
  = (0.0625)($100) / 3.3 = $1.8939
  Because this is less than basic EPS, this convertible preferred stock is dilutive.
- 8% convertible preferred stock:
  Preferred dividend / Common shares if converted
  = (0.08)($100) / 5 = $1.60
  Because this is less than basic EPS, this convertible preferred stock is dilutive.
- Warrants:
  Because the exercise price $38 is less than average share price $52, the warrants are dilutive.

Next, determine the number of common shares that would be created by exercise of each dilutive security:

- 6.125% convertible bonds:
  (100 bonds)(33) = 3,300 common shares
- 6.25% convertible preferred stock:
  (2,315 preferred shares)(3.3) = 7,640 common shares
- 8% convertible preferred stock:
  (2,572 preferred shares)(5) = 12,860 common shares
- Warrants:
  [($52 - $38) / $52] x 9,986 = 2,689 common shares

Diluted EPS = (Net income - preferred dividends + convertible preferred dividends + after-tax convertible debt interest) / Weighted average shares of common adjusted for exercise

[($200,000 - $35,045) + $35,045 + (0.06125)($1,000)(100)(1 - 0.4)] / (40,045 + 3,300 + 7,640 + 12,860 + 2,689) = $203,675 / 66,534 shares = $3.06

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

79. (C) **$4.00.**

Explanation

EPS = earnings available to common shareholders divided by the weighted average number of common shares outstanding. With no preferred shareholders, all of net income is available to the common shareholders. The weighted average number of shares outstanding equals the original 2 million shares plus 4/12 of the additional 600,000 shares. The 4/12 weight is used because the new shares were only outstanding 4 months of the year. Thus, EPS = $8.8 million / [2 million + (4/12)(600,000)] = 8.8/2.2 = $4.00.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

80. (A) **antidilutive securities.**

Explanation

Antidilutive securities, upon exercise, increase basic EPS or decrease per share losses. Shares from conversion are not included in the calculation of basic or diluted EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

81. (B) $1.50.

Explanation

Basic EPS = ($120,000 - $40,000 - $5,000) / 20,000 = $3.75.

Convertible preferred stock A: $40,000 / 2(10,000) = $2.00, which is less than basic EPS so the convertible preferred stock is dilutive.

Convertible preferred stock B: $5,000 / 4($10,000) = $0.125, which is less than basic EPS so the convertible preferred stock is dilutive.

Diluted EPS = $120,000 / [20,000 + 2(10,000) + 4(10,000)] = $1.50.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

82. (B) The numerator and denominator.

Explanation

The numerator will increase because earnings available to the common shareholder are increased by the reduction in preferred dividends. The denominator increases because the weighted average number of shares increases upon conversion of the preferred stock.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

83. (B) Convertible bonds.

Explanation

A complex capital structure means a firm has securities outstanding that can be converted to common shares, and therefore have the potential to dilute a firm's earnings per share. For example, convertible bonds, convertible preferred stock, options, and warrants have the potential to dilute earnings per share upon conversion or exercise.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

84. (C) Treasury Stock method.

Explanation

The treasury stock method assumes the hypothetical funds received by the company from the exercise of the options are used to purchase shares of the company's common stock in the market at the average market price.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

85. (B) $55.00 $48.00

Explanation

Rushford's basic EPS (net income / weighted average common shares outstanding) is $16,500,000 / 300,000 = $55.00. Diluted EPS is calculated under the assumption that the convertible bonds were converted into common stock, the bond interest net of tax is restored to net income, and the additional common shares are added to the denominator of the equation. Rushford's diluted EPS is [$16,500,000 + (50,000 × $1,000 × 0.09)(1 - .40)] / (300,000 + (50,000 × 2) = $48.00.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

86. (A) converting them to common shares would actually reduce earnings per share, compared to basic earnings per share.

Explanation

Securities are dilutive if they would decrease EPS (compared to basic EPS) if they are exercised or converted to common stock. Potentially dilutive securities include any that can be converted to common shares now or at any time in the future. Assuming conversion of securities such as convertible bonds or convertible preferred stock typically increases earnings available to common shareholders; these securities are dilutive to EPS if they increase common shares relatively more than they increase earnings available to common.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

87. (B) 25,000,000.

Explanation

The weighted average number of common shares outstanding is the number of shares outstanding during the year weighted by the portion of the year they were outstanding. Since no new common shares were issued in 2005, and there were 25 million shares at the end of 2004, there are 25 million shares at the end of 2005. Note that the preferred stock shares do not affect the common shares outstanding.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

88. (C) 57,750.

