Chapter 11

Reporting and Interpreting Owners’ Equity

ANSWERS TO QUESTIONS

1. A corporation is a separate legal entity (authorized by law to operate as an individual). It is owned by a number of persons and/or entities whose ownership is evidenced by shares of capital stock. Its primary advantages are: (a) transferability of ownership, (b) limited liability to the owners, and (c) the ability to accumulate large amounts of resources.

2. The charter of a corporation is a legal document from the state that authorizes its creation as a separate legal entity. The charter specifies the name of the entity, its purpose, and the kinds and number of shares of capital stock it can issue.

3. (a) Authorized capital stock—the maximum number of shares of stock that can be sold and issued as specified in the charter of the corporation.

(b) Issued capital stock—the total number of shares of capital stock that have been issued by the corporation at a particular date.

(c) Outstanding capital stock—the number of shares currently owned by the stockholders.

4. Common stock—the usual or normal stock of the corporation. It is the voting stock and generally ranks after the preferred stock for dividends and assets distributed upon dissolution. Often it is called the residual equity. Common stock may be either par value or no-par value.

Preferred stock—when one or more additional classes of stock are issued, the additional classes are called preferred stock. Preferred stock has modifications that make it different from common stock. Generally, preferred stock has both favorable and unfavorable features in comparison with common stock. Preferred stock usually is par value stock and usually specifies a dividend rate such as “6% preferred stock.”

5. Par value is a nominal per share amount established for the common stock and/or preferred stock in the charter of the corporation, and is printed on the face of each stock certificate. The stock that is sold by a corporation to investors above par value is said to have sold at a premium, while stock that is sold below par is said to have sold at a discount. The laws of practically all states forbid the initial sale of stock by a corporation to investors below par value. No-par value stock does not have an amount per share specified in the charter. As a consequence, it may be issued at any price without involving a discount or a premium. It avoids giving the impression of a value that is not present.

6. The usual characteristics of preferred stock are: (1) dividend preferences, (2) conversion privileges, (3) asset preferences, and (4) nonvoting specifications.

7. The two basic sources of stockholders’ equity are:

Contributed capital—the amount invested by stockholders by purchase from the corporation of shares of stock. It is comprised of two separate elements: (1) the par or stated amount derived from the sale of capital stock (common or preferred) and (2) the amount received in excess of par or stated value.

Retained earnings—the accumulated amount of all net income since the organization of the corporation, less losses and less the accumulated amount of dividends paid by the corporation since organization.

8. Stockholders’ equity is accounted for in terms of source. This means that several accounts are maintained for the various sources of stockholders’ equity, such as common stock, preferred stock, contributed capital in excess of par, and retained earnings.

9. Treasury stock is a corporation’s own capital stock that was sold (issued) and subsequently reacquired by the corporation. Corporations frequently purchase shares of their own capital stock for sound business reasons, such as to obtain shares needed for employees’ bonus plans, to influence the market price of the stock, to increase earnings per share amounts, and to have shares on hand for use in the acquisition of other companies. Treasury stock, while held by the issuing corporation, confers no voting, dividend, or other stockholder rights.

10. Treasury stock is reported on the balance sheet under stockholders’ equity as a deduction; that is, as contra stockholders’ equity. Any “gain or loss” on treasury stock that has been sold is reported on the financial statements as an addition to contributed capital if a gain; if a loss, it is deducted from any previous contributed capital, or otherwise from retained earnings.

11. The two basic requirements to support a cash dividend are: (1) cash on hand or the ability to obtain cash sufficient to pay the dividend and (2) a sufficient balance in retained earnings, because the dividend represents a return of earnings to the stockholders. A cash dividend reduces both the assets of a corporation and stockholders’ equity by the amount of the dividend.

12. Cumulative preferred stock has a dividend preference such that, should the dividends on the preferred stock for any year, or series of years, not be paid, dividends cannot be paid to the common stockholders until all such dividends in arrears are paid to the preferred stockholders. Noncumulative preferred stock does not have this preference; therefore, dividends not paid in past periods will never be paid to the preferred stockholders.

13. A stock dividend involves the issuance to the stockholders of a dividend in the corporation’s own stock (rather than cash). A stock dividend is significantly different from a cash dividend in that the corporation does not disburse any assets, while in the case of a cash dividend, cash is decreased by the amount of the dividend. A cash dividend also reduces total stockholders’ equity by the amount of the dividend. In contrast, a stock dividend does not change total stockholders’ equity.

14. The primary purposes for issuing a stock dividend are: (1) to maintain dividend consistency; that is, to pay dividends each year either in cash or in capital stock, and (2) to capitalize retained earnings; that is, a stock dividend requires a transfer from the Retained Earnings account to the permanent contributed capital accounts for the amount of the dividend. Although this transfer does not change stockholders’ equity in total, it does cause a shift from retained earnings to contributed capital.

