

Chapter 11

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Reporting and Interpreting Stockholder's Equity

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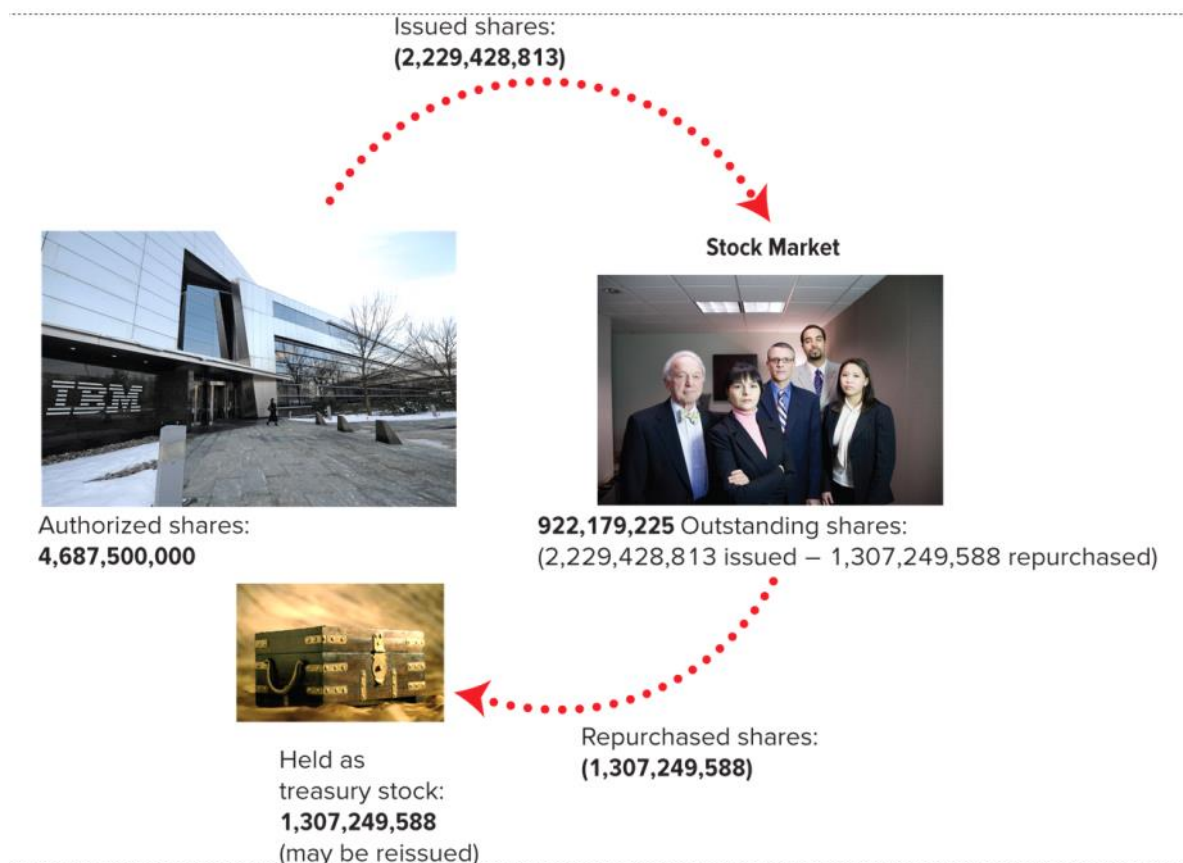
See [all UC Berkeley Notes opensourced by Yunhao](#)

Authorized Number of Shares - Maximum number of common shares that can be sold

Issued shares - shares that have been sold to the public.

Treasury stock - issued shares but not outstanding shares, shares being bought back by the company that had been sold to the public before.

Outstanding shares - shares of stock that are owned by stockholders on any date.



Common Stock Transactions

Common stock - basic voting stock issued by a corporation.

Though stockholders are owners and have the right to vote and share in the profitability of the business through dividends, they do not actively participate in managing the business. Instead, they elect a board of directors and it is the board's role to hire and monitor executives who manage a company's activities on a day-to-day basis.

Par Value(面额) - nominal value per share established in the corporate charter. It has no relationship to the market price.

Legal capital(法定资本) - The permanent amount of capital defined by state law that must remain invested in the business; serves as a cushion for creditors.

The original purpose of par value is to act as a legal capital, but now it does little to protect creditors. But now companies assign their par values to be \$0.01. Nowadays creditors have adopted other protection mechanisms such as debt covenants(契约) that we discussed in Ch.10.

Note: There are some states that require the issuance of no-par value stock. When a corporation issues no-par stock, legal capital is defined by state law.

Initial Sale of Stock

IPO Initial Public Offering 首次公开募股 - very first sale of a company's stock.