Explanation

The weighted average number of common shares outstanding is the number of shares outstanding during the year weighted by the portion of the year they were outstanding. Dividends and splits are applied to all shares issued or repurchased and all original or adjusted shares outstanding prior to the split or dividend.

Step 1: Apply the 04/01/04 dividend to the beginning-of-year shares: Adjusted shares = 1.05 x 50,000 = 52,500

Step 2: Apply the 10/01/04 dividend the adjusted beginning-of-year shares. Adjusted beginning of year shares = 57,750 (= 1.1 x 52,500).

Step 3: Compute the weighted average number of shares. 57,750 x (12/12) = 57,750 shares.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

89. (C) $1.00.

Explanation

Number of average common shares:

1/1 5,500 shares issued (includes 10% stock dividend on 6/1) x 12 = 66,000

7/1 1,000 shares repurchased x 6 months = -6,000 = 60,000

60,000 shares / 12 months = 5,000 average shares

Preferred dividends = ($10)(1,000) = $10,000

Number of shares from the conversion of the preferred shares

= (1,000 preferred shares)(8 x 1.1 shares of common/share of preferred)

= 8,800 common

Diluted EPS = [$15,000(NI) - $10,000(pfd) + $10,000(pfd)] / (5,000 common shares + 8,800 shares from the cony. pfd.) = $15,000 / 13,800 shares

= $1.09/share

This number needs to be compared to basic EPS to see if the preferred shares are antidilutive.

Basic EPS = [$15,000(N1) - $10,000(preferred dividends)] / 5,000 shares

= $5,000 / 5,000 shares = $1/share

Since the EPS after the conversion of the preferred shares is greater than before the conversion the preferred shares are antidilutive and they should not be treated as common in computing diluted EPS. Therefore diluted EPS is the same as basic EPS or $1/share.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

90. (C) Fair value Other comprehensive income

Explanation

Available-for-sale securities are reported on the balance sheet at fair value. The unrealized gains and losses bypass the income statement and are reported as a component of stockholders' equity as a part of other comprehensive income.

(Study Session 6, Module 17.5, LOS 17.l)

Related Material

SchweserNotes - Book 2

91. (B) Yes No

Explanation

Since Red Oak is a nonfinancial firm, the accrued interest is considered a nonoperating activity, related to how the firm is financed. Dividends paid to preferred shareholders do not affect net income.

(Study Session 6, Module 17.3, LOS 17.f)

Related Material

SchweserNotes - Book 2

92. (B) $5.80.

Explanation

If bonds are converted, then net income will increase by 480,000 [10 million × 0.08 x (1 — 0.4)] and shares outstanding will increase by 200,000.

numerator = 3,000,000 + 480,000 = 3,480,000

denominator = 350,000 + (150,000 × 4/12) + 200,000 = 600,000

diluted EPS = 3,480,000 / 600,000 = 5.80

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

93. (C) $1.77.

Explanation

The question is asking for basic EPS. Thus we can ignore the dilutive options and warrants.

Basic EPS = (net income – preferred dividends) / weighted average common shares outstanding

- The numerator = $7.5 million - $1.3 million = $6.2 million
- Calculating the denominator is a bit more work (calculation detailed in table below):

Event	Notes	Million Shares	# Months Outstanding	Total
Beginning Bal (BB)		3.000	12	36.000
New issue (March 01)		0.100	10	1.00

Stock divided	15% on BB	0.450	12	5.400
Stock divided	15% on new issue	0.015	10	0.150
Repurchase (Sept.1)		-0.125	4	-0.500
			Total	**42.050**

Average shares = 42,050,000 / 12 = 3,504,167

Basic EPS = $6.2 million / 3.504 million = $1.77

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

94. (C) $0.55 $0.52

Explanation

Able's basic earnings per share ((Net Income - Preferred Stock Dividends) / weighted average shares outstanding) for 2004 was [($720,000 - ($500 × 6,000 × 0.03) - ($1,000 × 1,000 × 0.08)] / 1,000,000 = $0.55. If the convertible preferred were converted to common stock on January 1,6,000 × 40 = 240,000 additional shares would have been issued. Also, dividends on the convertible preferred would not have been paid.

So diluted EPS was ($720,000 – 80,000) / (1,000,000 + 240,000) = $0.52.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

95. (C) 1,100,000.

