CHAPTER 11

Reporting and Analyzing Stockholders' Equity

Learning Objectives

1. Identify and discuss the major characteristics of a corporation.
2. Record the issuance of common stock.
3. Explain the accounting for the purchase of treasury stock.
4. Differentiate preferred stock from common stock.
5. Prepare the entries for cash dividends and understand the effect of stock dividends and stock splits.
6. Identify the items that affect retained earnings.
7. Prepare a comprehensive stockholders' equity section.
8. Evaluate a corporation's dividend and earnings performance from a stockholder's perspective.

*9. Prepare entries for stock dividends.

Summary of Questions by Learning Objectives and Bloom's Taxonomy

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
Questions														
1.	1	C	7.	2, 3	AP	12.	6	C	17.	5	C	22.	8	C
2.	1	C	8.	2	C	13.	7	C	18.	5	C	23.	8	C
3.	1	C	9.	3	C	14.	5	K	19.	5	C	24.	8	C
4.	1	K	10.	3	C	15.	5	C	20.	5, 6	K	25.	8	C
5.	1	K	11.	4	C	16.	5	C	21.	6	C	26.	8	C
6.	2	K												
Brief Exercises														
1.	1	K	4.	4	AP	7.	5	K	9.	8	C	11.	8	AP
2.	2	AP	5.	5	AP	8.	7	AP	10.	8	AP	12.	9*	AP
3.	2	AP	6.	5	AP									
Do It! Review Exercises														
1.	1	C	3.	3	AP	4.	4	AP	5.	5	AP	6.	7	AP
2.	2	AP												
Exercises														
1.	2	AP	4.	2, 3,		6.	5	AP	10.	7	AP	14.	8	AN
2.	2, 3,			4, 7	C	7.	5	AP	11.	8	AP	15.	8	AN
	4	AP	5.	2, 3,		8.	7	AP	12.	8	AP	16.	5, 9*	AP
3.	4, 7	AP		4	AN	9.	7	AP	13.	8	AN			
Problems: Set A														
1.	2, 4,		2.	2, 3,		3.	7	AP	5.	2, 3,		7.	8	AP
	7	AP		5, 7,		4.	5, 6,			4, 7	AP	8.	5, 7,	
				8	AP		7	AP	6.	7	AP		8, 9*	AP
Problems: Set B														
1.	2, 4,		2.	2, 3,		3.	7	AP	5.	2, 3,		8.	5, 7,	
										4, 7	AP			
	7	AP		5, 7,		4.	5, 6,		6.	7	AP		8, 9*	AP
				8	AP		7	AP	7.	8	AP			

*Continuing Cookie Solutions for this chapter are available online.

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Journalize stock transactions, post, and prepare paid-in capital section.	Simple	30–40
2A	Journalize transactions, post, and prepare a stockholders' equity section; calculate ratios.	Moderate	40–50
3A	Prepare a stockholders' equity section.	Moderate	20–30
4A	Reproduce retained earnings account, and prepare a stockholders' equity section.	Moderate	30–40
5A	Prepare entries for stock transactions, and prepare a stockholders' equity section.	Moderate	20–30
6A	Prepare a stockholders' equity section.	Simple	20–30
7A	Evaluate a company's profitability and solvency.	Moderate	20–30
*8A	Prepare dividend entries, prepare a stockholders' equity section, and calculate ratios.	Moderate	40–50
1B	Journalize stock transactions, post, and prepare paid-in capital section.	Simple	30–40
2B	Journalize transactions, post, and prepare a stockholders' equity section; calculate ratios.	Moderate	40–50
3B	Prepare a stockholders' equity section.	Moderate	20–30
4B	Reproduce retained earnings account, and prepare a stockholders' equity section.	Moderate	30–40
5B	Prepare entries for stock transactions, and prepare a stockholders' equity section.	Moderate	20–30
6B	Prepare a stockholders' equity section.	Simple	20–30
7B	Evaluate a company's profitability and solvency.	Moderate	30–40
*8B	Prepare dividend entries, prepare a stockholders' equity section, and calculate ratios.	Moderate	40–50

ANSWERS TO QUESTIONS

1. (a) Separate legal existence. A corporation is separate and distinct from its owners and it acts in its own name rather than in the name of its stockholders. In contrast to a partnership, the acts of the owners (stockholders) do not bind the corporation unless the owners are agents of the corporation.

(b) Limited liability of stockholders. Because of its separate legal existence, creditors of a corporation ordinarily have recourse only to corporate assets to satisfy their claims. Thus, the liability of stockholders is normally limited to their investment in the corporation.

(c) Transferable ownership rights. Ownership of a corporation is shown in shares of capital stock. The shares are transferable units. Stockholders may dispose of part or all of their interest by simply selling their stock. The transfer of ownership to another party is entirely at the discretion of the stockholder.

2. (a) Corporate management is an advantage to a corporation because it can hire professional managers to run the company. Corporate management is a disadvantage to a corporation because it prevents owners from having an active role in directly managing the company.

(b) Two other disadvantages of a corporation are government regulations and additional taxes. A corporation is subject to numerous state and federal regulations. For example, state laws prescribe the requirements for issuing stock, and federal securities laws govern the sale of stock to the general public. Corporations must pay both federal and state income taxes. These taxes are substantial. In addition, stockholders must pay income taxes on cash dividends received.

3. Janie is incorrect. A corporation must be incorporated in only one state. It is to the company's advantage to incorporate in a state whose laws are favorable to the corporate form of business organization. A corporation may incorporate in a state in which it does not have a headquarters' office or major operating facilities.

4. In the absence of restrictive provisions, the basic ownership rights of common stockholders are the rights to:

(1) vote in the election of the board of directors and in corporate actions that require stockholders' approval.
(2) share in corporate earnings.
(3) maintain the same percentage ownership when additional shares of common stock are issued (the preemptive right).
(4) share in assets upon liquidation.

5. Legally, a corporation is an entity, separate and distinct from its owners. As a legal entity, a corporation possesses most of the privileges and is subject to the same duties and responsibilities as a natural person. The corporation acts under its own name rather than under the names of its stockholders. A corporation may buy, own, and sell property, borrow money, enter into legally binding contracts, and sue or be sued.

6. The principal components of stockholders' equity for a corporation are paid-in capital and retained earnings.

7. The maximum number of shares that a corporation is legally allowed to issue is the number authorized. Gagne Corporation is authorized to sell 100,000 shares. Of these shares, 70,000 shares have been issued. Outstanding shares are those issued shares which have not been reacquired by the corporation; in other words, issued shares less treasury shares. Gagne has 66,000 shares outstanding (70,000 issued less 4,000 treasury).

8. The relative par values should have no effect on the investment decision. The par value of common stock has no effect on its market value. Par value used to be a legal amount per share which usually indicated the minimum amount at which a share of stock can be issued. Therefore, either stock mentioned in the question could be the better investment.

9. A corporation may acquire treasury stock (1) to reissue the shares to officers and employees under bonus and stock compensation plans, (2) to increase trading of the company's stock in the securities market in the hopes of enhancing its market value, (3) to have additional shares available for use in the acquisition of other companies, (4) to reduce the number of shares outstanding and, thereby, increase earnings per share, or (5) to avoid a takeover of the company by investors that are hostile to management.

10. When treasury stock is purchased, Treasury Stock is debited and Cash is credited at cost ($11,000 in this example). Treasury stock is a contra stockholders' equity account and cash is an asset. Thus, this transaction has (a) no effect on net income, (b) decreases total assets, (c) has no effect on total paid-in capital, and (d) decreases total stockholders' equity.

11. (a) Common stock and preferred stock both represent ownership of the corporation. Common stock signifies the basic residual ownership; preferred stock is ownership with certain privileges or preferences. Preferred stockholders typically have a preference as to dividends and as to assets in the event of liquidation. However, preferred stockholders generally do not have voting rights.

(b) Some preferred stocks possess the additional feature of being cumulative. Cumulative preferred stock means that preferred stockholders must be paid both current year dividends and unpaid prior year dividends before common stockholders receive any dividends.

(c) Dividends in arrears are disclosed in the notes to the financial statements.

12. The debits and credits to retained earnings are:

Debits	Credits
1. Net loss	1. Net income
2. Cash and stock dividends	

13. The answers are summarized in the table below:

	Account	Classification
(a)	Common Stock	Paid-in capital—capital stock
(b)	Paid-in Capital in Excess of Par Value	Paid-in capital—additional paid-in capital
(c)	Retained Earnings	Retained earnings
(d)	Treasury Stock	Deducted from total paid-in capital and retained earnings
(e)	Paid-in Capital in Excess of Stated Value	Paid-in capital—additional paid-in capital
(f)	Preferred Stock	Paid-in capital—capital stock

14. For a cash dividend to be paid, a corporation must have retained earnings, adequate cash, and a dividend declared by the board of directors.

15. May 1 is the date on which the board of directors formally declares (authorizes) and announces the cash dividend. May 15 is the record date which marks the time when ownership of outstanding shares is determined for dividend purposes from the stockholders' records. May 31 is the date when the dividend checks are mailed to stockholders. Accounting entries are made on May 1 (debit Cash Dividends and credit Dividends Payable), and on May 31 (debit Dividends Payable and credit Cash).

16. A cash dividend decreases assets, retained earnings, and total stockholders' equity. A stock dividend decreases retained earnings, increases paid-in capital, and has no effect on total assets and total stockholders' equity.

17. Angie is incorrect. A corporation generally issues stock dividends for one of the following reasons:

(1) To satisfy stockholders' dividend expectations without spending cash.
(2) To increase the marketability of its stock by increasing the number of shares outstanding and thereby decreasing the market price per share. Decreasing the market price of the stock makes it easier for small investors to purchase shares.
(3) To emphasize that a portion of stockholders' equity that had been reported as retained earnings has been permanently reinvested in the business and therefore is unavailable for cash dividends.