Seasoned Offerings - additional sales of new stocks to the public once a company's stock has been traded on established markets

Secondary Markets

When a company sells stock to the public, the transaction is between the issuing corporation and the investor. Subsequent to the initial sale, investors can sell shares to other investors without directly affecting the corporation.

Example of Secondary Markets:

1. New York Stock Exchange (NYSE)
2. Nasdaq

Stock for Employ

1. compensation packages can be developed to reward managers for meeting goals that are important to stockholdersees
2. offer managers stock options, which permit them to buy stock at a fixed price

Granting a stock option is a form of **compensation**, even if the grant price and the current stock price are the same. You can think of a stock option as a risk-free investment. If you hold a stock option and the stock price declines, you have lost nothing. If the stock price increases, you can exercise your option at the low grant price and sell the stock at the higher price for a profit.

Companies must estimate and report compensation expense associated with stock options.

Repurchase of Stock

- Due to regulations, it is cheaper to give employees repurchased stocks than to issue new stocks.
- And it also doesn't dilute the existing investor's shares.

	Debit	Credit
Treasury stock (+XSE, -SE) (100,000 × \$140)	14,000,000	
Cash (-A)		14,000,000

Dividends on Common Stock

It really depends, sometimes people don't care because they can earn money from stock price appreciation or sometimes they care.

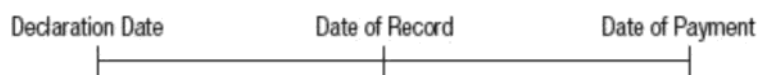
Dividend Yield

"How much does a company pay out in dividends each year relative to its share price?"

$$\text{Dividend Yield} = \frac{\text{Dividends per Share}}{\text{Market Price per Share}}$$

Key Dividend Dates

1. Declaration Date
 - a. The date on which the board of directors officially approves the dividend
2. Date of record
 - a. follows the declaration date
 - b. the date on which the corporation prepares the list of current stockholders who will receive the dividend payment
3. Date of payment
 - a. the date on which cash is disbursed to pay the dividend liability



Declaration Date

	Debit	Credit
Retained earnings (-SE)	1,387,000,000	
Dividends payable (+L)		1,387,000,000

Payment of the Liability

	Debit	Credit
Dividends payable (-L)	1,387,000,000	
Cash (-A)		1,387,000,000

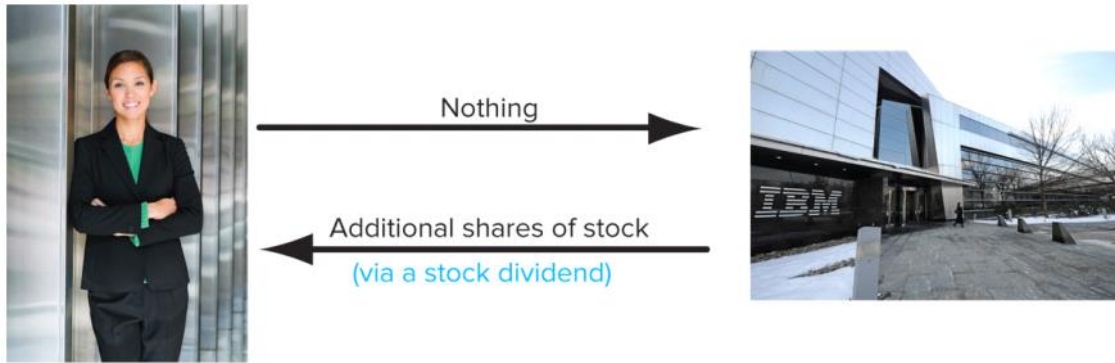
Two Fundamental Requirements for Cash Payment of Dividend:

- 1. Sufficient retained earnings or net income.** The corporation must have accumulated a sufficient amount of retained earnings, or earned a sufficient amount of income during the period, to cover the amount of the dividend.
- 2. Sufficient cash.** The corporation must have sufficient cash to pay the dividend and meet the operating needs of the business. The mere fact that the Retained Earnings account has a large credit balance does not mean that the board of directors can declare and pay a cash dividend. The cash generated in the past by earnings represented in the Retained Earnings account may have been spent to acquire inventory, buy operational assets, and pay liabilities. Consequently, no necessary relationship exists between the balance of retained earnings and the balance of cash on any particular date. Quite simply, retained earnings is not cash.

Stock Dividends and Stock Splits

Stock Dividend

Stock Dividend - a distribution of additional shares of a company's own stock to its stockholders on a pro rata basis (according to percentage of share owned) at no cost to the stockholder.

