

Diluted Earnings Per Share:

Reconciling Weighted Shares Outstanding

This article assumes you're familiar with calculating Diluted Earnings Per Share (EPS) using the Treasury Stock Method under FASB ASC 260. If you are not that familiar and this is brand new to you, before reading this article, make sure you've read our previous articles ["Diluted EPS: Treasury Stock Method Overview"](#) and ["Accounting Answers: Diluted EPS FAQs"](#). Many of our clients ask for help in reconciling the dilutive and anti-dilutive shares back to the original weighted shares outstanding.

Total weighted shares outstanding are very unlikely to equal the sum of dilutive and anti-dilutive shares.

We'll now go through a series of four examples to illustrate some of the various reasons that this may be the case, and one way to reconcile the numbers despite this challenge.

Imagine that you have a total of 400 weighted shares outstanding that includes four grants of 100 shares each. The average market value of the stock during the period was \$10.

Grant #	Award Type	Exercise Price	Weighted Shares Outstanding	Buyback Shares	Dilutive?	Dilutive Shares	Anti-dilutive Shares
A	NQ	\$8	100	70	Yes	30	0
B	NQ	\$12	100	30	No	0	100
C	NQ	\$8	100	120	No	0	100
D	RSU	\$0	100	-40	Yes	100	0

Regular Dilutive Grant

Grant A is our simplest example: an in-the-money NQ option, where the Buyback shares are less than the weighted shares outstanding. To determine the dilutive shares, you simply subtract the Buyback shares from the weighted shares outstanding to determine the dilutive shares.

Anti-dilutive: Underwater Option or Out-of-the-money

Grant B has an exercise price of \$12, so it is automatically excluded from the Treasury Stock Method as it is anti-dilutive. The Treasury Stock Method only considers grants that are considered In-the-money, which means the exercise price is less than the average market price during the period. Whether your equity database shows zero Buyback shares for underwater options or it calculates Buyback shares for these underwater grants, the ultimate result is the same: all the Weighted Shares Outstanding in the grant are anti-dilutive.

Anti-dilutive: Buyback Shares Exceed Weighted Shares Outstanding

Grant C is an in-the-money NQ option, where the Buyback shares are greater than the Weighted Shares Outstanding. Thus, Grant C is anti-dilutive and all the Weighted Shares Outstanding are part of the anti-dilutive shares.

Negative Buyback Shares

This is a common situation for RSUs where the market value (stock price) has dropped between the grant date and the reporting period end date.

For Grant D, the grant is an RSU so it's always in-the-money, but when the Buyback shares are calculated, the total buyback shares are a negative number. This can result from situations where the grant date fair value (expense) of the grant exceeds the "in-the-moneyness" of the grant. For Grant B, let's say that the fair value of the grant is \$12 (granted when the stock price was higher than it is today). The Tax Benefit Shares⁽¹⁾ would be calculated as the gain per share of \$10 (\$10 market value less \$0 price) less the \$12 fair value. The result is a negative \$2 per share (before being multiplied by the applicable tax rate). The exercise

proceeds are \$0 because the grant is an RSU, so unless the grant has enough proceeds from the average unamortized expense during the period, the tax benefit shares would be negative. (Total negative Buyback shares may also occur in other, less common scenarios.)

Grant D is dilutive since the Weighted Shares Outstanding are greater than the Buyback shares. However, if you were to *subtract* the Buyback shares from the Weighted Shares Outstanding, as for a “normally” dilutive grant, you’d end up with 140 dilutive shares. But dilutive shares cannot *exceed* weighted shares outstanding, so you would not subtract, and the entire 100 shares would be part of the dilutive shares.

⁽¹⁾- Since this article was originally written, some new accounting guidance has been released from the FASB that impact the Tax Benefit Shares calc. In short, if your company has adopted FASB ASU 2016-09, which was released in March 2016, exclude the Tax Benefit Shares from the Diluted EPS calculations since under that guidance, tax benefits (and deficiencies) are recorded to the income statement and included in the Diluted EPS numerator. See our ["Diluted EPS: Treasury Stock Method Overview"](#) and [FASB ASU 2016-09: Amendments to ASC 718](#) articles for details.

Reconciling

To compute the total dilutive or anti-dilutive shares, first compute the impact that the Buyback shares would have on the dilutive shares grant-by-grant. If the grant is underwater or the Buyback shares are greater than the Weighted Shares Outstanding, the impact is equal to the total Weighted Shares Outstanding (all are anti-dilutive). If the total Buyback shares are negative, the impact is 0. Otherwise the impact to dilutive shares is equal to the Buyback shares. So your formula might look something like this:

Impact of Buyback Shares on Dilutive Shares

IF Exercise Price > Average Market Value, Then Weighted Shares Outstanding

Else

IF Buyback Shares < 0, Then 0

Else

IF Buyback Shares <= Weighted Shares Outstanding, Then Buyback Shares

Else

Weighted Shares Outstanding

In our examples above the results would be as follows:

Grant #	Award Type	Exercise Price	Weighted Shares Outstanding	Buyback Shares	Impact on Dilutive Shares	Dilutive Shares	Anti-dilutive Shares
A	NQ	\$8	100	70	70	30	0
B	NQ	\$12	100	30	100	0	100
C	NQ	\$8	100	120	100	0	100
D	RSU	\$0*	100	-40	0	100	0
			400		270	130	200

* Remember, RSUs generally do not have an exercise price, so go straight to calculating Buyback Shares from the Proceeds from the Average Unrecognized Compensation Expense and Tax Benefit Shares (if your company has not adopted FASB ASU 2016-09 yet).

Now you can sum the Weighted Shares Outstanding (400), sum the Impact of Dilutive shares (270) and subtract the totals of those amounts to reconcile to the total Dilutive Shares (130).

To reconcile the anti-dilutive shares, simply sum the weighted shares column only if the option Exercise Price is greater than the Average Market Value OR if the Buyback shares are greater than the Weighted Shares Outstanding.

Questions or comments? Please email us at xtra@sos-team.com

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