FASB Emerging Issues Task Force

Issue No. 09-E

Title: Accounting for Distributions to Shareholders with Components of Stock and Cash in the Calculations and Presentation of Earnings per Share

Document: Issue Summary No. 1*

Date prepared: August XX, 2009

FASB Staff: Inzano (ext. 364)/Mills (ext. 317)

EITF Liaison: Mark Bielstein

Date previously discussed: None

Previously distributed EITF materials: None

References:

FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections* (Topic 250)

FASB Accounting Standards Codification Topic 260, *Earnings Per Share* (Topic 260)

FASB Accounting Standards Codification Topic 480, *Distinguishing Liabilities from Equity* (Topic 480)

FASB Accounting Standards Codification Topic 505, *Equity* (Topic 505)

FASB Accounting Standards Codification Topic 855, *Subsequent Events* (Topic 855)

FASB Statement No. 128, *Earnings per Share* (currently under Topic 260) (Statement 128)

FASB Statement No. 165, *Subsequent Events* (currently under Topic 855) (Statement 165)

AICPA Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins* (currently under Topic 260 and Topic 505) (ARB 43)

IAS 33, *Earnings Per Share* (IAS 33)

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* **The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

Background

1. Topic 260 establishes guidance for computing and presenting earnings per share (EPS) and applies to entities with publicly held common stock or potential common stock. Paragraph 260-10-55-12 (Earnings Per Share > Overall > Implementation Guidance and Illustrations > Restatement of EPS Data > Stock Dividends or Stock Splits) states that if the number of common shares outstanding increases as a result of a stock dividend, the computations of basic and diluted EPS should be adjusted retroactively for all periods presented to reflect that change in capital structure.

2. Paragraph 505-20-05-3 (Equity > Stock Dividends and Stock Splits > Overview and Background > General) states that a stock dividend "takes nothing from the property of the corporation and adds nothing to the interests of the stockholders; that is, the corporation's property is not diminished and the interests of the stockholders are not increased. The proportional interest of each shareholder remains the same."

3. Real estate investment trusts (REITs) are required to distribute 90 percent of their taxable income in accordance with tax regulations. Historically, some REITs have issued "special dividends," that is, dividends above the REIT's recurring quarterly dividend, in periods of large, non-recurring earnings, for example, in conjunction with the sale of a property. In many cases, REITs issued these special dividends in the form of cash and stock, subject to approval by the Internal Revenue Service (IRS) by means of a private letter ruling.

4. In 2008, the IRS issued Revenue Procedure 2008-68 (the IRS Revenue Procedure) that allows REITs to make distributions in the form of cash and stock to satisfy their annual distribution requirements, which may be in the form of normal recurring dividends or special dividends, without having obtained a private letter ruling in advance. For a REIT to qualify for taxable dividend treatment under the IRS Revenue Procedure, the distribution must meet the following requirements:

- The REIT's stock must be publicly traded on an established securities market in the United States.

- Shareholders must be offered the ability to elect to receive their entire dividend distribution in cash or stock of equivalent value. The REIT may place a limitation on the amount of cash to be distributed in the aggregate to all shareholders, but the total amount of cash available to be distributed must not be less than 10 percent of the total distribution. If too many shareholders elect to receive cash, each shareholder electing to receive cash must receive a pro rata amount of cash corresponding to their proportionate interest in the distribution, but in no event will any shareholder electing to receive cash receive less than 10 percent of their entire distribution in cash.
- The calculation of the number of shares to be received by any shareholder must be determined as close as practicable to the payment date, based on a formula that uses market prices that is designed to equate in value the number of shares to be issued with the amount of cash that could be received instead.
- The distribution must be declared for a taxable year ending on or before December 31, 2009.

5. In January 2009, the IRS extended this guidance to closed-end investment funds, which are also required to distribute 90 percent of their taxable income. Although closed-end investment funds do not present EPS, they do present per share information, such as net asset value per share and changes in net asset value per share.

6. Diversity in practice has developed regarding how entities account for these dividend arrangements. Some entities consider the stock portion of the dividend to be a new stock issuance that is reflected in EPS prospectively (View A of Issue 1). Others consider it to be a stock dividend under paragraph 260-10-55-12 and retrospectively restate shares outstanding and EPS (View B of Issue 1). In addition, paragraph 260-10-55-12 requires that if changes in common stock resulting from stock dividends occur after the close of the period but before issuance of the financial statements, the per-share computation for those and any prior-period financial statements presented must be based on the new number of shares. Currently, there is also diversity in practice as to when a stock dividend is recorded. Some believe a stock dividend should be reflected in earnings per share on the date the dividend is declared. Others believe that a stock dividend should be reflected in earnings per share when the trading price of the shares

has been adjusted to reflect the effects of the stock dividend, which some believe is the record date while others believe it is the day after the distribution date.