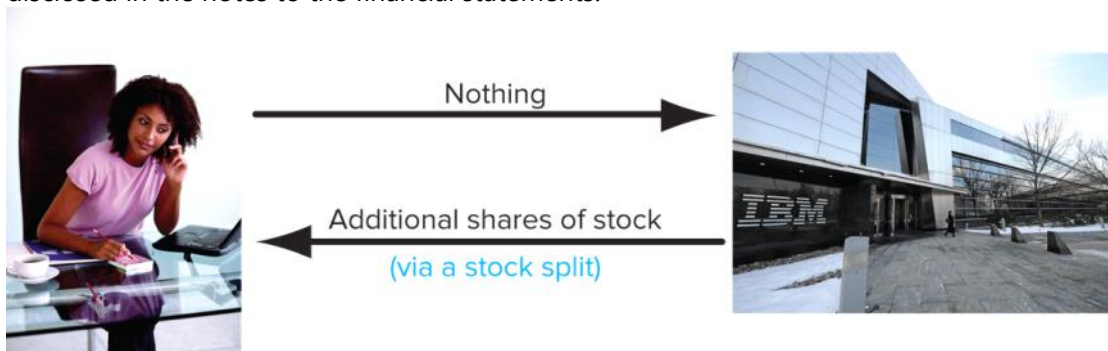


	Debit	Credit
Retained earnings (-SE) (\$0.20 par value × 50,000,000)	10,000,000	
Common stock (+SE) (\$0.20 par value × 50,000,000)		10,000,000

	Debit	Credit
Retained earnings (-SE) (\$150 market price × 5,000,000)	750,000,000	
Common stock (+SE) (\$0.20 par value × 5,000,000)		1,000,000
Additional paid-in capital (+SE) (remainder)		749,000,000

Stock Splits

Stock Splits - **not dividends**. Gives stockholders a specified number of additional shares for each share that they currently hold. a stock split **does not require a journal entry** but is disclosed in the notes to the financial statements.



For example, when a company declares a two-for-one stock split, a stockholder who owned one share of stock before the split will own two shares of stock after the split. In essence, the one share has been “split” into two shares. A company’s footnotes will state whether the stock split applies to all authorized, issued, and outstanding shares.

STOCKHOLDERS' EQUITY

	Before	After a 100% Stock Dividend	After a 2-for-1 Stock Split
Number of shares outstanding	300,000	600,000	600,000
Par value per share	\$ 1.00	\$ 1.00	\$ 0.50
Common stock	\$300,000	\$600,000	\$300,000
Retained earnings	650,000	350,000	650,000
Total stockholders' equity	950,000	950,000	950,000

Updated Statement of Stockholder's Equity

IBM CORPORATION Consolidated Statement of Changes in Equity (\$ in millions)							
	Common Stock and Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders' Equity	Non- Controlling Interests	Total Equity
Equity, January 1, 2017	\$53,935	\$152,759	\$(159,050)	\$(29,398)	\$18,246	\$146	\$18,392
Cumulative effect of change in accounting principle*		102			102		102
Net income plus other comprehensive income/(loss)							
Net income		5,753			5,753		5,753
Other comprehensive income/(loss)				2,806	2,806		2,806
Total comprehensive income/(loss)					\$ 8,559		\$ 8,559
Cash dividends paid— common stock		(5,506)			(5,506)		(5,506)
Common stock issued under employee plans (4,311,998 shares)	631				631		631
Purchases (1,226,080 shares) and sales (463,083 shares) of treasury stock under employee plans—net		18	(134)		(116)		(116)
Other treasury shares purchased, not retired (27,237,179 shares)			(4,323)		(4,323)		(4,323)
Changes in other equity		0			0		0
Changes in noncontrolling interests						(15)	(15)
Equity, December 31, 2017	\$54,566	\$153,126	\$(163,507)	\$(26,592)	\$17,594	\$131	\$17,725

Most important changes - **accumulated other comprehensive income** (loss), which captures certain items that are reported as a part of comprehensive income, but not net income. Examples of items that are not included in the computation of net income:

1. Unrealized holding gains or losses from certain types of securities. Under GAAP, gains and losses from holding certain types of securities are reported on the income statement **only when the stock is sold**. Unrealized gains and losses that occur before the stock is sold are included in comprehensive income.
2. Foreign currency translation gains and losses. Many U.S. companies have foreign subsidiaries that conduct business using foreign currencies. Incorporating the financial statements of these foreign subsidiaries into a U.S. company's financial statements requires the use of a foreign currency exchange rate. Changes in exchange rates from year to year result in foreign currency translation gains and losses. These gains and losses are included in comprehensive income.