18. In a stock split, the number of shares is increased in the same proportion that par value is decreased. Thus, in Deane Corporation the number of shares will increase to 30,000 (10,000 X 3) and the par value will decrease to $5 ($15 ÷ 3). The effect of a split on market value is generally inversely proportional to the size of the split. In this case, the market price would fall to approximately $40 per share ($120 ÷ 3).

19. The different effects of a stock split versus a stock dividend are:

Item	Stock Split	Stock Dividend
Total paid-in capital	No change	Increase
Total retained earnings	No change	Decrease
Total par value (common stock)	No change	Increase
Par value per share	Decrease	No change

20. The cost of Tootsie Roll's treasury stock at December 31, 2011 was $1,992,000. It declared cash dividends of $18,360,000. The stock dividend reduced retained earnings by $47,175,000.

21. (a) The purpose of a retained earnings restriction is to indicate that a portion of retained earnings is currently unavailable for dividends.

(b) Restrictions may result from the following causes: legal, contractual, or voluntary.

22. Par value is a legal amount per share, often set at an arbitrarily selected amount, which usually indicates the minimum amount at which a share of stock can be issued. Market value is generally unrelated to par value. A stock's market value will reflect many factors, including the company's anticipated future earnings, its expected dividend rate per share, its current financial position, the current state of the economy, and the current state of the securities markets.

23. The payout ratio is computed by dividing cash dividends declared on common stock by net income. The payout ratio indicates the percentage of earnings distributed as cash dividends to common stockholders.

24. Debt financing will increase the return on common stockholders' equity when the return on assets exceeds the interest rate paid on debt.

25. The return on assets will equal the return on common stockholders' equity when a company has no preferred dividends or debt.

26. The issuance of bonds combined with a reduction in outstanding shares increases the company's reliance on debt financing which will be reflected in an increase of the debt to assets ratio. The return on common stockholders' equity should increase because the company's return on assets exceeds the interest rate on the new debt and because the amount of stockholders' equity in the denominator of the ratio has been reduced.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 11-1

The advantages and disadvantages of a corporation are as follows:

Advantages	Disadvantages
Separate legal existence	Corporate management—separation of ownership and management
Limited liability of stockholders	Government regulations
Transferable ownership rights	Additional taxes
Ability to acquire capital	
Continuous life	
Corporate management—professional managers	

BRIEF EXERCISE 11-2

May 10	Cash (2,500 X $13)	32,500	
	Common Stock (2,500 X $5)		12,500
	Paid-in Capital in Excess of Par Value—Common Stock (2,500 X $8)		20,000

BRIEF EXERCISE 11-3

June 1	Cash (3,000 X $7)	21,000	
	Common Stock		21,000

BRIEF EXERCISE 11-4

Cash (8,000 X $106)	848,000	
Preferred Stock (8,000 X $100)		800,000
Paid-in Capital in Excess of Par Value—Preferred Stock (8,000 X $6)		48,000

BRIEF EXERCISE 11-5

Nov.	1	Cash Dividends (7,000 X $1)	7,000	
		Dividends Payable		7,000
Dec.	31	Dividends Payable	7,000	
		Cash		7,000

BRIEF EXERCISE 11-6

	Before Dividend	After Dividend
(a) Stockholders' equity		
Paid-in capital		
Common stock, $8 par	$1,000,000	$1,100,000
Paid in capital in excess of par value—common stock	–	137,500
Total paid-in capital	1,000,000	1,237,500
Retained earnings	300,000	62,500
Total stockholders' equity	$1,300,000	$1,300,000
(b) Outstanding shares	125,000	137,500

BRIEF EXERCISE 11-7

Transaction	Total Assets	Total Liabilities	Total Stockholders' Equity
(a) Declared cash dividend	N/A	+	–
(b) Paid cash dividend declared in (a)	–	–	N/A
(c) Declared stock dividend	N/A	N/A	N/A
(d) Distributed stock dividend declared in (c)	N/A	N/A	N/A
(e) Split stock three-for-one	N/A	N/A	N/A

BRIEF EXERCISE 11-8

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, $10 par value, 5,000 shares issued and 4,500 shares outstanding	$ 50,000
Additional paid-in capital	
Paid-in capital in excess of par value—common stock	22,000
Total paid-in capital	72,000
Retained earnings	42,000
Total paid-in capital and retained earnings	114,000
Less: Treasury stock (500 shares)	(11,000)
Total stockholders' equity	$103,000

BRIEF EXERCISE 11-9

Payout ratio—last year = $\frac{\$120{,}000}{\$600{,}000} = 20\%$

Dividends paid this year = $1,600,000 X .20 = $320,000 (assuming the same payout ratio)

Maintaining a constant payout ratio may be considered a sign of stability from the stockholders' perspective. However, maintaining a constant payout ratio may have a negative impact on the company's cash flow and its ability to grow.

BRIEF EXERCISE 11-10

$$\text{Return on stockholders' equity} = \frac{\text{Net income} - \text{Preferred dividends}}{\text{Average common stockholders' equity}}$$

$$\frac{\$393 - \$0}{(\$2{,}581 + \$2{,}887) \div 2} = 14.37\%$$

Supervalu's 14.37% return on stockholders' equity indicates that about 14 cents of net income was earned for each dollar invested by common stockholders.

BRIEF EXERCISE 11-11

	Issue Stock	Issue Bond
Income before interest and taxes	$1,500,000	$1,500,000
Interest ($2,000,000 X 6%)	0	120,000
Income before income taxes	1,500,000	1,380,000
Income tax expense (30%)	450,000	414,000
Net Income (a)	$1,050,000	$ 966,000
Outstanding shares (b)	900,000	700,000
Earnings per share (a) ÷ (b)	$1.17	$1.38

Net income is higher if stock is used. However, earnings per share is lower than earnings per share if bonds are used because of the additional shares of stock that are outstanding. Issuance of bonds is preferable since earnings per share is higher under this alternative.

*BRIEF EXERCISE 11-12

Dec. 1	Stock Dividends (24,000 X $17)	408,000	
	Common Stock Dividends Distributable (24,000 X $10)		240,000
	Paid-in Capital in Excess of Par Value—Common Stock (24,000 X $7)		168,000
31	Common Stock Dividends Distributable	240,000	
	Common Stock		240,000

SOLUTIONS TO DO IT! REVIEW EXERCISES

DO IT! 11-1

1. True.
2. True.
3. False. Additional government regulation is a disadvantage of the corporate form of business.
4. True.
5. False. No-par value stock is quite common today.

DO IT! 11-2

Apr. 1	Cash	....	715,000	
	Common Stock	....		275,000
	Paid-in Capital in Excess of Par Value—Common Stock	....		440,000

DO IT! 11-3

Aug. 1	Treasury Stock	....	76,000	
	Cash	....		76,000

DO IT! 11-4

(1) The company has not missed past dividends and the preferred stock is noncumulative; thus, the preferred stockholders are paid only this year's dividend. The dividend paid to preferred stockholders would be $24,000 (3,000 X .08 X $100). The dividend paid to common stockholders would be $81,000 ($105,000 – $24,000).

(2) The preferred stock is noncumulative; thus, past unpaid dividends do not have to be paid. The dividend paid to preferred stockholders would be $24,000 (3,000 X .08 X $100). The dividend paid to common stockholders would be $81,000 ($105,000 – $24,000).

(3) The preferred stock is cumulative; thus, dividends that have been missed in the past (dividends in arrears) must be paid. The dividend paid to preferred stockholders would be $72,000 (3 X 3,000 X .08 X $100). The dividend paid to common stockholders would be $33,000 ($105,000 – $72,000).

DO IT! 11-5

(a) 1. The stock dividend amount is $3,000,000 [(400,000 X 15%) X $50]. The new balance in retained earnings is $9,000,000 ($12,000,000 – $3,000,000).

2. The retained earnings after the stock split would be the same as it was before the split: $12,000,000.

DO IT! 11-5 (Continued)

(b) (1) and (2) The effects on the stockholders' equity accounts are as follows:

	Original Balance	After Dividend	After Split
Paid-in capital	$ 2,400,000	$ 5,400,000	$ 2,400,000
Retained earnings	12,000,000	9,000,000	12,000,000
Total stockholder's equity	$14,400,000	$14,400,000	$14,400,000
Shares outstanding	400,000	460,000	800,000

Total stockholders' equity remains the same under both options.