7. The following example illustrates the EPS presentation under View A and View B in Issue 1 below and will be used to facilitate discussion of this Issue at the September 9-10, 2009 EITF meeting. The EPS presentation under View C depends on whether the stock distribution is proportionate. If the distribution is proportionate, the presentation under View C would be the same as under View B if it is not proportionate, the presentation would be the same as under View A.

> Assume that REIT X had $10 million of earnings each year in 2008 through 2011 and 1 million shares outstanding prior to any dividends being issued. REIT X issued cash dividends for 2008, 2010, and 2011. On February 2, 2010, REIT X declares a $9 per share distribution for 2009 (aggregate distribution of $9 million). The distribution is payable in cash and shares, and the total cash component is limited to $1.8 million (20 percent of the total). Shareholders may elect to receive the distribution in either all cash or all shares, and must submit their election prior to March 15. Under the terms of the dividend, if shareholders representing more than 20 percent of the shares outstanding elect cash, all shareholders electing stock will receive stock, and the shareholders who elect cash will receive a ratable allocation of the 20 percent cash. Therefore, if shareholders representing at least 20 percent of the shares outstanding elect cash, the total distribution will be 20 percent in cash and 80 percent in shares. Shareholders who do not make an election will receive 20 percent in cash and 80 percent in common shares. REIT X issues a press release announcing 2009 results on February 2, 2010, files its Form 10-K on February 28, 2010, and pays the dividend on April 1, 2010. REIT X's share price on February 2, February 28, and April 1, 2010, is $65, $68, and $60, respectively. REIT X ultimately distributes 120 shares based on shareholder elections (shareholders representing more than 20 percent of the shares outstanding elected cash) and the share price of $60 on the payment date. The resulting EPS calculation based on the shares issued on April 1, 2010, under View A and View B below is as follows (in thousands, except per share amounts):

	2008	2009	2010	2011
Net income	$10,000	$10,000	$10,000	$10,000
Shares outstanding – View A[1]	1,000	1,000	1,090	1,120
Shares outstanding – View B	1,120	1,120	1,120	1,120
Basic EPS – View A	$10.00	$10.00	$9.17	$8.93
Basic EPS – View B	$8.93	$8.93	$8.93	$8.93

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Accounting Issues and Alternatives

Issue 1: Whether the stock portion of a distribution to shareholders that contains components of cash and stock and allows shareholders to select their preferred form of the distribution should be accounted for as a stock dividend for EPS purposes

View A: The stock portion of the distribution should not be considered a stock dividend for EPS purposes. Retrospective application of EPS is prohibited, regardless of whether the actual stock distribution is proportionate.

8. Proponents of View A believe that a distribution of stock and cash that allows shareholders the ability to select the form of the distribution would result in a change in the shareholders' proportionate interests in the entity unless all shareholders make the same election, which is unlikely. Since Topic 505 specifies that a stock dividend would not give rise to any change in shareholders' proportionate interests in the entity, proponents of View A believe that the dividend should not be treated as a stock dividend for purposes of applying the provisions of paragraph 260-10-55-12.

9. Further, proponents of View A argue that this form of distribution is specifically excluded from the scope of Subtopic 505-20, and, therefore, should not be considered a stock dividend. Paragraph 505-20-15-3 (Equity > Stock Dividends and Stock Splits > Scope and Scope Exceptions > Transactions) states that "[t]he guidance in this Subtopic does not apply to the accounting for a distribution or issuance to shareholders of…shares of the same class in cases in

[1] Under View A, the 120 shares distributed are accounted for as an issuance of stock. Because the issuance occurred on April 1, 2010, only 90 shares are included in weighted-average shares outstanding in 2010.

which each shareholder is given an election to receive cash or shares." Opponents of View A believe that the scope exclusion described in the preceding sentence applies to circumstances in which the shareholders' choices are strictly honored and, therefore, the entity does not know the combination of cash and stock that will be paid or issued. Opponents believe that a circumstance in which the entity knows the total value of shares that will be issued in the dividend was not contemplated in this scope exception. Opponents of View A also question whether an entity should be permitted to avoid stock dividend treatment simply by offering an election to receive a small portion of the distribution in cash. For example, opponents of View A question whether an entity that is not subject to the IRS Revenue Procedure could limit the cash portion to 1 percent of the total distribution and avoid stock dividend treatment for the remaining 99 percent distributed in shares.

10. Proponents of View A also note that the purpose of these arrangements is to allow the REIT to conserve cash while still meeting its obligations to distribute income. Paragraph 505-20-05-3 states that a stock dividend "takes nothing from the property of the corporation and adds nothing to the interests of the stockholders; that is, the corporation's property is not diminished and the interests of the stockholders are not increased. The proportional interest of each shareholder remains the same." As noted above, these dividend programs will likely change the shareholders' proportionate interests. View A proponents believe that the shareholders receiving shares have effectively purchased the shares from the entity in exchange for a forgone cash dividend.