Preferred Stock Transactions

Preferred stock - stock has specified rights over common stock

Differences with common stock:

- **Preferred stock typically does not have voting rights.** Without voting rights, preferred stock does not appeal to investors who want some control over the operations of a corporation. The lack of voting rights is one of the reasons some corporations issue preferred stock to raise capital: Issuing preferred stock permits them to raise money without issuing additional common shares with voting rights.
- **Preferred stock is less risky.** Generally, preferred stock is less risky than common stock because holders receive priority payment of dividends and distribution of assets if the corporation goes out of business. Usually a specified amount per share must be paid to preferred stockholders before any remaining assets can be distributed to the common stockholders.
- **Preferred stock typically has a fixed dividend rate.** For example, "6 percent preferred stock, par value \$10 per share," pays an annual dividend of 6 percent of par value, or \$0.60 per share. If preferred stock had no par value, the preferred dividend would be specified as \$0.60 per share. The fixed dividend is attractive to certain investors who want stable income from their investments.

Current Dividend Preference - requires that dividends be paid to preferred stockholders before any dividends are paid to common stockholders.

Cumulative Dividend Preference - requires any unpaid dividends on preferred stock to accumulate. The cumulative unpaid amount is dividends in arrears.

HW Notes:

Tandy Company was issued a charter by the state of Indiana on January 15 of this year. The charter authorized the following:

Common stock, \$8 par value, 118,000 shares authorized

Preferred stock, 13 percent, par value \$8 per share, 4,600 shares authorized

During the year, the following transactions took place in the order presented:

- Sold and issued 20,700 shares of common stock at \$16 cash per share.
- Sold and issued 1,900 shares of preferred stock at \$20 cash per share.
- At the end of the year, the accounts showed net income of \$41,900. No dividends were declared.

Required:

- Prepare the stockholders' equity section of the balance sheet at the end of the year.

✓ Answer is complete and correct.

TANDY, INCORPORATED		
Balance Sheet (Partial)		
At December 31, this year		
Stockholders' equity:		
Contributed capital:		
Additional paid-in capital, common stock	✓ \$ 165,600 ✓	
Additional paid-in capital, preferred stock	✓ 22,800 ✓	
Common stock	✓ 165,600 ✓	
Preferred stock	✓ 15,200 ✓	
Total contributed capital		369,200
Retained earnings	✓	41,900 ✓
Total stockholders' equity		\$ 411,100

The following information was extracted from the records of TAC Corporation at the end of the fiscal year after all adjusting entries were completed:

Common stock (\$16 par value; 108,000 shares authorized, 35,000 shares issued, 32,000 shares outstanding)	\$560,000
Additional paid-in capital	167,000
Dividends declared and paid during the year	14,000
Retained earnings at the beginning of the year	66,000
Treasury stock at cost (3,000 shares)	(37,000)

The following information was extracted from the records of TAC Corporation at the end of the fiscal year after all adjusting entries were completed:

Common stock (\$16 par value; 108,000 shares authorized, 35,000 shares issued, 32,000 shares outstanding)	\$560,000
Additional paid-in capital	167,000
Dividends declared and paid during the year	14,000
Retained earnings at the beginning of the year	66,000
Treasury stock at cost (3,000 shares)	(37,000)

Net income for the year was \$44,000. The stock price is currently \$24.29 per share.

Required:

1. Prepare the stockholders' equity section of the balance sheet at the end of the fiscal year. (Amounts to be deducted should be indicated by a minus sign.)

✓ Answer is complete and correct.

TAC CORPORATION		
Balance Sheet (Partial)		
At End of This Fiscal Year		
Stockholders' equity:		
Contributed capital		
Additional paid-in capital	✓ \$ 167,000 ✓	
Common stock	✓ 560,000 ✓	
Total contributed capital		\$ 727,000
Retained earnings	✓ 96,000 ✓	
Total contributed capital and retained earnings		\$ 823,000
Treasury stock	✓ (37,000) ✓	
Total stockholders' equity		\$ 786,000

At the beginning of the year, the stockholders' equity section of the balance sheet of Solutions Corporation reflected the following:

Common stock (\$12 par value; 70,000 shares authorized, 31,000 shares outstanding)	\$ 372,000
Additional paid-in capital	124,000
Retained earnings	754,000

On February 1, the board of directors declared a 65 percent stock dividend to be issued April 30. The market value of the stock on February 1 was \$15 per share. The market value of the stock on April 30 was \$18 per share.

Required:

1. For comparative purposes, prepare the Stockholders' Equity section of the balance sheet immediately before the stock dividend and immediately after the stock dividend.

✓ Answer is complete and correct.

SOLUTIONS CORPORATION		
Balance Sheet (Partial)		
At February 1, This Year		
	Stockholders' Equity	
	Before Stock Dividend	After Stock Dividend
Contributed capital:		
Common stock	\$ 372,000 ✓	\$ 613,800 ✓
Additional paid-in capital	124,000 ✓	124,000 ✓
Retained earnings	754,000 ✓	512,200 ✓
Total stockholders' equity	\$ 1,250,000	\$ 1,250,000

Note: k Percent stock dividend means a 100 shares will receive additional k shares for retained earnings.