Explanation

First, Check for dilution: Basic EPS = 1,500,000 / 1,000,000 = 1.50

Warrants: anti-dilutive since the average stock price is less than the exercise price

Convertible bonds:

Numerator impact = (# bonds) × (par value) × (interest rate) × (tax retention rate) × (0.5 for 1/2 year outstanding) = (10,000) × (100) × (0.06) × (0.6) × (0.5) = 18,000, so the numerator = 1,518,000

Denominator impact: increase in average shares = [(# bonds) × (conversion factor) × (# months outstanding)] / 12 = (1,200,000 / 12 = 100,000) so, the denominator = 1,100,000 and EPS with conversion = 1,518,000 / 1,100,000 = 1.38, which is less than 1.50. The bonds are dilutive and the diluted EPS calculation should use 1,100,000 shares of common stock in the denominator. The warrants are out of the money based on the average price of $20.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

96. (C) 41,550,000.

Explanation

Outstanding all year	10,000,000 × 2 × 2 × 1	40,000,000
Outstanding for 0.75 years	500,000 × 2 × 2 × 0.75	1,500,000
Outstanding For 0.25 years	100,000 × 2 × 0.25	50,000
Weighted average	Number of shares for year	**41,550,000**

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

97. (B) $0.15.

Explanation

Caledonia's basic EPS = (net income - preferred stock dividends) / (weighted average common shares outstanding)

= [$460,000 - ($1,000 x 1,000 x 0.08)] / 2,300,000 = $0.17.

Using the treasury stock method, if the warrants were exercised, cash inflow would be 10,000 x 100 x $1.50 = $1,500,000. The number of Caledonia shares that could be purchased with the inflow, using the average share price, is $1,500,000 / $2 = 750,000. The net increase in common shares outstanding would have been 1,000,000 - 750,000 = 250,000.

Diluted EPS = $380,000 / (2,300,000 + 250,000) = $0.15.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

98. (B) Supple Moves and Perfect Collection.

Explanation

A complex capital structure is one that has potentially dilutive elements. Here, Supple Moves and Perfect Collection both meet this criteria. (The warrants for Supple Moves will be dilutive if the average stock prices were over $50.00.)

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

99. (A) $2.64.

Explanation

1/1/00 22,000 shares (adjusted for 10% stock dividend) × 12 months

= 264,000

6/1/00 7,700 shares (adjusted for 10% stock dividend) × 7 months = 53,900

Total share month = 317,900

Average shares = 317,900 / 12 = 26,492

Basic EPS = ($150,000 - $80,000) / 26,492 = 2.64

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

100. (B) average market price of Zachary increased.

Explanation

An increase in average market price could cause Zachary's warrants to go from antidilutive to dilutive. If the average price of the stock increases during the year, the warrants are likely to be exercised at some point during the year. Neither of the other choices would do this.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

101. (B) 105,500.

Explanation

Initial shares:	90,000 × 1.20	=	108,000
- Reacquired treasury shares:	10,000 × 3/12	=	-2,500
			105,500

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

102. (C) $490,000 $435,000

Explanation

Net income is equal to $490,000 ($600,000 gross profit - $100,000 operating expenses + $15,000 dividends received - $25,000 interest expense). Comprehensive income includes all transactions that affect stockholders' equity except transactions with shareholders. Thus, comprehensive income is equal to $435,000 ($490,000 net income - $30,000 unrealized loss from foreign currency translation - $45,000 increase in minimum pension liability + $20,000 unrealized gain on available-for-sale securities). The treasury stock purchase is a transaction with shareholders and is not included in either comprehensive income or net income.

(Study Session 6, Module 17.5, LOS 17.k)

Related Material

SchweserNotes - Book 2

103. (A) $1,800 4,500

Explanation

The interest expense for three months net of tax is added to the numerator (12% × $100,000 × 3/12 x 60 %) = $1,800. The number of shares added to the denominator are 4,500. (18,000 × 3 / 12).

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

104. (A) 2,225,000 shares.

Explanation

Basic EPS does not consider potential dilution from convertible bonds.

Original shares	=	2,000,000(12)	=	24,000,000
+ Stock dividend	=	200,000(12)	=	2,400,000
+ New shares	=	100,000(3)	=	300,000
				26,700,000

$$\frac{26,700,000}{12} = 2,225,000$$

Alternatively, 2 million (1.1) + (1/4) (100,000) = 2.225 million.

