FINM2063 Introduction to Finance

Chapter 6 Exercises

Solutions

1. The impact of the 20 percent stock dividend:

Common stock (120,000 shares at $1 par) $120,000

Additional paid-in capital 260,000

Retained earnings 145,000

20,000 new shares are issued worth $4 x 20,000 = $80,000, and retained are decreased by $80,000. $20,000 is added to common stock ($1 x 20,000) and the balance ($60,000) is added to additional paid-in capital.

The impact of the $0.25 a share cash dividend:

Common stock (120,000 shares at $1 par) $120,000

Additional paid-in capital 260,000

Retained earnings 115,000

The amount of the dividend ($0.25 x 120,000 = $30,000) is subtracted from retained earnings. (Notice that the number of shares increased from the original 100,000 shares to 120,000 because the stock dividend preceded the cash dividend.)

1. a. The 3 for 1 split only alters the common stock entry:

Common stock (6,000,000 shares outstanding, $1.67 par).

b. The $1.25 cash dividend reduces cash and retained earnings by 2,000,000 x 1.25 = $2,500,000. The new entries are

Cash $7,500,000

Retained earnings 39,500,000

c. The 10% stock dividend results in .1 x 2,000,000 =

200,000 shares being issued with a value of $15 x

200,000 = $3,000,000.

The new entry for common stock is

Common stock (2,200,000 shares outstanding, $5 par)

$11,000,000.

Since the par value accounts for only $1,000,000 (200,000 x $5) of the reduction in retained earnings, additional paid‑in‑capital increases by the $2,000,000. The new entry is

Additional paid-in capital $5,000,000.

Retained earnings are reduced by $3,000,000, the amount of the increase in common stock plus paid-in capital. The new entry for retained earnings is

Retained earnings $39,000,000.

1. The impact of the 2 for 1 split is

a. Earnings per share decline from $4.20 to $2.10.

b. Total equity does not change.

c. Long‑term debt does not change.

d. Paid‑in capital does not change.

e. Number of shares doubles from 1,000,000 to 2,000,000.

f. Earnings do not change.