

ACCT 2101
Exam 4 - SOLUTION
Fall Semester, 2011

Version 2

Name Solution with Grading Guideline Section _____
(please print clearly)

Pledge:

On my honor, I have neither given nor received any unauthorized help on this exam.

(signed)

Instructions:

1. **You may not ask questions during the exam.** However, all notes you write to the instructor will be read and considered during the grading process.
2. **FOR ALL ANSWERS, ROUND TO THE CLOSEST DOLLAR AMOUNT.**
3. Please use your time wisely. Remember: Perfect answers are not required to get most of the points.
4. Only the approved calculators may be used during the quiz.
5. You must write legibly or your answers will not be graded.
6. Do **NOT** pull this exam apart under any circumstances.
7. Make sure you have 7 numbered pages including the cover sheet.
8. Good luck!

BF → **Point Allocation:**

Problem 1: (6 parts @ .4)	2.4
Problem 2: (6 parts @ .4)	2.4
Problem 3: (7 parts @ .4)	2.8
Problem 4: (3 parts @ .4)	1.2
Problem 5: (3 parts @ .4)	<u>1.2</u>

TOTAL AVAILABLE POINTS = 10.0 points

PROBLEM 1. Multiple-Choice Questions.

C 1. Rye Company has provided the following information:

- Number of issued common shares, 225,000;
- Net income, \$500,000;
- Number of authorized common shares, 400,000;
- Number of treasury shares, 25,000.

What is Rye's earnings per share?

- A. \$2.22
B. \$1.25
C. \$2.50
D. \$1.33

Issued	225,000	Net Income	\$500,000
- Treasury	- 25,000	÷ Outstanding	÷ 200,000
	<u>200,000</u>	Shares	
Outstanding		= EPS	<u>\$2.50</u>
Shares			

A 2. Which of the following correctly describes the effect of declaring and distributing a common stock dividend?

- A. Total stockholders' equity remains the same. T
B. Total stockholders' equity decreases. F
C. The number of shares outstanding increases while the par value of each share decreases. F
D. The number of shares outstanding decreases while the par value of each share increases. F

C 3. Which of the following statements is false?

- A. Both stock splits and stock dividends increase the common shares issued. T
B. Both stock splits and stock dividends increase the common shares outstanding. T
C. Stock splits reallocate amounts between retained earnings and contributed capital accounts. F
D. Both stock splits and stock dividends have the impact of reducing the market price of the stock. T

D 4. Assume the following capital structure:

Preferred stock, 6%, \$50 par value, 1,000 shares issued and outstanding with dividends in arrears for three prior years (2007 - 2009).

Common stock, \$100 par value, 2,000 shares issued and outstanding.

Total dividends declared and paid in 2010 were \$50,000. How much of the 2010 dividend will be paid to the preferred stockholders assuming the preferred stock is cumulative?

- A. \$38,000
B. \$3,000
C. \$47,000
D. \$12,000

$$\text{Annual Dividend} = 6\% \times \$50 \times 1,000 \text{ shares} = \$3,000$$

$$\text{Dividends in Arrears: } 3 \times \$3,000 = \$9,000$$

Current Dividend:

Total Preferred Dividend

$$\begin{array}{r} 3,000 \\ + 9,000 \\ \hline \$12,000 \end{array}$$

B 5. A company reported total stockholders' equity of \$340,000 on its balance sheet dated December 31, 2010. During the year ended December 31, 2011, the company reported net income of \$40,000, declared and paid a cash dividend of \$8,000, declared and distributed a 10% stock dividend with a \$10,000 total market value, purchased treasury stock costing \$12,000, and issued additional common stock for \$60,000. What is total stockholders' equity as of December 31, 2011?

- A. \$432,000
- B. \$420,000
- C. \$444,000
- D. \$410,000

Stockholder's' Equity:

Note: Stock Dividends
do not affect overall
s/H Equity.

Beg Bal	340,000
Net Income	+ 40,000
Cash Div	- 8,000
Purch Treas Stock	- 12,000
Stock Issued	+ 60,000
	<u>\$420,000</u>

C 6. Which of the following statements is correct?

- A. A 2-for-1 common stock split decreases both earnings per share and total stockholders' equity. F
- B. A 2-for-1 common stock split increases both the number of common shares outstanding and total stockholders' equity. F
- C. A 30% common stock dividend increases the number of common shares outstanding and does not affect total stockholders' equity. T
- D. A 10% common stock dividend decreases both earnings per share and total stockholders' equity. F

PROBLEM 2.

Same as Problem 1 on Problem Set #4.

REQUIRED: Using the information below, prepare the journal entries to record the transactions. You may continue your solution on the reverse side.

The stockholders' equity of Elson Corporation at January 1 is shown below:

5 Percent preferred stock, \$100 par value, 10,000 shares authorized; 4,000 shares issued and outstanding	\$ 400,000
Common stock, \$5 par value, 200,000 shares authorized; 50,000 shares issued and outstanding	250,000
Paid-in capital in excess of par value—Preferred stock	40,000
Paid-in capital in excess of par value—Common stock	300,000
Retained earnings	656,000
Total Stockholders' Equity	<u>\$1,646,000</u>

The following transactions, among others, occurred during the year:

- Apr. 1 Declared a 100 percent stock dividend on all outstanding shares of common stock. The market value of the stock was \$11 per share.
- 15 Issued the stock dividend declared on April 1.
- Dec. 7 Declared a three percent stock dividend on all outstanding shares of common stock. The market value of the stock was \$14 per share.
- 17 Issued the stock dividend declared on December 7.
- 20 Declared the annual cash dividend on the preferred stock and a cash dividend of 80 cents per common share, payable on January 15 to common stockholders of record on December 31.
- 31 Closed the Income Summary account, with net income of \$253,000, to the Retained Earnings account.