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.g)

CFA® Program Curriculum, Volume 3, page 34

Related Material

SchweserNotes - Book 2

105.(A) Both appear on the income statement.

Explanation

Gains and losses result from, transactions that are not a part of the firm's normal business operations. Expenses are amounts that are incurred to generate revenue; thus, expenses result from the firm's ongoing operations. Both are included on the income statement.

(Study Session 6, Module 17.1, LOS 17.a)

Related Material

SchweserNotes - Book 2

106. (A) 1,200,000.

Explanation

original shares of common stock	=	1,000,000(12)	=	12,000,000
stock dividend	=	100,000(12)	=	1,200,000
new shares of common stock	=	400,000(3)	=	1,200,000

$$\text{total shares of common stock} = \frac{14,400,000}{12} = 1,200,000$$

Stock dividends are assumed to have been outstanding since the beginning of the year.

For Further Reference:

(Study Session 6, Module 17.4, LOS 17.g)

CFA® Program Curriculum, Volume 3, page 34

Related Material

SchweserNotes - Book 2

107. (C) 5,250,000 shares.

Explanation

Applying the treasury stock method to the warrants, 5,000,000 + [500,000 - (500,000 x $20) / $40] = 5,250,000 shares. The options are antidilutive because their exercise price is higher than the average stock price for the year.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

108. (B) It requires restatement of any prior period results that are presented in the current financial statements.

Explanation

If a company changes from an incorrect method of accounting to an acceptable one, the company must disclose the nature of the error and its effect on net income, and restate any prior period results that are presented in the current financial statements.

(Study Session 6, Module 17.3, LOS 17.e)

Related Material

SchweserNotes - Book 2

109. (A) 37,000.

Explanation

The end-of-period weighted average number of common shares outstanding is the number of shares outstanding during the year weighted by the portion of the year they were outstanding. Dividends and splits are applied to all shares issued or repurchased and all original or adjusted shares outstanding prior to the split or dividend.

Step 1: Apply the 04/01/06 dividend to the beginning of year shares:

Adjusted shares = 1.05 × 20,000 = 21,000

Step 2: Apply the 10/01/06 split to the adjusted beginning-of-year shares and the repurchase. Adjusted beginning-of-year shares

= 42,000 (= 2× 21,000)

Adjusted repurchase = 10,000 (= 2 × 5,000)

Step 3: Compute the weighted average number of shares.
42,000(12/12) - 10,000(6/12) = 37,000 shares
(Study Session 6, Module 17.4, LOS 17.g)
Related Material
SchweserNotes - Book 2

110. (B) $3.38.

Explanation
Jersey, Inc.'s basic EPS = (net income - preferred dividends) / (weighted average number of common shares outstanding) was ($720,000 - $180,000)/160,000 = $3.38.
(Study Session 6, Module 17.4, LOS 17.g)
Related Material
SchweserNotes - Book 2

111. (C) 512,000.

Explanation
Dilution occurs since the exercise price for the warrants ($45) is less than the average market price for the shares ($50). The incremental number of shares outstanding is found from:

$$\left(\frac{\text{market price} - \text{exercise price}}{\text{market price}}\right) \times \#\text{warrants}$$

$$= \left(\frac{50 - 45}{50}\right) \times 120{,}000 = 12{,}000$$

Number of shares to use in diluted EPS calculation = 500,000 + 12,000 = 512,000.
For Further Reference:
(Study Session 6, Module 17.4, LOS 17.h)
CFA® Program Curriculum, Volume 3, page 34
CFA® Program Curriculum, Volume 3, page 43
Related Material
SchweserNotes - Book 2

112. (B) revenue.

Explanation
A vertical common-size income statement states each item as a percentage of revenue.
(Study Session 6, Module 17.5, LOS 17.i)
Related Material
SchweserNotes - Book 2

113. (A) 735,000.

Explanation

The January 1 balance is adjusted retroactively for the stock dividend and (540,000 x 1.5) = 810,000 shares are treated as outstanding from January 1. The weighted average number of shares is computed by multiplying the shares by the number of months held, as follows:

January 1	Initial shares	(810,000 × 12) =	9,720,000
July 1	Reacquired shares	(-180,000 × 6) =	1,080,000
October 1	Reissued shares	(60,000 × 3) =	180,000
			8,820,000

Weighted average shares was (8,820,000 / 12) = 735,000 shares.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

114. (C) $0.98.