11. Proponents of View A believe that the portion of the dividend to be paid in shares would be considered contingently issuable shares until paid.

View B: The dividend should be considered a stock dividend for purposes of applying the provisions of paragraph 260-10-55-12. Retrospective application of EPS is required, regardless of whether the actual stock distribution is proportionate.

12. Proponents of View B believe that the stock portion of these distributions should be considered stock dividends because the aggregate value of the distribution (in the form of stock,

cash, or both) is distributed to each shareholder proportionately based on their relative ownership interests. Further, the minimum value of shares to be distributed is known on the dividend declaration date (except for changes in the number of shares outstanding resulting from the entity's transactions in its own shares between the declaration date and the record date). Some proponents of View B also believe that these types of distributions generally result in a proportionate amount of cash and shares being distributed to shareholders because the majority of shareholders elect to receive cash.

13. View B proponents note that absent the elections by the shareholders, the distribution would be proportionate. View B proponents view the shareholder elections with respect to their preferred form of the distribution as the REIT distributing a fixed ratio of cash and shares for each share of stock and subsequently facilitating exchanges of cash and shares among the shareholders, rather than the REIT changing the relative ownership interests. For example, proponents of View B believe that REIT X in the example above effectively distributes the dividend amount in the form of 80 percent stock and 20 percent cash to all shareholders, and then facilitates transactions among the shareholders to re-allocate the stock and cash based on the shareholders elections and the terms of the distribution. Proponents of View B do not believe that the EPS under View A illustrated above is representative of the economics of these distributions. Ignoring other possible changes to the denominator, they do not believe that it is appropriate for the trend in EPS, or any per-share metric, to decrease when the numerator has remained constant.

14. Opponents of View B note that the total value of shares to be distributed may not be known on the dividend declaration date. For example, if 85 percent of shareholders selected all stock, only 15 percent of the total distribution would be in cash. Proponents of View B note that in practice, a majority of shareholders select all cash and believe it is unlikely that an entity would not distribute all of the cash that is available for distribution. Additionally, some proponents of View B believe that the total value of shares accounted for as a stock dividend should be set on the date the dividend is declared (80 percent of the total distribution in the above example) based on the minimum amount of shares that would be distributed. Those proponents believe that any additional shares issued should not be treated as a stock dividend. The shareholders are effectively purchasing the shares from the entity in exchange for the forgone cash dividend.

View C: The stock portion of the distribution should be considered a stock dividend for purposes of applying the provisions of paragraph 260-10-55-12, if the stock ultimately distributed will not change the shareholders' proportionate interests in the entity.

15. Proponents of View C believe that if the shares ultimately distributed are proportionate to the relative shareholder interests, then the dividend is consistent with the definition of a stock dividend in Subtopic 505-20 (Equity > Stock Dividends and Stock Splits) and should be accounted for as such.

16. Opponents of View C observe that an entity may not consistently account for distributions with the same terms based on the shareholder elections associated with each distribution. They believe that a distribution with the same terms should be reflected consistently in EPS from period-to-period regardless of the outcome of the shareholder elections.

17. Opponents of View C also question whether the distribution would be required to be exactly proportionate to be considered a stock dividend. If the distribution must be exactly proportionate, one shareholder selecting all stock and the remainder selecting all cash would result in the distribution not being accounted for as stock dividend.

Issue 2: If the Task Force reaches a tentative conclusion supporting View B or View C of Issue 1 and the stock portion of the distribution is considered a stock dividend, whether an entity should reflect the stock dividend in EPS in its financial statements issued prior to the date the number of shares to be issued is known for purposes of applying the provisions of paragraph 260-10-55-12.

18. Issue 2 is not necessarily limited to the REIT fact patterns discussed in this Issue but could also arise in the event that an entity declares a dividend for a fixed dollar amount that will be paid in stock.

View A: An entity should reflect the stock dividend in EPS in its financial statements if the dividend was declared before the issuance of its financial statements. The entity should disclose that EPS is subject to change pending the final number of shares issued on the payment date.