DO IT! 11-6

FOYLE CORPORATION
Balance Sheet (Partial)

Stockholders' equity		
Paid-in capital		
Capital Stock		
9% preferred stock, $100 par value, 10,000 shares authorized, 2,000 shares issued and outstanding.......	$200,000	
Common stock, $5 par value, 500,000 shares authorized, 100,000 shares issued, and 93,000 shares outstanding	500,000	
Total capital stock		$ 700,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	23,000	
Paid-in capital in excess of par value—common stock	263,000	
Total additional paid-in capital ...		286,000
Total paid-in capital		986,000
Retained earnings..		372,000
Total paid-in capital and retained earnings......................		1,358,000
Less: Treasury stock (7,000 shares) (at cost)..		46,000
Total stockholders' equity		$1,312,000

SOLUTIONS TO EXERCISES

EXERCISE 11-1

(a)	Jan. 10	Cash (30,000 X $5)	150,000	
		Common Stock		150,000
	July 1	Cash (60,000 X $7)	420,000	
		Common Stock (60,000 X $5)		300,000
		Paid-in Capital in Excess of Par Value—Common Stock (60,000 X $2)		120,000
(b)	Jan. 10	Cash (30,000 X $5)	150,000	
		Common Stock (30,000 X $1)		30,000
		Paid-in Capital in Excess of Stated Value—Common Stock (30,000 X $4)		120,000
	July 1	Cash (60,000 X $7)	420,000	
		Common Stock (60,000 X $1)		60,000
		Paid-in Capital in Excess of Stated Value—Common Stock (60,000 X $6)		360,000

EXERCISE 11-2

June 12	Cash	300,000	
	Common Stock (80,000 X $1)		80,000
	Paid-in Capital in Excess of Par Value—Common Stock		220,000
July 11	Cash (3,000 X $106)	318,000	
	Preferred Stock (3,000 X $100)		300,000
	Paid-in Capital in Excess of Par Value—Preferred Stock (3,000 X $6)		18,000
Nov. 28	Treasury Stock	9,000	
	Cash		9,000

EXERCISE 11-3

(a)

Feb. 1	Cash (40,000 X $51)...............................	2,040,000	
	Preferred Stock (40,000 X $50)		2,000,000
	Paid-in Capital in Excess of Par Value—Preferred Stock (40,000 X $1)		40,000
July 1	Cash (60,000 X $56)...............................	3,360,000	
	Preferred Stock (60,000 X $50)		3,000,000
	Paid-in Capital in Excess of Par Value—Preferred Stock (60,000 X $6)		360,000

(b)

Preferred Stock

	2/1	2,000,000
	7/1	3,000,000
		5,000,000

Paid-in Capital in Excess of Par Value—Preferred Stock

	2/1	40,000
	7/1	360,000
		400,000

(c) Preferred Stock—listed first in paid-in capital under capital stock. Paid in Capital in Excess of Par Value—Preferred Stock—listed first under additional paid-in capital.

EXERCISE 11-4

(a) Common stock outstanding is 574,000 shares. (Issued shares 580,000 less treasury shares 6,000.)

(b) The stated value of the common stock is $5 per share. (Common stock issued $2,900,000 ÷ 580,000 shares.)

(c) The par value of the preferred stock is $100 per share. (Preferred stock $600,000 ÷ 6,000 shares.)

(d) The dividend rate is 6% ($36,000 ÷ $600,000).

(e) The Retained Earnings balance is still $1,158,000. Cumulative dividends in arrears are only disclosed in the notes to the financial statements.

EXERCISE 11-5

May 2	Cash (8,000 X $13)	104,000	
	Common Stock (8,000 X $10)		80,000
	Paid-in Capital in Excess of Par Value—Common Stock (8,000 X $3)		24,000
10	Cash (10,000 X $53)	530,000	
	Preferred Stock (10,000 X $20)		200,000
	Paid-in Capital in Excess of Par Value—Preferred Stock (10,000 X $33)		330,000
15	Treasury Stock (600 X $12)	7,200	
	Cash		7,200

EXERCISE 11-6

(a)

June 15	Cash Dividends (69,000* X $1.50)	103,500	
	Dividends Payable		103,500
	*60,000 shares + 9,000 shares		
July 10	Dividends Payable	103,500	
	Cash		103,500
Dec. 15	Cash Dividends (73,000** X $1.60)	116,800	
	Dividends Payable		116,800
	**69,000 shares + 4,000 shares		

(b) In the retained earnings statement, dividends of $220,300 will be deducted. In the balance sheet, Dividends Payable of $116,800 will be reported as a current liability.

EXERCISE 11-7

	Before Action	After Stock Dividend	After Stock Split
Stockholders' equity			
Paid-in capital	$ 648,000	$ 716,850	$ 648,000
Retained earnings	400,000	331,150	400,000
Total stockholders' equity	$1,048,000	$1,048,000	$1,048,000
Outstanding shares	81,000	85,050	162,000

EXERCISE 11-8

WELLS FARGO & COMPANY
Partial Balance Sheet
December 31, 2014
(in millions)

Stockholders' equity		
Paid-in capital		
Capital stock		
Preferred stock	$8,485	
Common stock, $1⅔ par value, 6 billion shares authorized, 5,245,971,422 shares issued, and 5,178,624,593 shares outstanding	8,743	
Total capital stock		$ 17,228
Additional paid-in capital		
Paid-in capital in excess of par value—common stock		52,878
Total paid-in capital		70,106
Retained earnings		41,563
Total paid-in capital and retained earnings		111,669
Less: Treasury stock (67,346,829 shares)		2,450
Total stockholders' equity		$109,219

EXERCISE 11-9

RODER CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
8% Preferred stock, $100 par value, noncumulative, 6,000 shares issued	$ 600,000	
Common stock, no par, $2 stated value, 800,000 shares issued, and 788,000 shares outstanding	1,600,000	
Total capital stock		$2,200,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	45,000	
Paid-in capital in excess of stated value—common stock	1,050,000	
Total additional paid-in capital		1,095,000
Total paid-in capital		3,295,000
Retained earnings		1,334,000
Total paid-in capital and retained earnings		4,629,000
Less: Treasury stock (12,000 common shares)		72,000
Total stockholders' equity		$4,557,000

EXERCISE 11-10

POLZIN INC.
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
8% Preferred stock, $50 par value, 40,000 shares authorized, 14,000 shares issued	$ 700,000	
Common stock, no-par, $1 stated value, 400,000 shares authorized, 250,000 shares issued and 241,000 outstanding	250,000	
Total capital stock		$ 950,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	24,000	
Paid-in capital in excess of stated value—common stock	1,200,000	
Total additional paid-in capital		1,224,000
Total paid-in capital		2,174,000
Retained earnings (See Note R)		920,000
Total paid-in capital and retained earnings		3,094,000
Less: Treasury stock (9,000 common shares)		(64,000)
Total stockholders' equity		$3,030,000

Note R: Retained earnings restricted for plant expansion, $100,000.

EXERCISE 11-11

	2014	2013
Payout ratio	$\frac{\$298}{\$504} = 59.1\%$	$\frac{\$611}{\$555} = 110.1\%$
Return on common stockholders' equity	$\frac{\$504 - \$40}{\$2,532} = 18.3\%$	$\frac{\$555 - \$40}{\$2,591} = 19.9\%$

Whitlock Corporation's dividends decreased over 51% even though its net income decreased only 9% and return on stockholders' equity decreased 8%. The company's dividend policies should be reviewed for an explanation of these inconsistencies.

EXERCISE 11-12

	2014	2013
Payout ratio	$\frac{\$471}{\$2,006} = 23.5\%$	$\frac{394}{\$2,157} = 18.3\%$
Return on common stockholders' equity	$\frac{\$2,006 - \$0}{\$13,622.5} = 14.7\%$	$\frac{\$2,157 - \$0}{\$11,986.5} = 18\%$

Walgreen's payout ratio increased 28% even though its return on common stockholders' equity and net income decreased by 18% and 7% respectively. The company's dividend policies should be reviewed for an explanation.

EXERCISE 11-13

(a) 2014: $$\frac{\$182,000 - \$8,000}{\$1,000,000} = 17.4\%$$

2013: $$\frac{\$150,000 - \$8,000}{\$700,000} = 20.3\%$$

EXERCISE 11-13 (Continued)

(b) Korsak Corporation's net income increased in part because it retired bonds and eliminated the interest expense associated with the bonds. Such an increase in income would produce an increase in return on common equity if stockholders' equity had remained constant. In this example, common stockholders' equity increased by 43% [($1,000,000 – $700,000) ÷ $700,000] while income increased by only 21%.

(c) 2014: $\dfrac{\$200,000}{\$1,200,000} = 16.7\%$

2013: $\dfrac{\$500,000}{\$1,200,000} = 41.7\%$

Korsak Corporation retired all of its long term debt on January 1, 2014. This decreased its debt to assets ratio from 41.7% to 16.7%. Korsak Corporation would be considered to be very solvent.

EXERCISE 11-14

	(a) Plan One Issue Stock	(b) Plan Two Issue Bonds
Income before interest and taxes	$800,000	$800,000
Interest ($2,000,000 X 12%)		240,000
Income before taxes	800,000	560,000
Income tax expense (30%)	240,000	168,000
Net income	$560,000	$392,000
Outstanding shares	140,000	90,000
Earnings per share	$4.00	$4.36

EXERCISE 11-15

(a)

	2013	2014
Pre-debt net income	$100,000	$100,000
Adjustment for interest expense ($400,000 X .04)	0	16,000
Net income	$100,000	$ 84,000
Outstanding shares	40,000	20,000
Earnings per share	$ 2.50	$ 4.20

(b)

	2013	2014
Net income / Average common stockholders' equity	$ 100,000 / $1,000,000 = 10%	$ 84,000 / $600,000 = 14%

(c)

	2013	2014
Total liabilities / Total assets	0 / $1,000,000 = 0	$ 400,000 / $1,000,000 = 40%

(d) The issuance of debt reduced the company's net income because of the interest cost that was incurred. However, the debt significantly increased the company's earnings per share because it was used to acquire treasury stock. This reduced the number of outstanding shares, thus increasing earnings per share.

The issuance of debt also increased the company's leverage. Because the interest rate paid on the debt was only 4% but the company's return on assets was 10%, the company was able to earn much more on each dollar invested in assets than it was paying on the debt. Thus, it was able to significantly increase its return on common stockholders' equity. This was especially true because it used the debt to repurchase shares of stock.

The issuance of the debt did, however, reduce the company's solvency. Prior to the debt, the company had no liabilities. After issuing the debt, it had a debt to total assets ratio of 40%. Investors might be concerned that the increased reliance on debt has made the company too risky. The determination as to whether this was a good decision depends on one's opinion regarding the tradeoff between the increased risk versus the increased return.