Explanation

Use the Treasury stock method

Proceeds = 100,000 ($40) = $4,000,000

Shares assumed purchased with proceeds = $4,000,000/$50 = 80,000 shares

Potential dilution = 100,000 - 80,000 = 20,000 shares

Basic EPS = $1/share

Diluted EPS = $1,000,000 / 1,020,000 = $0.98/share

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

115. (C) $6.00 $5.45

Explanation

Protocol's basic EPS (net income / weighted average common shares outstanding) was $4,800,000 / 800,000 = $6.00. Diluted EPS is calculated under the assumption that the convertible bonds were converted into common stock, and the bond interest net of tax was restored to net income. The common shares from the conversion of the bonds are added to the denominator of the equation. Protocol's Diluted EPS was [$4,800,000 + (5,000 x $1,000 x 0.08)(1 - 0.40)] / [800,000 + (5,000 x 25)] = $5.45.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

116. (B) $0.457.

Explanation

50,000,000 common shares × 12 months = 600,000,000
5,000,000 common shares × 6 months = 30,000,000 = 630,000,000
630,000,000 / 12 = 52,500,000 average shares
[$25,000,000(N1) - $1,000,000(preferred dividends)] / 52,500,000 shares
= $24,000,000 / 52,5000,000 = $0.457
(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

117. (A) 0

Explanation

The calculation for basic EPS is not adjusted for the impact of potentially dilutive securities.
(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

118. (A) Straight Line.

Explanation

Using straight-line depreciation, the amount to be depreciated over the asset's life is $90 – $10 million = $80 million, and depreciation expense in each year is $80 million / 8 = $10 million.
If the firm had used double-declining balance, depreciation expense in the first year would have been 2/8 × $90 million = $22.5 million. Based on units of production, depreciation expense in the first year would have been (30 million / 150 million) × $80 million = $16 million.
(Study Session 6, Module 17.3, LOS 17.d)

Related Material

SchweserNotes - Book 2

119. (B) None of these choices are correct.

Explanation

Anti-dilutive is when dilutive EPS > basic EPS. When calculating diluted EPS, you must add the shares created from the conversion of the bonds to the denominator and the interest (1 - tax rate) to the numerator.
(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

120. (C) added to earnings available to common shareholders without an adjustment for taxes.

Explanation

Diluted EPS = [(Net income - Preferred dividends) + Convertible preferred dividends + (Convertible debt interest)(1 - t)] / [(Weighted average shares) + (Shares from conversion of cony. pfd shares) + (Shares from conversion of cony. debt) + (Shares issuable from stock options)]

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

121. (A) 150,000.

Explanation

Connecticut's January 1 balance of common shares outstanding is adjusted retroactively for the 1 for 3 reverse stock split, meaning there are (360,000 / 3) = 120,000 "new" shares treated as if they had been outstanding since January 1. The weighted average of the shares issued in July, (60,000 x 6 / 12) = 30,000 is added to that figure, for a total of 150,000.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

122. (B) $5.45.

Explanation

Baltimore's basic earnings per share (EPS) (net income / weighted average shares outstanding) for 2004 was $4,200,000 / 750,000 = $5.60.

To calculate diluted EPS, we use the treasury stock method to account for the warrants:

- Number of common shares created if options are exercised = 10,000 × 10 = 100,000
- Cash inflow if warrants are exercised = $40 × 100,000 = $4,000,000
- Shares purchased with these funds = $4,000,000 / 50 = 80,000
- Net increase in shares outstanding = 100,000 – 80,000 = 20,000

Diluted EPS = $4,200,000 / (750,000 + 20,000) = $5.45.

Related Material

SchweserNotes - Book 2

123. (C) non operating expenses are increasing.

Explanation

Nonoperating expenses are equal to the difference between operating profit and pretax profit. Based on the given profit margins, Mulroy's nonoperating expenses increased from 3% of sales in 20X1 to 9% of sales in 20X3. Because gross profit margin is increasing, cost of goods sold is decreasing as a percentage of sales. Other operating expenses and income tax expense, as a percentage of sales, were stable over the period shown.

(Study Session 6, Module 17.5, LOS 17.j)

Related Material

SchweserNotes - Book 2

124. (B) assumes that the hypothetical funds received by the company from the exercise of the options are used to sell shares of the company's common stock in the market at the average market price.

Explanation

The treasury stock method assumes any funds received by the company from the exercise of the options are used to purchase shares (not sell shares) of the company's common stock in the market at the average market price.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

125. (B) $1.19.