19. Proponents believe that a stock dividend should be reflected retrospectively in earnings per share once the dividend is declared. Proponents of View A believe that an entity should estimate the number of shares that will be issued under the dividend using the stock price on the date it issues its financial statements, or on a date as close as practicable thereto. Once the number of shares to be issued is known, the entity would retrospectively reflect that change in its financial statements. For example, REIT X would use its stock price on February 28, 2010 (the date it files its Form 10-K) and report EPS of $9.04 in 2007, 2008, and 2009, as follows

Net income		$10,000
Shares outstanding – pre-split	1,000	
Additional shares estimated:		
Total value of dividend	$7,200	
Stock price on February 28	$68	
Additional shares estimated	106	
Adjusted shares outstanding		1,106
EPS		$9.04

REIT X would also disclose that EPS is subject to change pending the final number of shares issued on the payment date. In filings after April 1, 2010, REIT X would retrospectively adjust its EPS, based on the number of shares that were actually issued, to $8.93.

20. Opponents of View A note that REIT X would likely disclose per share information in its press release of February 2, 2010. If it followed this model, it would have disclosed EPS of $9.00, based on the February 2, 2010 share price. Opponents of View A do not believe that an entity reporting multiple amounts for EPS over such a brief period is beneficial to users. Those opponents also do not believe it is practicable to require an entity to adjust its EPS calculations for share price changes through the issuance date of its financial statements. Opponents of View

A further note that View A requires that the change in estimate be recognized retrospectively, which is inconsistent with the requirements of Topic 250.

21. Some opponents of View A also do not believe that it is appropriate to reflect a stock dividend in EPS of an entity until the trading price of the entity's shares has been adjusted to reflect the effects of the stock dividend, which would likely not occur until after the number of shares that will be issued under the dividend is known.

22. Opponents of View A who support View C of Issue 1 point out that the results of the shareholders' elections (and whether the shares issued are proportionate to the relative ownerships interests) may not be known until after the entity has issued its financial statements. Therefore, the entity may not know whether the distribution should be accounted for as a stock dividend as of the date the financial statements are issued. Those opponents believe that View A would require entities to assess whether it is probable that the shares issued will be proportionate to comply with this requirement, which could result in an entity retroactively adjusting EPS for a stock dividend and then subsequently reversing that adjustment because the distribution is not ultimately proportionate.

View B: An entity should reflect the stock dividend in EPS in its financial statements in the period the number of shares to be issued is known. If the financial statements are issued before the number of shares is known, the entity should disclose the fact that EPS will change in the future based on the dividend.

23. Proponents of View B do not believe that reporting EPS or other per-share metrics that will change based on changes in the entity's stock price over a short period of time is beneficial to users. They believe that, in the example above, REIT X should present EPS of $10.00 and disclose that EPS will change to reflect shares issued in conjunction with the stock dividend.

Disclosures

24. Paragraph 260-10-50-2 (Earnings Per Share > Overall > Disclosure > General) requires disclosure of any transaction that occurs after the end of the most recent period but before the

financial statements are issued or are available to be issued (as discussed in Section 855-10-25 (Subsequent Events > Overall > Recognition)) that would have changed materially the number of common shares or potential common shares outstanding at the end of the period if the transaction had occurred before the end of the period. The staff does not recommend any additional disclosures beyond those noted in Issue 2.

International Convergence

25. Paragraph 26 of IAS 33 has guidance similar to paragraph 260-10-55-12. IAS 33 requires that the "weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares, *that have changed the number of ordinary shares outstanding without a corresponding change in resources*" (emphasis added). Paragraph 27 includes a stock dividend as such a transaction. The notion of the stock dividend not resulting in a change in the entity's resources is consistent with the notion in Subtopic 505-20 of the stock dividend taking "nothing from the property of the corporation." However, IAS 33 does *not* state that stock dividends would not result in changes to shareholders' proportionate interests.

26. Although IAS 33 does not state that stock dividends would not result in changes to shareholders' proportionate inertest, the staff believes that a similar question exists under IFRS as to whether an agreement to provide shareholders with cash or shares at the shareholders' option should be accounted for as a stock dividend or considered a forfeiture of cash in exchange for an issuance of shares.

Interaction with Other Board Agenda Projects

27. The FASB and IASB have a short-term convergence project related to EPS. However, this Issue is not currently included in that project. In addition, that project is currently on hold.

Transition and Effective Date

View A: A consensus should be effective for interim and annual periods ending on or after December 15, 2009. The consensus would require retrospective application.

28. Proponents of View A note that although entities may receive a private letter ruling from the IRS, the IRS Revenue Procedure that allows REITs to make distributions in the form of cash and stock to satisfy their annual distribution requirements without obtaining a private letter ruling only applies to distributions that will be declared for taxable years ending on or before December 31, 2009. Proponents of View A believe that entities should have the information readily available to apply this consensus immediately.

View B: A consensus should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2009. The consensus would require retrospective application. Earlier application would be permitted.

29. Proponents of View B note that the earliest a final consensus could be reached on this Issue is at the November 18-19, 2009 EITF meeting. Therefore, proponents of View B do not believe entities will have sufficient time to apply this consensus retrospectively starting with periods ending on or after December 15, 2009.