*EXERCISE 11-16

(a)	Stock Dividends (22,500* X $15).........................	337,500	
	Common Stock Dividends Distributable (22,500 X $10)......................		225,000
	Paid-in Capital in Excess of Par Value— Common Stock (22,500 X $5)		112,500

*[($1,200,000 ÷ $10) + 30,000] X 15%

(b)	Stock Dividends (40,500* X $8)..........................	324,000	
	Common Stock Dividends Distributable (40,500 X $5)........................		202,500
	Paid-in Capital in Excess of Par Value— Common Stock (40,500 X $3)		121,500

*[($1,200,000 ÷ $5) + 30,000] X 15%

SOLUTIONS TO PROBLEMS

PROBLEM 11-1A

(a)

Jan. 10	Cash (70,000 X $4)	280,000	
	Common Stock (70,000 X $1)		70,000
	Paid-in Capital in Excess of Stated Value—Common Stock (70,000 X $3)		210,000
Mar. 1	Cash (12,000 X $53)	636,000	
	Preferred Stock (12,000 X $50)		600,000
	Paid-in Capital in Excess of Par Value—Preferred Stock (12,000 X $3)		36,000
May 1	Cash (120,000 X $6)	720,000	
	Common Stock (120,000 X $1)		120,000
	Paid-in Capital in Excess of Stated Value—Common Stock (120,000 X $5)		600,000
Sept. 1	Cash (5,000 X $5)	25,000	
	Common Stock (5,000 X $1)		5,000
	Paid-in Capital in Excess of Stated Value—Common Stock (5,000 X $4)		20,000
Nov. 1	Cash (3,000 X $56)	168,000	
	Preferred Stock (3,000 X $50)		150,000
	Paid-in Capital in Excess of Par Value—Preferred Stock (3,000 X $6)		18,000

(b)

Preferred Stock

	3/1	600,000
	11/1	150,000
	12/31 Bal.	750,000

Paid-in Capital in Excess of Par Value—Preferred Stock

	3/1	36,000
	11/1	18,000
	12/31 Bal.	54,000

Common Stock		
	1/10	70,000
	5/1	120,000
	9/1	5,000
	12/31 Bal.	195,000

Paid-in Capital in Excess of Stated Value—Common Stock		
	1/10	210,000
	5/1	600,000
	9/1	20,000
	12/31 Bal.	830,000

(c)

TIDWELL CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
6% Preferred stock, $50 par value, 20,000 shares authorized and 15,000 shares issued	$750,000	
Common stock, no-par, $1 stated value, 500,000 shares authorized, 195,000 shares issued	195,000	
Total capital stock		$ 945,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	54,000	
Paid-in capital in excess of stated value—common stock	830,000	
Total additional paid-in capital		884,000
Total paid-in capital		$1,829,000

PROBLEM 11-2A

(a)

Feb.	1	Cash	30,000	
		Common Stock (5,000 X $4)		20,000
		Paid-in Capital in Excess of Stated Value—Common Stock		10,000
Mar.	20	Treasury Stock (1,000 X $7)	7,000	
		Cash		7,000
Oct.	1	Cash Dividends ($300,000 X .07)	21,000	
		Dividends Payable		21,000
Nov.	1	Dividends Payable	21,000	
		Cash		21,000
Dec.	1	Cash Dividends	124,500	
		[250,000* + 5,000 – (5,000 + 1,000)] X $.50		
		Dividends Payable		124,500
Dec.	31	Income Summary	280,000	
		Retained Earnings		280,000
	31	Retained Earnings	145,500	
		Cash Dividends ($21,000 + $124,500)		145,500
	31	Dividends Payable	124,500	
		Cash		124,500

*$1,000,000 ÷ $4

(b)

Preferred Stock

	1/1	Bal.	300,000
	12/31	Bal.	300,000

Paid-in Capital in Excess of Par Value—Preferred Stock

	1/1	Bal.	15,000
	12/31	Bal.	15,000

Common Stock

	1/1	Bal.	1,000,000
	2/1		20,000
	12/31	Bal.	1,020,000

Paid-in Capital in Excess of Stated Value—Common Stock

	1/1	Bal.	480,000
	2/1		10,000
	12/31	Bal.	490,000

PROBLEM 11-2A (Continued)

Retained Earnings

12/31	145,500	1/1 Bal.	688,000
		12/31	280,000
		12/31 Bal.	822,500

Treasury Stock

1/1 Bal.	40,000		
3/20	7,000		
12/31 Bal.	47,000		

Cash Dividends

10/1	21,000		
12/1	124,500	12/31	145,500
12/31 Bal.	–0–		

(c)

MILEY CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
7% Preferred stock, $100 par value, noncumulative, 5,000 shares authorized, 3,000 shares issued and outstanding	$ 300,000	
Common stock, no-par, $4 stated value, 300,000 shares authorized, 255,000 shares issued and 249,000 shares outstanding	1,020,000	
Total capital stock		$1,320,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	15,000	
Paid-in capital in excess of stated value—common stock	490,000	
Total additional paid-in capital		505,000
Total paid-in capital		1,825,000
Retained earnings		822,500
Total paid-in capital and retained earnings		2,647,500
Less: Treasury stock (6,000 common shares)		47,000
Total stockholders' equity		$2,600,500

PROBLEM 11-2A (Continued)

(d) $$\text{Payout ratio} = \frac{\$124{,}500}{\$280{,}000} = 44.5\%$$

$$\text{Earnings per share} = \frac{\$280{,}000 - \$21{,}000}{(245{,}000^{*} + 249{,}000^{**}) \div 2} = \frac{\$259{,}000}{247{,}000} = \$1.05$$

*250,000 – 5,000 **255,000 – 6,000

Return on common stockholders' equity =

$$\frac{\$280{,}000 - \$21{,}000}{(\$2{,}128{,}000^{a} + \$2{,}285{,}500^{b}) \div 2} = \frac{\$259{,}000}{\$2{,}206{,}750} = 11.7\%$$

[a]Beginning common stockholders' equity:
$1,000,000 + $480,000 + $688,000 – $40,000

[b]Ending common stockholders' equity:
$1,020,000 + $490,000 + $822,500 – $47,000

PROBLEM 11-3A

PAXSON COMPANY
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
9% Preferred stock, $100 par value, cumulative, 120,000 shares issued and outstanding	$12,000,000	
Common stock, $5 par value, 1,300,000 shares issued and 1,285,000 shares outstanding	6,500,000	
Total capital stock		$18,500,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	840,000	
Paid-in capital in excess of par value—common stock	1,800,000	
Total additional paid-in capital		2,640,000
Total paid-in capital		21,140,000
Retained earnings		2,178,000*
Total paid-in capital and retained earnings		23,318,000
Less: Treasury stock (15,000 shares)		165,000
Total stockholders' equity		$23,153,000

*$1,200,000 + $3,600,000 – $1,542,000[a] – $1,080,000

[a]1,300,000 shares issued less 15,000 shares in treasury = 1,285,000 shares; outstanding; 1,285,000 X $1.20 = $1,542,000.

PROBLEM 11-4A

(a) **Retained Earnings**

Dec. 31	400,000	Jan. 1	Balance	2,380,000
		Dec. 31		880,000
		Dec. 31	Balance	2,860,000

(b)

WADE CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
8% Preferred stock, $100 par value, noncumulative, 20,000 shares authorized, 10,000 shares issued and outstanding	$1,000,000	
Common stock, no-par, $5 stated value, 600,000 shares authorized, 300,000 shares issued and outstanding	1,500,000	
Total capital stock		$2,500,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	200,000	
Paid-in capital in excess of stated value—common stock	1,600,000	
Total additional paid-in capital		1,800,000
Total paid-in capital		4,300,000
Retained earnings (See Note A)		2,860,000
Total stockholders' equity		$7,160,000

Note A: Retained earnings restricted for plant expansion, $160,000.

PROBLEM 11-5A

			Debit	Credit
(a)	1.	Cash	170,000	
		Preferred Stock (1,500 X $100)		150,000
		Paid-in Capital in Excess of Par Value—Preferred Stock		20,000
	2.	Cash	3,520,000	
		Common Stock (400,000 X $5)		2,000,000
		Paid-in Capital in Excess of Stated Value—Common Stock		1,520,000
	3.	Treasury Stock (4,000 X $9)	36,000	
		Cash		36,000

(b)

PRINGLE CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
7% Preferred stock, $100 par value, noncumulative, 20,000 shares authorized, 1,500 shares issued and outstanding	$ 150,000	
Common stock, no-par, $5 stated value, 1,000,000 shares authorized, 400,000 shares issued, and 396,000 shares outstanding	2,000,000	
Total capital stock		$2,150,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	20,000	
Paid-in capital in excess of stated value—common stock	1,520,000	
Total additional paid-in capital		1,540,000
Total paid-in capital		3,690,000
Retained earnings		82,000
Total paid-in capital and retained earnings		3,772,000
Less: Treasury stock (4,000 shares)		36,000
Total stockholders' equity		$3,736,000

PROBLEM 11-6A

KESSLER INC.
Partial Balance Sheet
December 31, 2014

Stockholders' equity	
Paid-in capital	
Common stock, $1 par value, 2,000,000 shares authorized, 710,000* shares issued, and 690,000 shares outstanding	$ 710,000
Additional paid-in capital	
Paid-in capital in excess of par value—common stock	1,780,000**
Total paid-in capital	2,490,000
Retained earnings	903,000***
Total paid-in capital and retained earnings	3,393,000
Less: Treasury stock—common (20,000 shares)	76,000
Total stockholders' equity	$3,317,000

*600,000 + 50,000 + 60,000 = 710,000 shares
**$1,500,000 + (50,000 X $2) + (60,000 X $3) = $1,780,000
***$700,000 – $207,000 + $410,000 = $903,000

PROBLEM 11-7A

(a)

		2014	2013
(i)	Return on assets	$\frac{\$2,240,000}{\$15,687,500} = 14.3\%$	$\frac{\$2,500,000}{\$17,763,000} = 14.1\%$
(ii)	Return on common stockholders' equity	$\frac{\$2,240,000 - \$300,000}{\$9,400,000} = 20.6\%$	$\frac{\$2,500,000 - \$300,000}{\$14,100,000} = 15.6\%$
(iii)	Payout ratio	$\frac{\$890,000}{\$2,240,000} = 39.7\%$	$\frac{\$1,026,000}{\$2,500,000} = 41.0\%$
(iv)	Debt to assets ratio	$\frac{\$6,000,000}{\$14,500,000} = 41.4\%$	$\frac{\$3,000,000}{\$16,875,000} = 17.8\%$
(v)	Times interest earned	$\frac{(\$2,240,000 + \$500,000 + \$670,000)}{\$500,000}$ = 6.8 times	$\frac{(\$2,500,000 + \$140,000 + \$750,000)}{\$140,000}$ = 24.2 times

(b) Cepeda's net income declined from $2,500,000 to $2,240,000. Its return on assets increased slightly, but its return on common stockholders' equity increased 32%. Based on these two measures, profitability improved. The payout ratio declined about 3%.