Explanation

Only the options and convertible preferred stock are dilutive. First, calculate basic EPS to use as a benchmark to determine dilutive capital components.

Basic EPS = (net income - preferred dividends) / weighted average common shares outstanding = (9.0 - 1.5) / 5.0 = $1.50.

Next, check for dilution.

- The stock options are dilutive because the exercise price is less than the average stock price. There is no numerator impact from the options. The denominator impact = # options - [(# options x exercise price) / average stock price)] = 400,000 - [(400,000 × 32) / 35] = 34,286 or 0.034 million.
- To check whether the convertible preferred stock is dilutive we need to determine whether it decreases EPS. To the numerator, we add back the preferred dividend. The denominator impact = (# preferred shares × conversion rate) = 500,000 × 5 = 2,500,000, or 2.5 million. Then, EPS = (9.0 - 1.5 + 1.5) / (5.0 + 2.5) = $1.20. Thus the convertible preferred stock is dilutive.
- To check whether the convertible bonds are dilutive we need to determine whether they decrease EPS. To the numerator, we add back the after-tax

impact of the coupon, or (face value x coupon x (1 - t)), or (10,000 bonds × 1,000 par × 0.06 coupon × 0.6) = 360,000, or $0.360 million. The denominator impact = (# convertible bonds × conversion rate) = 10,000 × 8 = 80,000, or 0.080 million. Then, EPS = (9.0 - 1.5 + 0.360) / (5.0 + 0.080) = $1.55. Thus the bonds are antidilutive.

Finally, calculate diluted EPS:

Diluted EPS = (9.0 - 1.5 + 1.5) / (5.0 + 2.5 + 0.034) = $1.1946.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

126. (B) 1,325,000 shares.

Explanation

The 300,000 shares issued on April 1 were outstanding for 8 months, or 8 / 12 = 75% of the year. The 200,000 shares issued on July 1 were outstanding for 6 months, or 6 / 12 = 50% of the year. Weighted average shares = 1,000,000 + (0.75) 300,000 + (0.5) 200,000 = 1,325,000 shares

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

127. (A) $5.32.

Explanation

Feder's basic earnings per share ((net income - preferred dividends) / weighted average shares outstanding) was (($7,650,000 - ($1,000 × 10,000 × 0.06)) / 1,100,000 =) $6.41.

If the convertible preferred stock was converted to common stock at January 1, (10,000 × 20 =) 200,000 additional common shares would have been issued, dividends on the preferred stock would not have been paid, and Diluted EPS would have been ($7,650,000 / (1,100,000 + 200,000) = $5.88. Because $5.88 is less than basic EPS of $6.41, the preferred shares are dilutive.

Using the treasury stock method, if the options were exercised cash inflow would be (70,000 × 10 × $50 =) $35,000,000. The number of Feder shares that can be purchased with the inflow (cash inflow divided by the average share price) is ($35,000,000 / $62 =) 564,516.

The number of shares that would have been created is (700,000 - 564,516 =) 135,484. Diluted EPS was [($7,650,000 - ($1,000 × 10,000 × 0.06)] / (1,100,000 + 135,484) =) $5.71. Because this is less than the EPS of $6.41, the options are dilutive.

Combining the calculations, Diluted EPS was (($7,650,000) / (1,100,000 + 200,000 + 135,484) = $5.32

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

128. (A) 1,200,000.

Explanation

	1,000,000(12)	=	12,000,000
	100,000(12)	=	1,200,000
	400,000(3)	=	1,200,000
Total	$\frac{14,400,000}{12}$	=	**1,200,000**

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

129. (C) $1.74.

Explanation

Savannah Corp.'s basic EPS ((net income - preferred dividends) / weighted average number of common shares outstanding) was (($122,000 - $35,000) / $50,000 =) $1.74.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

130. (C) preferred stock.

Explanation

Not all preferred stock is dilutive. Only convertible preferred stock is potentially dilutive.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

131. (C) 104,000.

Explanation

Only the stock options with an exercise price of $20 are dilutive. The additional shares of 4,000 (20,000 - [(20,000 x 20) / 25]) are added to the 100,000 common shares outstanding. (Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

132. (C) $41,000 $43,000

Explanation

Net income is equal to $41,000 ($100,000 revenue - $40,000 COGS - $20,000 operating expenses + $1,000 realized gain on sale of equipment). Comprehensive income includes all transactions that affect stockholders' equity except transactions with shareholders. Comprehensive income includes net income, unrealized gains and losses from available-for-sales securities, unrealized gains and losses from cash flow hedging derivatives, and gains and losses from foreign currency translation. Thus, comprehensive income is equal to $43,000 ($41,000 net income + $5,000 unrealized gain from foreign currency translation – $3,000 unrealized loss from cash flow hedging derivatives). Dividends paid is a transaction with shareholders and is not included in comprehensive income.