(solution on next page.)

0.4 points each entry

Problem 2.

4/1 Retained Earnings ($50,000 \times 100\% \times \5) 250,000
Common Stock Distributable ($50,000 \times \$5$) 250,000

4/15 Common Stock Distributable 250,000
Common Stock 250,000

12/7 Retained Earnings* 42,000
Common Stock Distributable ($3,000 \times \$5$) 15,000
PIC - Excess of Par 27,000
* $(100,000 \times 3\%) = 3,000 \text{ shares} \times \$14 = \$42,000$

12/17 Common Stock Distributable 15,000
Common Stock 15,000

12/20 Retained Earnings ($103,000 \times \$0.80$) 82,400
Dividends Payable - Common 82,400

Retained Earnings ($4,000 \times 5\% \times \100) 20,000
Dividends Payable - Preferred 20,000

12/31 Income Summary 253,000
Retained Earnings 253,000

Same as Problem 3 on Problem Set #4.

PROBLEM 3.

REQUIRED: Using the information below, prepare the journal entries to record the transactions. You may continue your solution on the reverse side.

The stockholders' equity of Xeltron Corporation at January 1 follows:

9 Percent preferred stock, \$100 par value, 20,000 shares authorized; 6,000 shares issued and outstanding	\$ 600,000
Common stock, \$2 par value, 100,000 shares authorized; 40,000 shares issued and outstanding	80,000
Paid-in capital in excess of par value—Preferred stock	400,000
Paid-in capital in excess of par value—Common stock	800,000
Retained earnings	750,000
Total Stockholders' Equity	<u>\$2,630,000</u>

The following transactions, among others, occurred during the year:

- Jan. 1 Announced a 2-for-1 common stock split, reducing the par value of the common stock to \$1.00 per share.
- Mar. 31 Converted \$100,000 face value of convertible bonds payable (the book value of the bonds was \$103,000) to common stock. Each \$1,000 bond converted to 125 shares of common stock.
- June 1 Acquired equipment with a fair market value of \$30,000 in exchange for 200 shares of preferred stock.
- Sept. 1 Acquired 10,000 shares of common stock for cash at \$20 per share.
- Nov. 21 Issued 5,000 shares of common stock at \$22 cash per share.
- Dec. 28 Sold 1,000 treasury shares at \$23 per share.
- 31 Closed the Income Summary account, with net income of \$200,000, to the Retained Earnings account.

(Solution on next page.)

0.4 points each entry

Problem 3.

1/1	Common Stock ($40,000 \times \$2$)	80,000
	Common Stock ($80,000 \times \$1$)	80,000

3/31	Bonds Payable	100,000
	Premium on Bonds Payable	3,000
	Common Stock ($100 \times 125 \times \$1$)	12,500
	PIC - Excess of Par	90,500

6/1	Equipment	30,000
	Preferred Stock ($200 \times \$100$)	20,000
	PIC - Excess of Par - Preferred	10,000

9/1	Treasury Stock ($10,000 \times \$20$)	200,000
	Cash	200,000

11/21	Cash ($5,000 \times \$22$)	110,000
	Common Stock ($5,000 \times \$1$)	5,000
	PIC - Excess of Par	105,000

12/28	Cash ($1,000 \times \$23$)	23,000
	Treasury Stock ($1,000 \times \$20$)	20,000
	PIC - TST	3,000

12/31	Income Summary	200,000
	Retained Earnings	200,000

PROBLEM 4.

The Turner Company has investments on the balance sheet at the beginning of the period in the amount of \$458,630. At the end of the period, the fair market value of these investments is \$488,073.

Record the journal entry to reflect the change in value under each of the assumptions below. Also identify which financial statement each account in the journal entry is reported.

- (a) The investments are classified as trading securities.
- (b) The investments are classified as available-for-sale securities.
- (c) The investments are classified as debt securities that will be held to maturity.

BB \$458,630
EB 488,073
Gain \$29,443

(a) Investments

Unrealized Gain on Investments

29,443 ← Balance Sheet
29,443 ↗ Income Stmt

(b) Investments

Unrealized Gain on Investments

29,443 ← Balance Sheet
29,443 ↗ AOCI/Balance Sheet

(c) No entry.

PROBLEM 5. PLEASE USE COMPLETE SENTENCES.

- (a) Explain the difference between a stock option and restricted stock. Which is usually better for the employee? Why?

A stock option is the right to purchase a share of stock at a specified price at a specified time.

Restricted stock is stock that is transferred with a restriction regarding when it can be sold.

Many employees prefer restricted stock because they have something of value even if the stock price does not go up.

- (b) Why do companies reacquire their own common stock? Identify two reasons.

We discussed four reasons in class:

- a. Increase the market value of the remaining outstanding shares.
- b. Buy back shares when the company believes they are under-priced so they can later reissue them when the market price increases.
- c. Appease dissatisfied shareholders and possibly ward off a hostile takeover attempt.
- d. Fund stock option and employee stock ownership plans without violating the pre-emptive right that accompanies most common shares.

- (c) What is a reverse stock split? What is its purpose?

Reverse stock splits are designed to increase the company's stock price. The company makes an announcement that there will be an increase in the par value of its stock and a proportionate reduction the number of shares outstanding. Reverse stock splits are used to make sure a company's trading price does not fall below the minimum set by the stock exchange (to avoid being delisted).