(c) Cepeda's debt to assets ratio increased from 17.8% to 41.4% and its times interest earned decreased from 24.2 to 6.8 times. These changes indicate that Cepeda is less solvent in 2014 than 2013.

(d) It appears that the decision to issue debt to purchase common stock was wise. Cepeda's 10% interest rate was less than its return on assets of 14.3%. This resulted in the 32% increase in return on common stockholders' equity. Although the solvency ratios declined, Cepeda does not appear to be in trouble covering the extra debt. Its times interest earned ratio of 6.8 times is probably good coverage. If Cepeda's earnings start to drop, it could consider reissuing the treasury stock and paying off debt.

*PROBLEM 11-8A

(a)

Jan.	15	Cash Dividends (70,000 X $0.50)......	35,000	
		Dividends Payable		35,000
Feb.	15	Dividends Payable............................	35,000	
		Cash		35,000
Apr.	15	Stock Dividends (7,000 X $14)..........	98,000	
		Common Stock Dividends Distributable (7,000 X $10)......		70,000
		Paid-in Capital in Excess of Par Value—Common Stock (7,000 X $4)		28,000
May	15	Common Stock Dividends Distributable..................................	70,000	
		Common Stock (7,000 X $10)		70,000
Dec.	1	Cash Dividends (77,000 X $0.60)......	46,200	
		Dividends Payable		46,200
	31	Income Summary..............................	400,000	
		Retained Earnings......................		400,000
	31	Retained Earnings	98,000	
		Stock Dividends		98,000
	31	Retained Earnings	81,200	
		Cash Dividends		81,200

(b)

Common Stock

	1/1 Bal.	700,000
	5/15	70,000
	12/31 Bal.	770,000

Retained Earnings

12/31	98,000	1/1 Bal.	620,000
12/31	81,200	12/31	400,000
		12/31 Bal.	840,800

*PROBLEM 11-8A (Continued)

Paid-in Capital in Excess of Par Value

		1/1 Bal.	500,000
		4/15	28,000
		12/31 Bal.	528,000

Common Stock Dividends Distributable

5/15	70,000	4/15	70,000
		12/31 Bal.	–0–

Cash Dividends

1/15	35,000		
12/1	46,200	12/31	81,200
12/31 Bal.	–0–		

Stock Dividends

4/15	98,000		
		12/31	98,000
12/31 Bal.	–0–		

(c)

EVERETT CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, $10 par value, 77,000 shares issued and outstanding..	$ 770,000
Additional paid-in capital	
Paid-in capital in excess of par value..	528,000
Total paid-in capital	1,298,000
Retained earnings...	840,800
Total stockholders' equity.............	$2,138,800

***PROBLEM 11-8A (Continued)**

(d) $$\text{Payout ratio} = \frac{\$81,200}{\$400,000} = 20.3\%$$

Return on common stockholders' equity =

$$\frac{\$400,000 - 0}{(\$1,820,000^{*} + \$2,138,800^{**}) \div 2} = \frac{\$400,000}{\$1,979,400} = 20.2\%$$

***$700,000 + $500,000 + $620,000 **from req. (c)**

PROBLEM 11-1B

(a)

Jan.	10	Cash (40,000 X $3.60)	144,000	
		Common Stock (40,000 X $1).....		40,000
		Paid-in Capital in Excess of Stated Value-Common Stock (40,000 X $2.60)		104,000
Mar.	1	Cash (5,000 X $102)	510,000	
		Preferred Stock (5,000 X $100).....		500,000
		Paid-in Capital in Excess of Par Value—Preferred Stock (5,000 X $2)..............................		10,000
May	1	Cash (90,000 X $4)	360,000	
		Common Stock (90,000 X $1).....		90,000
		Paid-in Capital in Excess of Stated Value—Common Stock (90,000 X $3)		270,000
Sept.	1	Cash (10,000 X $4.40)	44,000	
		Common Stock (10,000 X $1).....		10,000
		Paid-in Capital in Excess of Stated Value—Common Stock (10,000 X $3.40)		34,000
Nov.	1	Cash (4,000 X $103)	412,000	
		Preferred Stock (4,000 X $100)....		400,000
		Paid-in Capital in Excess of Par Value—Preferred Stock (4,000 X $3)..............................		12,000

(b)

Preferred Stock

Debit	Credit	
	3/1	500,000
	11/1	400,000
	12/31 Bal.	900,000

Paid-in Capital in Excess of Par Value—Preferred Stock

Debit	Credit	
	3/1	10,000
	11/1	12,000
	12/31 Bal.	22,000

Common Stock

	1/10	40,000
	5/1	90,000
	9/1	10,000
	12/31 Bal.	140,000

Paid-in Capital in Excess of Stated Value—Common Stock

	1/10	104,000
	5/1	270,000
	9/1	34,000
	12/31 Bal.	408,000

(c)

BENNIS CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
8% Preferred stock, $100 par value, 10,000 shares authorized, 9,000 shares issued	$900,000	
Common stock, no-par, $1 stated value, 500,000 shares authorized, 140,000 shares issued	140,000	
Total capital stock		$1,040,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	22,000	
Paid-in capital in excess of stated value—common stock	408,000	
Total additional paid-in capital		430,000
Total paid-in capital		$1,470,000

PROBLEM 11-2B

(a)	Feb.	1	Cash	160,000	
			Common Stock (20,000 X $1)		20,000
			Paid-in Capital in Excess of Stated Value—Common Stock ($160,000 – $20,000)		140,000
	Nov.	10	Treasury Stock	16,000	
			Cash		16,000
	Nov.	15	Cash Dividends ($200,000 X .09)	18,000	
			Dividends Payable		18,000
	Dec.	1	Cash Dividends ([1,000,000 – 8,000 + 20,000 – 4,000) X $0.30]	302,400	
			Dividends Payable		302,400
	Dec.	15	Dividends Payable	18,000	
			Cash		18,000
	Dec.	31	Income Summary	408,000	
			Retained Earnings		408,000
			Retained Earnings	320,400	
			Cash Dividends		320,400
		31	Dividends Payable	302,400	
			Cash		302,400

(b)

Preferred Stock

	1/1 Bal. 200,000
	12/31 Bal. 200,000

Paid-in Capital in Excess of Par Value—Preferred Stock

	1/1 Bal. 16,000
	12/31 Bal. 16,000

Common Stock

	1/1 Bal. 1,000,000
	2/1 20,000
	12/31 Bal. 1,020,000

Paid-in Capital in Excess of Stated Value—Common Stock

	1/1 Bal. 1,400,000
	2/1 140,000
	12/31 Bal. 1,540,000

PROBLEM 11-2B (Continued)

Retained Earnings

12/31	320,400	1/1 Bal.	1,716,000
		12/31	408,000
		12/31 Bal.	1,803,600

Treasury Stock—Common

1/1 Bal.	20,000		
11/10	16,000		
12/31 Bal.	36,000		

Cash Dividends

11/15	18,000		
12/1	302,400	12/31	320,400
12/31 Bal.	–0–		

(c)

WARDEN CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
9% Preferred stock, $50 par value, cumulative, 10,000 shares authorized, 4,000 shares issued and outstanding	$ 200,000	
Common stock, no-par, $1 stated value, 2,000,000 shares authorized, 1,020,000 shares issued and 1,008,000 shares outstanding	1,020,000	
Total capital stock		$1,220,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	16,000	
Paid-in capital in excess of stated value—common stock	1,540,000	
Total additional paid-in capital		1,556,000
Total paid-in capital		2,776,000
Retained earnings		1,803,600
Total paid-in capital and retained earnings		4,579,600
Less: Treasury stock (12,000 common shares)		36,000
Total stockholders' equity		$4,543,600

PROBLEM 11-2B (Continued)

(d) $$\text{Payout ratio} = \frac{\$302{,}400}{\$408{,}000} = 74.1\%$$

$$\text{Earnings per share} = \frac{\$408{,}000 - \$18{,}000}{(992{,}000^{*} + 1{,}008{,}000^{**}) \div 2} = \frac{\$390{,}000}{1{,}000{,}000} = \$0.39$$

***1,000,000 – 8,000 **1,020,000 – 12,000**

Return on common stockholders' equity =

$$\frac{\$408{,}000 - \$18{,}000}{(\$4{,}096{,}000^{a} + \$4{,}327{,}600^{b}) \div 2} = \frac{\$390{,}000}{\$4{,}211{,}800} = 9.3\%$$

[a]Beginning common stockholders' equity:
$1,000,000 + $1,400,000 + $1,716,000 – $20,000

[b]Ending common stockholders' equity:
$1,020,000 + $1,540,000 + $1,803,600 – $36,000

PROBLEM 11-3B

PEABODY COMPANY
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
7% Preferred stock, $100 par value, cumulative, 80,000 shares issued and outstanding	$8,000,000	
Common stock, $10 par value, 820,000 shares issued and 800,000 shares outstanding	8,200,000	
Total capital stock		$16,200,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	560,000	
Paid-in capital in excess of par value—common stock	2,460,000	
Total additional paid-in capital		3,020,000
Total paid-in capital		19,220,000
Retained earnings		2,340,000*
Total paid-in capital and retained earnings		21,560,000
Less: Treasury stock—common (20,000 shares)		300,000
Total stockholders' equity		$21,260,000

*$1,600,000 + $2,900,000 – $1,600,000[a] – $560,000

[a]820,000 shares issued less 20,000 shares in treasury = 800,000 shares; outstanding; 800,000 X $2.00 = $1,600,000.

