Q-1. Solution: B.

Preferred stock dividends of \$70,000 (0.07× 1,000,000)

$$\text{BEPS} = \frac{\textbf{\textit{Net income}} - \textbf{\textit{preferred dividends}}}{\textbf{\textit{Weighted average number of common shares outstanding}}}$$

$$= \frac{\mathbf{1,250,000 - 70,000}}{\mathbf{1,000,000}} = \mathbf{1.18}$$

$$\text{DEPS} = \frac{\textbf{\textit{Net income}} - \text{D}_{ps} + \text{converted preferred dividends}}{\text{WACSO} + \text{number of shares converted}}$$

$$= \frac{\mathbf{1,250,000 - 70,000 + 70,000}}{\mathbf{1,000,000 + 1000 \times 25}} = \mathbf{1.21}$$

Because DEPS for the company is 1.21, which is larger than its BEPS, which is 1.18, so the preferred stock is an anti-dilutive stock, DEPS for the company is 1.18

Q-2. Solution: C.

Incremental shares issued from stock option exercise (Treasury Stock Method)		
(Shares issued at exercise price – Shares purchased with cash received at average market price) = 100,000 shares – (100,000×\$5)/\$20=75,000 shares		
Weighted average shares outstanding		
Original shares	2,000,000	2,000,000 sh × 12 months/12 months
Incremental shares issued assuming options were exercised	75,000	75,000 sh × 12 months/12 months
Shares issued, April 1	225,000	300,000 sh × 9 months/12 months
Shares repurchased, July 1	(50,000)	100,000 sh × 6 months/12 months
Weighted average shares o/s	2,250,000	
Diluted EPS		
$\frac{\text{Net income} - \text{preferred dividends}}{\text{Weighted average number of shares}}$	$\frac{\$5{,}000{,}000 - \$0}{2{,}250{,}000} = \$2.22/\text{share}$	

Q-3. Solution: A.

Because both the preferred shares and the bonds are dilutive, they should both be converted to calculate the diluted EPS. Diluted EPS is the lowest possible value.

	Basic EPS	**Diluted EPS: Bond Converted**	**Diluted EPS: Preferred Converted**	**Diluted EPS: Both Converted**
Net income	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Preferred dividends	–\$20,000	–\$20,000	0	0
After-tax cost of		\$3,840		\$3,840

interest 8% × $160,000 × (1 – 30%)				
Numerator	$980,000	$983,840	$1,000,000	$1,003,840
Average common shares outstanding	100,000	100,000	100,000	100,000
Preferred converted			10,000	10,000
Bond converted		20,000		20,000
Denominator	100,000	120,000	110,000	130,000
EPS	$9.80	$8.20	$9.09	$7.72

Q-4. Solution: C.

Metric	(£'000)
Ending retained earnings	821,000
Less: opening retained earnings	(580,000)
Add back: dividends paid	60,000
Net income	301,000
Comprehensive income	246,000
OCI = Comprehensive income – net income	(55,000) LOSS

Q-5. Solution: B.

All categories have realized gains or losses treated in the same way; they are reported on the income statement. It is the unrealized gains and losses that are included in other comprehensive income (in equity) for available-for-sale securities carried at market value.