(Study Session 6, Module 17.5, LOS 17.k)

Related Material

SchweserNotes - Book 2

133. (B) Antidilutive securities decrease EPS if they are exercised or converted.

Explanation

Antidilutive securities increase EPS if exercised or converted to common stock.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

134. (A) $8.32.

Explanation

Indigo's weighted average common shares = [(500,000 × 12) + (200,000 × 6) - (100,000 × 3)] / 12 = 575,000. Basic EPS = $5,600,000 / 575,000 = $9.74.

For diluted EPS, assume the bonds were converted on January 1, and that interest payments were not made on the bonds. Increasing net income by the amount of bond interest net of tax = $5,600,000 + [6,000 × $1,000× × 0.05 × (1 - 0.40)] = $5,780,000. Diluted EPS = $5,780,000 / (575,000 + 120,000) = $8.32.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

135. (C) neither basic nor diluted EPS.

Explanation

Antidilutive securities would increase EPS if exercised or converted to common stock. Therefore we do not assume they are converted when we calculate diluted EPS. Basic EPS is calculated before assuming any potentially dilutive securities are converted.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

136. (C) Increase No effect

Explanation

When a firm recognizes revenue before cash is collected, equity increases (retained earnings) and assets increase (accounts receivable). Liabilities would not be affected.

(Study Session 6, Module 17.3, LOS 17.d)

Related Material

SchweserNotes - Book 2

137. (C) $4.00.

Explanation

The new shares were only outstanding 4 months of the year. Thus, the weighted average number of shares outstanding is [1.4 + (4/12)(1.2)] million = 1.8 million shares. So basic EPS = $7.2 million / 1.8 million = $4.00.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

138. (C) $5.00 / share.

Explanation

(210,000 – 110,000) / 20,000 = $5 share

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

139. (C) added to earnings available to common shareholders after an adjustment for taxes.

Explanation

Formula = Diluted EPS = [(Net income - Preferred dividends) + Convertible preferred dividends + (Convertible debt interest)(1 - t)] / [(Weighted average shares) + (Shares from conversion of cony. pfd shares) + (Shares from conversion of cony. debt) + (Shares issuable from stock options)]

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

140. (C) $3.40.

Explanation

Orange's basic EPS ((net income - preferred dividends) / weighted average common shares outstanding) is [($7,600,000 - (10,000 x $1,000 x 0.08)] / 2,000,000 = $3.40. To check for dilution, EPS is calculated under the assumption that the convertible preferred shares are converted into common shares at the beginning of the year. The preferred dividends paid are added back to the numerator of the Diluted EPS equation, and the additional common shares are added to the denominator of the equation. Orange's if-converted EPS is

$7,600,000 / (2,000,000 + 200,000) = $3.45. Because if-converted EPS is higher than basic EPS, the preferred stock is antidilutive and no adjustment is made to basic EPS.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

141. (C) FIFO.

Explanation

The FIFO method recognizes the oldest costs in the cost of goods sold. With rising prices, COGS will be lower and net income will be higher using FIFO as compared to the LIFO or average cost methods. Higher net income relative to sales (which are not affected by the inventory cost method) means higher profit margins.

For Further Reference:

(Study Session 6, Module 17.3, LOS 17.d)

CFA® Program Curriculum, Volume 3, page 18

Related Material

SchweserNotes - Book 2

142. (A) Restructuring and severance costs applicable to asset sales and plant shutdown costs.

Explanation

Restructuring and plant shutdown costs are considered part of a company's normal operations. Gains and losses related to discontinued operations are reported separately in the income statement because these activities are no longer included as part of the company's continuing operations.

(Study Session 6, Module 17.3, LOS 17.f)

Related Material

SchweserNotes - Book 2

143. (A) 2,689.