PROBLEM 11-4B

(a) **Retained Earnings**

Dec. 31	380,000	Jan. 1	Balance	800,000
		Dec. 31	Net Income	300,000
		Dec. 31	Balance	720,000

(b)

DONDEC CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
10% Preferred stock, $50 par value, cumulative, 20,000 shares authorized, 6,000 shares issued and outstanding	$ 300,000	
Common stock, $10 par value, 500,000 shares authorized, 350,000 shares issued and outstanding	3,500,000	
Total capital stock		$3,800,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	250,000	
Paid-in capital in excess of par value—common stock	520,000	
Total additional paid-in capital		770,000
Total paid-in capital		4,570,000
Retained earnings (See Note X)		720,000
Total stockholders' equity		$5,290,000

Note X: Retained earnings restricted for plant expansion, $150,000.

PROBLEM 11-5B

(a)	(1)	Cash	452,000	
		Preferred Stock (4,000 X $100)		400,000
		Paid-in Capital in Excess of Par Value—Preferred Stock		52,000
	(2)	Cash	9,000,000	
		Common Stock (600,000 X $4)		2,400,000
		Paid-in Capital in Excess of Stated Value—Common Stock		6,600,000
	(3)	Treasury Stock (40,000 X $17)	680,000	
		Cash		680,000

PROBLEM 11-5B (Continued)

(b)

HARTWELL CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity		
Paid-in capital		
Capital stock		
8% Preferred stock, $100 par value, noncumulative, 25,000 shares authorized, 4,000 shares issued and outstanding	$ 400,000	
Common stock, no-par, $4 stated value, 1,000,000 shares authorized, 600,000 shares issued, and 560,000 shares outstanding	2,400,000	
Total capital stock		$ 2,800,000
Additional paid-in capital		
Paid-in capital in excess of par value—preferred stock	52,000	
Paid-in capital in excess of stated value—common stock	6,600,000	
Total additional paid-in capital		6,652,000
Total paid-in capital		9,452,000
Retained earnings		3,630,000
Total paid-in capital and retained earnings		13,082,000
Less: Treasury stock (40,000 shares)		680,000
Total stockholders' equity		$12,402,000

PROBLEM 11-6B

FERRIS INC.
Partial Balance Sheet
December 31, 2014

Stockholders' equity	
Paid-in capital	
Common stock, $5 par value, 2,000,000 shares authorized, 735,000* shares issued, and 710,000 shares outstanding	**$3,675,000**
Additional paid-in capital	
Paid-in capital in excess of par value— common stock	**2,370,000****
Total paid-in capital	**6,045,000**
Retained earnings	**1,386,000*****
Total paid-in capital and retained earnings	**7,431,000**
Less: Treasury stock (25,000 shares)	**250,000**
Total stockholders' equity	**$7,181,000**

*600,000 + 75,000 + 60,000 = 735,000 shares
**$1,800,000 + (75,000 X $4) + (60,000 X $4.50) = $2,370,000
***$810,000 – $284,000 + $860,000 = $1,386,000

PROBLEM 11-7B

	2014	2013
(a) (i) Return on assets	$\dfrac{\$800,000}{\$5,312,500} = 15.1\%$	$\dfrac{\$900,000}{\$6,230,000} = 14.4\%$
(ii) Return on common stockholders' equity	$\dfrac{\$800,000 - \$40,000}{\$3,322,500} = 22.9\%$	$\dfrac{\$900,000 - \$40,000}{\$5,250,000} = 16.4\%$
(iii) Payout ratio	$\dfrac{\$270,000}{\$800,000} = 33.8\%$	$\dfrac{\$300,000}{\$900,000} = 33.3\%$
(iv) Debt to assets ratio	$\dfrac{\$2,000,000}{\$5,000,000} = 40\%$	$\dfrac{\$1,200,000}{\$5,610,000} = 21.4\%$
(v) Times interest earned	$\dfrac{(\$800,000 + \$120,000 + \$166,000)}{\$120,000} = 9.1 \text{ times}$	$\dfrac{(\$900,000 + \$50,000 + \$190,000)}{\$50,000} = 22.8 \text{ times}$

(b) Hercules Company's net income decreased $100,000 in 2014 even though its sales remained constant. Its return on assets, 15.1% increased about 5% from 2013 to 2014. Its payout ratio increased 0.2%. Its return on common stockholders' equity increased almost 40% from 2013 to 2014. An increase of this size indicates improved profitability.

(c) Hercules Company acquired more debt in 2014 and became less solvent. Its debt to assets ratio increased from 21.4% to 40%. In 2013, Hercules times interest earned was 22.8 times compared to 9.1 times in 2014. It is clear that Hercules is less solvent in 2014 than 2013.

PROBLEM 11-7B (Continued)

(d) It appears that the decision to issue bonds and purchase treasury stock was a wise choice. The bonds require payment of 8% interest which is less than Hercules 15.1% return on assets. This positive difference resulted in the significant improvement in return on common stockholders' equity.

Hercules is less solvent in 2014 than 2013 but does not appear to have trouble covering interest payments.

If Hercules earnings drop, it could consider reissuing the treasury stock to pay off the bonds.

*PROBLEM 11-8B

(a)	Feb.	1	Cash Dividends (80,000 X $1.00)	80,000	
			Dividends Payable		80,000
	Mar.	1	Dividends Payable	80,000	
			Cash		80,000
	July	1	Stock Dividends (12,000* X $25)	300,000	
			Common Stock Dividends Distributable (12,000 X $20)		240,000
			Paid-in Capital in Excess of Par Value (12,000 X $5)		60,000
			*80,000 shares X 0.15		
		31	Common Stock Dividends Distributable	240,000	
			Common Stock		240,000
	Dec.	1	Cash Dividends (92,000 X $1)	92,000	
			Dividends Payable		92,000
		31	Income Summary	500,000	
			Retained Earnings		500,000
			Retained Earnings	300,000	
			Stock Dividends		300,000
			Retained Earnings	172,000	
			Cash Dividends		172,000

*PROBLEM 11-8B (Continued)

(b)

Common Stock

		1/1 Bal.	1,600,000
		7/31	240,000
		12/31 Bal.	1,840,000

Retained Earnings

12/31	300,000	1/1 Bal.	750,000
12/31	172,000	12/31	500,000
		12/31 Bal.	778,000

Paid-in Capital in Excess of Par Value

		1/1 Bal.	240,000
		7/1	60,000
		12/31 Bal.	300,000

Common Stock Dividends Distributable

7/31	240,000	7/1	240,000
		12/31 Bal.	–0–

Cash Dividends

2/1	80,000		
12/1	92,000	12/31	172,000
12/31 Bal.	–0–		

Stock Dividends

7/1	300,000		
		12/31	300,000
12/31 Bal.	–0–		

*PROBLEM 11-8B (Continued)

(c)

LAMAR CORPORATION
Partial Balance Sheet
December 31, 2014

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, $20 par value, 92,000 shares issued and outstanding	$1,840,000
Additional paid-in capital	
Paid-in capital in excess of par value	300,000
Total paid-in capital	2,140,000
Retained earnings	778,000
Total stockholders' equity	$2,918,000

(d) $$\text{Payout ratio} = \frac{\$172,000^{a}}{\$500,000} = 34.4\%$$

[a]($80,000 + $92,000)

Return on common stockholders' equity =

$$\frac{\$500,000 - 0}{(\$2,590,000* + \$2,918,000**) \div 2} = \frac{\$500,000}{\$2,754,000} = 18.2\%$$

*$1,600,000 + $240,000 + $750,000 **from req. (c)

COMPREHENSIVE PROBLEM SOLUTION

(a)	1. Cash	49,200	
	Preferred Stock		48,000
	Paid-in Capital in Excess of Par Value—Preferred Stock		1,200
	2. Cash	21,000	
	Common Stock		9,000
	Paid-in Capital in Excess of Par Value—Common Stock		12,000
	3. Accounts Receivable	320,000	
	Service Revenue		320,000
	4. Cash	36,000	
	Unearned Service Revenue		36,000
	5. Cash	276,000	
	Accounts Receivable		276,000
	6. Supplies	35,100	
	Accounts Payable		35,100
	7. Accounts Payable	32,200	
	Cash		32,200
	8. Treasury Stock	11,200	
	Cash		11,200
	9. Other Operating Expenses	188,200	
	Cash		188,200
	10. Cash Dividends ($3,360 + $10,200*)	13,560	
	Dividends Payable		13,560
	11. Allowance for Doubtful Accounts	1,700	
	Accounts Receivable		1,700

*[($80,000 ÷ $10) + 900 – 400] X $1.20

Adjusting Entries

		Debit	Credit
1.	Supplies Expense ($4,400 + $35,100 – $5,900)...	33,600	
	Supplies..		33,600
2.	Unearned Service Revenue...........................	27,000	
	Service Revenue ($36,000 X 9/12)..........		27,000
3.	Bad Debts Expense [$3,500 – ($1,500 – $1,700)]...	3,700	
	Allowance for Doubtful Accounts..........		3,700
4.	Depreciation Expense....................................	4,400	
	Accumulated Depreciation—Buildings ($142,000 – $10,000) ÷ 30.....................		4,400
5.	Income Tax Expense.....................................	35,130	
	Income Taxes Payable		35,130

(b)

KLINGER CORPORATION
Adjusted Trial Balance
12/31/14

Account	Debit	Credit
Cash	$175,200	
Accounts Receivable..	87,800	
Allowance for Doubtful Accounts		$ 3,500
Supplies	5,900	
Land	40,000	
Buildings..	142,000	
Accum. Depreciation—Buildings		26,400
Accounts Payable		28,500
Income Taxes Payable......................................		35,130
Unearned Service Revenue...............................		9,000
Dividends Payable		13,560
Preferred Stock		48,000
Paid-in Capital in Excess of Par Value—P.S.		1,200
Common Stock...		89,000
Paid-in Capital in Excess of Par Value—C.S.		12,000
Retained Earnings		127,400
Cash Dividends	13,560	
Treasury Stock	11,200	
Service Revenue		347,000
Bad Debt Expense	3,700	
Depreciation Expense	4,400	
Supplies Expense	33,600	
Other Operating Expenses................................	188,200	
Income Tax Expense	35,130	
Total...	$740,690	$740,690

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(c) Optional T Accounts

Cash

Bal.	24,600		32,200
	49,200		11,200
	21,000		188,200
	36,000		
	276,000		
Bal.	175,200		

Accounts Receivable

Bal.	45,500		276,000
	320,000		1,700
Bal.	87,800		

Allowance for Doubtful Accounts

	1,700	Bal.	1,500
			3,700
		Bal.	3,500

Supplies

Bal.	4,400		33,600
	35,100		
Bal.	5,900		

Land

Bal.	40,000		

Buildings

Bal.	142,000		

Accum. Depreciation—Buildings

		Bal.	22,000
			4,400
		Bal.	26,400

Accounts Payable

	32,200	Bal.	25,600
			35,100
		Bal.	28,500

Income Taxes Payable

			35,130

Unearned Service Revenue

	27,000		36,000
		Bal.	9,000

Dividends Payable

			13,560

Preferred Stock

			48,000

Paid-in Capital in Excess of Par Value—P.S.

			1,200

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(c) (Continued)

Common Stock

	Bal.	80,000
		9,000
	Bal.	89,000

Paid-in Capital in Excess of Par Value—C.S.

		12,000

Retained Earnings

	Bal.	127,400

Cash Dividends

13,560	

Treasury Stock

11,200	

Service Revenue

		320,000
		27,000
	Bal.	347,000

Bad Debt Expense

3,700	

Depreciation Expense

4,400	

Supplies Expense

33,600	

Other Operating Expenses

188,200	

Income Tax Expense

35,130	

(d)

KLINGER CORPORATION
Income Statement
For the Year ending December 31, 2014

Service revenue		$347,000
Operating expenses		
Other operating expenses	$188,200	
Supplies expense	33,600	
Depreciation expense	4,400	
Bad debt expense	3,700	
Total operating expenses		229,900
Income before taxes		117,100
Income tax expense		35,130
Net income		$ 81,970

KLINGER CORPORATION
Statement of Retained Earnings
For the Year ending December 31, 2014

Retained earnings, 1/1/14	$127,400
Add: Net income	81,970
	209,370
Less: Dividends	13,560
Retained earnings, 12/31/14	$195,810

KLINGER CORPORATION
Balance Sheet
At December 31, 2014

Assets			
Current assets			
Cash			$175,200
Accounts receivable		$ 87,800	
Allowance for doubtful accounts		(3,500)	84,300
Supplies			5,900
Total current assets			265,400
Property, plant, and equipment			
Land		40,000	
Buildings	$142,000		
Accumulated depreciation	(26,400)	115,600	155,600
Total assets			$421,000
Liabilities and Stockholders' Equity			
Current liabilities			
Accounts payable		$ 28,500	
Income taxes payable		35,130	
Dividends payable		13,560	
Unearned service revenue		9,000	
Total current liabilities			$ 86,190
Stockholders' equity			
Paid-in capital			
Capital stock			
Preferred stock	$48,000		
Common stock	89,000		
Total capital stock		137,000	
Additional paid-in capital			
Paid-in capital in excess of par value—preferred stock	1,200		
Paid-in capital in excess of par value—common stock	12,000		
Total additional paid-in capital		13,200	
Total paid-in capital		150,200	
Retained earnings		195,810	
Total paid-in capital and retained earnings		346,010	
Less: Treasury stock (400 shares)		11,200	
Total stockholders' equity			334,810
Total liabilities and stockholders' equity			$421,000

BYP 11-1 FINANCIAL REPORTING PROBLEM

(a) The common stock has a par value of $0.69 4/9 per share.

(b) There are 160 million shares authorized (120 million class A and 40 million class B) of which 57,504,000 (36,479,000 + 21,025,000) are issued. The percentage is 36% (57,504,000 ÷ 160,000,000).

(c)

	2011	2010
The shares outstanding were	57,433,000*	56,454,000**

*57,504,000 – 71,000 **56,523,000 – 69,000

(d) $$\text{Payout ratio} = \frac{\$18{,}360}{\$43{,}938} = 41.8\%$$

Earnings per share = $0.76 (given under financial highlights and statement of earnings)

$$\text{Return on common stockholders' equity} = \frac{\$43{,}938 - 0}{\$666{,}671^{*}} = 6.6\%$$

*($665,935 + $667,408) ÷ 2

BYP 11-2 COMPARATIVE ANALYSIS PROBLEM

(a)

	Hershey Company	Tootsie Roll
Return on common stockholders' equity	$628,962 ÷ $905,124.5* = 69.5%	$43,938 ÷ $666,671.5** = 6.6%
*($937,601 + $872,648) ÷ 2		**($665,935 + $667,408) ÷ 2
Debt to assets	$3,539,551 ÷ $4,412,199 = 80.2%	$191,921** ÷ $857,856 = 22.4%
		**($58,355 + $133,566)
Return on assets	$628,962 ÷ $4,342,466* = 14.5%	$43,938 ÷ $857,907.5** = 5.1%
*($4,412,199 + $4,272,732) ÷ 2		**($857,856 + $857,959) ÷ 2

(b) Hershey Company's return on assets, 14.5%, is larger than Tootsie Roll's 5.1% indicating that it is more profitable. Comparing the return on common stockholders' equity indicates that Hershey is significantly more profitable because its shareholders earned 69.5% on each dollar invested while Tootsie Roll's investors earned only 6.6%.

These differences in profitability can be better understood by looking at the debt to assets ratios. Hershey Company's relies much more on debt to provide a return to its investors. Hershey's return to stockholders is higher than Tootsie Roll's because it uses leverage to boost its return to shareholders. Hershey's interest rate on borrowing is less than the rate it earns on its assets, therefore by borrowing it can increase its return. However, its reliance on debt increases its risk of default and decreases its solvency.

BYP 11-2 (Continued)

	Hershey Company	Tootsie Roll
(c) Payout ratio	$\frac{\$304,083}{\$628,962} = 48.3\%$	$\frac{\$18,360}{\$43,938} = 41.8\%$

Hershey Company pays out a higher portion of its earnings as dividends.

BYP 11-3 RESEARCH CASE

(a) **Before it considered paying a dividend or doing a stock buyback the company paid off near-term debt maturities.**

(b) **Time Warner pays out 40% of its free cash flow as dividends.**

(c) **Investors prefer steady dividends. If a company pays a high dividend in one year, investors often expect a high dividend in subsequent years. Therefore, the company might instead choose to pay a lower dividend that it knows it can sustain in future years, and use the excess to do share buybacks. Using this approach gives the company more flexibility to increase the dividend over time.**

(d) **In the past media companies often attracted investors that were interested in growth. Paying a large dividend will likely attract income-oriented investors that are less concerned with growth.**

(e) **In the past media companies have been criticized for wasting the company's cash on bad acquisitions. By paying significant dividends the companies might be trying to send a signal that they will be more careful in the future with how they spend the company's money. If they don't see a good investment opportunity they will instead return cash to investors in the form of dividends or stock buybacks.**

BYP 11-4 RESEARCH CASE

(a) McDonalds is shifting away from leasing properties toward buying them because the depressed real estate market has made the purchase of properties attractive.

(b) McDonalds owns 45 percent of the land that its restaurants sit on, and 70 percent of its restaurant buildings.

(c) William Ackerman proposed that the company should borrow money against its real estate properties, and then use this borrowed money to buy back shares of its own stock as treasury stock.

(d) Assuming that the rate of return on the company's assets exceeds the rate paid on the debt, the actions proposed by William Ackerman would increase the company's return on stockholders' equity ratio. This would occur because both the increased borrowing as well as the purchase of treasury shares would increase the companies use of leverage.

(e) McDonalds probably decided not to do this because they were concerned that the increased leverage would increase the riskiness of the company by reducing its solvency.

BYP 11-5 INTERPRETING FINANCIAL STATEMENTS

(a) This is a dividend transaction—a property dividend.

(b)

	Host Marriott	Marriott International
Debt to assets ratio	$\frac{\$3,112}{\$3,822} = 81.4\%$	$\frac{\$2,440}{\$3,207} = 76.1\%$

(c)

Return on assets	$\frac{\$(25)}{\$3,822} = (.7\%)$	$\frac{\$200}{\$3,207} = 6.2\%$
Return on common stockholders' equity	$\frac{\$(25)}{\$710} = (3.5\%)$	$\frac{\$200}{\$767} = 26.1\%$

(d) The debtholders were concerned that by splitting the company and leaving most of the debt with only one half of the original company the likelihood that the debtholders would be repaid was reduced—that is, the probability that Marriott would default on the debt increased. This reduces the value of the debt investment.