Explanation

If the warrants were exercised, the firm would receive the exercise price for each warrant: 9,986 x $38 = $379,468

Using the treasury stock method, we assume the firm uses this cash to repurchase shares at the average price for the year:

$379,468 / $52 = 7,297 common shares

If these repurchased shares were used toward fulfilling the warrants, the firm would need to issue 9,986 - 7,297 = 2,689 new common shares to fulfill the rest of the warrants.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

144. (C) $10,000.00

Explanation

Under the percentage-of-completion method, one-half of the total revenue is recognized because one-half of the costs have been incurred ($40,000 / $80,000). Therefore, revenue will be equal to $50,000, expenses are $40,000, and net income will be $10,000.

(Study Session 6, Module 17.2, LOS 17.c)

Related Material

SchweserNotes - Book 2

145. (B) Other comprehensive income Net income

Explanation

Unrealized gains and losses from cash flow hedging derivatives and unrealized gains and losses from available-for-sale securities are not recognized in the income statement; rather, they are both recognized as a component of stockholders' equity as a part of other comprehensive income.

(Study Session 6, Module 17.5, LOS 17.l)

Related Material

SchweserNotes - Book 2

146. (B) Pretax income 35%

Explanation

Common-size income statements express each line item as a percentage of sales.

Sales	100%
Cost of goods sold	50%
Selling and administrative expense	10%
Interest expense	5%
Pretax income	35%
Income tax expense	12.25%
Net Income	22.75%

(Study Session 6, Module 17.5, LOS 17.i)

Related Material

SchweserNotes - Book 2

147. (A) warrants, convertible securities, or options.

Explanation

A complex structure contains potentially dilutive securities. These include any securities that can potentially be converted into common shares, such as options, warrants, convertible preferred stock, or convertible bonds. Simple capital structures contain no potentially dilutive securities but may include non-convertible debt securities or non-convertible preferred stock.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

148. (C) $1.15.

Explanation

The firm's basic EPS = ($1,700,000 - $1,100,000) / (523,000) = $1.147.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

149. (A) 306.

Explanation

(816)(5) = $4,080. $4,080 / $8 = 510 shares. 816 - 510 = 306 new shares or [(8 - 5) / 8]816 = 306.

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

150. (B) Yes No

Explanation

Gross profit is equal to sales minus cost of goods sold. Cost of goods sold includes the direct costs of producing a product or service such as raw materials, direct labor, and overhead (fixed costs). Thus, an increase in raw materials costs will result in higher cost of goods sold and lower gross profit. Marketing expenses are considered operating expenses (SG&A), not in cost of goods sold.

(Study Session 6, Module 17.1, LOS 17.a)

Related Material

SchweserNotes - Book 2

151.(A) $1.53.

Explanation

Diluted EPS = adjusted earnings after conversion (EAC) / weighted average plus potential common shares outstanding.

Step 1: Calculate Adjusted EAC

adjusted EAC:		net income- preferred dividends
	+	after-tax interest on convertible debt
	=	adjusted earnings available for common shares

preferred dividends = (0.08)(90)(2,000) = 14,400

convertible debt interest = (60,000)(0.06)(1 - 0.40) = 2,160

adjusted EAC = (30,000 - 14,400 + 2,160) = $17,760

Step 2: Calculate Weighted average plus potential common shares outstanding.

weighted average common shares	=	5,000
shares from conversion of convertible bonds = (60 × 110)	=	6,600
weighted ave. plus potential common shares outst.	=	**11,600**

Step 3: Calculate Diluted EPS

Diluted EPS = 17,760 / 11,600 **= $1.53.**

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2

152. (A) **3%, $100 par value convertible bond.**

Explanation

If convertible bonds exist, the firm has a complex capital structure.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

153. (A) **$10 million.**

Explanation

Reported profit (in millions) = ($30 / $75)($100 - 75) = $10.

(Study Session 6, Module 17.2, LOS 17.c)

Related Material

SchweserNotes - Book 2

154. (C) **Simple.**

Explanation

A complex capital structure contains potentially dilutive securities such as options, warrants, or convertible securities. There is no basic capital structure but there are basic earnings per share which does NOT consider the effects of any dilutive securities in the computation of EPS.

(Study Session 6, Module 17.4, LOS 17.g)

Related Material

SchweserNotes - Book 2

155. (B) **$1.95 $1.86**

Explanation

Basic EPS: [400,000 - 10,000] / 200,000 shares = $1.95 per share

Diluted EPS: [400,000 + (30,000 x 0.6)] / [200,000 + 10,000 + 15,000]

= $1.86 per share

(Study Session 6, Module 17.4, LOS 17.h)

Related Material

SchweserNotes - Book 2