BYP 11-6 REAL-WORLD FOCUS

Answers will vary depending on the company chosen by the student.

BYP 11-7 DECISION MAKING ACROSS THE ORGANIZATION

	Year ended After Purchase of Treasury Stock	Year ended Before Purchase of Treasury Stock
(a) Earnings per share	$\frac{\$193.6 - 0}{109.7} = \$1.76$	$\frac{\$123.4 - 0}{119.9} = \$1.03$
Return on common stockholders' equity	$\frac{\$193.6}{\$1,078} = 18\%$	$\frac{\$123.4}{\$1,126.2} = 11\%$
Return on assets	$\frac{\$193.6}{\$2,016.9} = 9.6\%$	$\frac{\$123.4}{\$1,889.8} = 6.5\%$

All three measures indicate a significant increase in profitability.

(b) Payout ratio	$\frac{\$26.8}{\$193.6} = 13.8\%$	$\frac{\$31.0}{\$123.4} = 25.1\%$
Average cash dividend paid per share	$\frac{\$26.8}{109.7} = \$.24$	$\frac{\$31.0}{119.9} = \$.26$

Wendy's paid less of its earnings as dividends after the purchase of treasury shares than the year before. Wendy's appeared to be retaining more of its earnings to invest in its operations.

(c) Debt to assets ratio	$\frac{\$1,046.3}{\$2,076.0} = 50.4\%$	$\frac{\$769.9}{\$1,837.9} = 41.9\%$
Times interest earned ratio	$\frac{(\$193.6 + \$30.2 + \$113.7)}{\$30.2} = 11.2 \text{ times}$	$\frac{(\$123.4 + \$19.8 + \$84.3)}{\$19.8} = 11.5 \text{ times}$

BYP 11-7 (Continued)

Wendy's debt to assets ratio increased from 41.9% to 50.4% indicating a decrease in its solvency. This increase may not be cause for concern since Wendy's times interest earned decreased only slightly.

(d) Since Wendy's return on assets and its return on common stockholders' equity both increased it can be concluded that the improvement was due partially to increased reliance on debt financing and partially to improved profitability in use of assets.

(e) It appears that Wendy's International acted wisely in purchasing treasury stock and taking on more debt. Its profitability improved significantly and it appears to be handling its debt payments comfortably. Wendy's has been able to increase its earnings per share and return to its stockholders.

BYP 11-8 COMMUNICATION ACTIVITY

Dear Uncle Ken:

Thanks for your recent letter and for asking me to explain four terms.

Here are my explanations:

(1) <u>Authorized stock</u> is the total amount of stock that a corporation is given permission to sell as indicated in its charter. If all authorized stock is sold, a corporation must obtain the consent of the state to amend its charter before it can issue additional shares.

(2) <u>Issued stock</u> is the amount of stock that has been sold either directly to investors or indirectly through an investment banking firm.

(3) <u>Outstanding stock</u> is capital stock that has been issued and is being held by stockholders. It represents the difference between the stock issued by the company and the stock repurchased by the company.

(4) <u>Preferred stock</u> is capital stock that has contractual preferences over common stock in certain areas.

I really enjoy my accounting classes and especially like the accounting instructors. I hope your corporation does well, and I wish you continued success with your inventions.

Regards,

BYP 11-9 ETHICS CASE

(a) The stakeholders in this situation are:

The director of Jobe's R&D division.

The president of Jobe.

The shareholders of Jobe.

Those who live in the environment to be sprayed by the new (untested) chemical.

(b) The president is risking the environment and everything and everybody in it that is exposed to this new chemical in order to enhance his company's sales and to preserve his job. Presidents and entrepreneurs frequently take risks in performing their leadership functions, but this action appears to be irresponsible and unethical.

(c) A parent company may protect itself against loss and most reasonable business risks by establishing separate subsidiary corporations, but whether it can insulate itself against this type of action is a matter of state corporate law and criminal law.

BYP 11-10 ETHICS CASE

(a) The stakeholders in this situation are:
Mr. Sigle, president of Osborn Corporation.
Mandy Drummond, financial vice-president.
The stockholders of Osborn Corporation.

(b) There is nothing unethical in issuing a stock dividend. But the president's order to write a press release convincing the stockholders that the stock dividend is just as good as a cash dividend is unethical. A stock dividend is not a cash dividend and does not necessarily place the stockholder in the same position. A stock dividend is a "paper" dividend—the issuance of a certificate, not a check (cash).

(c) The stock dividend results in a decrease in retained earnings and an increase of the same amount in paid-in capital with no change in total stockholders' equity. There is no change in total assets and no change in total liabilities and stockholders' equity.

As a stockholder, preference for a cash dividend versus stock dividend is dependent upon one's investment objective—income (cash flow) or growth (reinvestment).

BYP 11-11 ALL ABOUT YOU

Student responses will vary depending on the organization chosen by the student.

BYP 11-12 FASB CODIFICATION ACTIVITY

(a) Stock Dividend: An issuance by a corporation of its own common shares to its common shareholders without consideration and under conditions indicating that such action is prompted mainly by a desire to give the recipient shareholders some ostensibly separate evidence of a part of their respective interests in accumulated corporate earnings without distribution of cash or other property that the board of directors deems necessary or desirable to retain in the business.

(b) Stock Split: An issuance by a corporation of its own common shares to its common shareholders without consideration and under conditions indicating that such action is prompted mainly by a desire to increase the number of outstanding shares for the purpose of effecting a reduction in their unit market price and, thereby, of obtaining wider distribution and improved marketability of the shares. It is sometimes called a stock split-up.

(c) Except for a few instances, the issuance of additional shares of less than 20 or 25 percent of the number of previously outstanding shares would call for treatment as a stock dividend as described in paragraph 505-20-30-3.

BYP 11-13 CONSIDERING PEOPLE, PLANET AND PROFIT

(a) **The new law allows a company to incorporate under a new charter which classifies a company as a "benefit company." A benefit company's governing board is allowed to consider social or environmental objectives ahead of profits. The purpose of the law is to shield the board from lawsuits from investors who feel that the purpose of the company should be to maximize profits and shareholder value.**

(b) **The article says that some people say the biggest benefit of the law would occur when the company is being considered for either a sale or break-up. Currently, if shareholder value would be maximized by selling the company or breaking it into pieces, board members can be sued if they do not agree to sell or breakup the company. Under this law, the board would be allowed to consider other factors, such as the impact of a sale on the employees or the community. The article suggests that if Ben and Jerry's had been structured as a benefit corporation the board would not have allowed the company to be sold to Unilever.**

(c) **Critics of the new law say that it reduces the accountability of the company to its shareholders. They say that if management makes a bad decision which hurts the value of the company, management can say that it made the decision for reasons other than to maximize profits.**

(d) **Previously companies could apply for "B Corp" certification. Under this program, companies are evaluated by a private entity that created and administers the certification. Companies choose to obtain this certification in order to demonstrate their commitment to social and environmental causes. The difference is that this certification does not shield a company from investor lawsuits which claim that the company's social or environment programs are causing it to not maximizing profits.**

(e) **The companies that the article cites as either having adopted benefit corporation standing, or are considering it are:**

Patagonia
Ben and Jerry's Homemade
Emerge Workplace Solutions
Greyston Bakery
Comet Skateboards

IFRS CONCEPTS AND APPLICATION

IFRS 11-1

May 10	Cash (1,000 X $18)	18,000	
	Share Capital—Ordinary (1,000 X $10)		10,000
	Share Premium—Ordinary (1,000 X $8)		8,000

IFRS 11-2

LUTHER CORPORATION
Partial Statement of Financial Position
December 31, 2014

Equity	
Share capital—ordinary, €10 par value, 5,000 shares issued and 4,500 shares outstanding	€50,000
Share premium—ordinary	10,000
Retained earnings	45,000
Less: Treasury shares (500 shares)	11,000
Total equity	€94,000

IFRS 11-3

June 12	Cash	375,000	
	Share Capital—Ordinary (60,000 X $1)		60,000
	Share Premium—Ordinary		315,000
July 11	Cash (1,000 X $110)	110,000	
	Share Capital—Preference (1,000 X $100)		100,000
	Share Premium—Preference (1,000 X $10)		10,000
Nov. 28	Treasury Shares	80,000	
	Cash		80,000

IFRS 11-4

(a) **Santander is issuing shares of its Mexican banking subsidiary to the public in order to raise capital. It needs the capital because it has had very high loan-losses on its loans in southern Europe.**

(b) **The bank feels that the local listings raise awareness of the bank's brand when local investors become shareholders. Also, the bank feels that the listing give a "market-based gauge on how each unit is performing." This is useful for evaluating the performance of the managers in that country.**

(c) **Santander has done local listings in Brazil, Chile, Poland, and Peru. Regulators in those countries like the local listings because the fact that the bank has locally traded shares gives the regulators the right to exercise some oversight over the banks.**

(d) **Many of Santander's rivals that needed cash infusions have had to issue shares at deeply discounted prices because their stock price had fallen sharply due to European problems. Santander has instead taken advantage of the fact that hit has large subsidiaries in emerging economies where stock prices were still strong. It has raised funds by issuing some shares in these markets, while still keeping the majority of the shares, and thus maintaining control.**

IFRS 11-5 INTERNATIONAL FINANCIAL REPORTING PROBLEM

(a)

Cash	14	
Share Capital—Ordinary		0
Share Premium—Ordinary		14

(b) (£4,482 – 0) ÷ [(£41,755 + £46,287) ÷ 2] = 10.2%

(c)

Share capital	Common stock
Share premium	Paid-in capital in excess of par value
Merger reserve	Accumulated other comprehensive income
Equity reserve	Accumulated other comprehensive income
Retained earnings	Retained earnings