15. When a dividend is declared and paid, the three important dates are:

Declaration date—the date on which the board of directors votes the dividend. In the case of a cash dividend, a dividend liability comes into existence on this date and must be recorded as a debit to Retained Earnings and as a credit to Dividends Payable.

Date of record—this date usually is about one month after the date of declaration. It is the date on which the corporation extracts from its stockholders’ records the list of individuals owning shares. The dividend is paid only to those names listed on the record date. No entry in the accounts is made on this date.

Date of payment—the date on which the cash is disbursed to pay the dividend. It follows the date of record as specified in the dividend announcement. The entry to record the cash disbursement for the dividend is a debit to Dividends Payable and a credit to Cash.

16. Retained earnings is the accumulated amount of all net income of the corporation less all losses and less the accumulated amount of all dividends declared to date. The primary components of retained earnings are: beginning balance, plus net income, less net losses, minus dividends declared, equals the ending balance.

ANSWERS TO MULTIPLE CHOICE

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1. c) | 1. d) | 1. b) | 1. a) | 1. c) |
| 1. b) | 1. c) | 1. c) | 1. d) | 1. a) |

Authors’ Recommended Solution Time

(Time in minutes)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Mini exercises | | Exercises | | Problems | | Alternate  Problems | | Cases and  Projects | |
| No. | Time | No. | Time | No. | Time | No. | Time | No. | Time |
| 1 | 5 | 1 | 15 | 1 | 45 | 1 | 45 | 1 | 30 |
| 2 | 5 | 2 | 15 | 2 | 45 | 2 | 30 | 2 | 30 |
| 3 | 5 | 3 | 30 | 3 | 45 | 3 | 30 | 3 | 20 |
| 4 | 5 | 4 | 30 | 4 | 60 | 4 | 35 | 4 | 20 |
| 5 | 5 | 5 | 20 | 5 | 30 |  |  | 5 | 20 |
| 6 | 5 | 6 | 20 | 6 | 30 |  |  | 6 | 30 |
| 7 | 5 | 7 | 45 | 7 | 30 |  |  | 7 | \* |
| 8 | 5 | 8 | 15 | 8 | 45 |  |  |  |  |
| 9 | 5 | 9 | 30 | 9 | 20 |  |  |  |  |
| 10 | 5 | 10 | 15 | 10 | 20 |  |  |  |  |
|  |  | 11 | 20 | 11 | 30 |  |  |  |  |
|  |  | 12 | 20 | 12 | 45 |  |  |  |  |
|  |  | 13 | 20 |  |  |  |  |  |  |
|  |  | 14 | 30 |  |  |  |  |  |  |
|  |  | 15 | 30 |  |  |  |  |  |  |
|  |  | 16 | 30 |  |  |  |  |  |  |
|  |  | 17 | 20 |  |  |  |  |  |  |
|  |  | 18 | 30 |  |  |  |  |  |  |
|  |  | 19  20  21  22  23  24  25 | 20  15  15  20  20  15  15 |  |  |  |  |  |  |

\* Due to the nature of this project, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time to discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

**MINI- EXERCISES**

**M11–1.**

Stockholders may:

1. Vote in the stockholders’ meeting (or by proxy) on major issues concerning management of the corporation.
2. Participate proportionately with other stockholders in the distribution of the corporation’s profits.
3. Share proportionately with other stockholders in the distribution of corporate assets upon liquidation.

Being able to vote is the most important of the rights because this ensures that the owners have an input at the stockholders’ meeting and some control of the management of the corporation, thus enabling them to protect their rights as stockholders.

**M11–2.**

Unissued shares = 90,000 (268,000 – 178,000)

**M11–3.**

|  |  |  |
| --- | --- | --- |
| Cash (170,000 × $21) (+A) | 3,570,000 |  |
| Common Stock (170,000 × $1) (+SE) |  | 170,000 |
| Capital in Excess of Par (+SE) |  | 3,400,000 |

The journal entry would be different if the par value were $2:

|  |  |  |
| --- | --- | --- |
| Cash (170,000 × $21) (+A) | 3,570,000 |  |
| Common Stock (170,000 × $2) (+SE) |  | 340,000 |
| Capital in Excess of Par (+SE) |  | 3,230,000 |

**M11–4.**

Common stock is the basic voting stock issued by a corporation. It ranks after preferred stock for dividends and assets distributed upon liquidation of the corporation. The dividend rate for common stock is determined by the board of directors, and is based on the company’s profitability. The dividend rate for preferred stock is fixed by a contract. Common stock has more potential for growth than preferred stock if the company is profitable. On the other hand, the investor may lose more money with common stock than with preferred stock if the company is not profitable.

Usually, It is advisable to invest in the common stock if you believe the company will be profitable. Common stock will receive a higher return on the $100,000 than preferred stock would.

**M11–5.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Assets | Liabilities | Stockholders’ Equity | Net Income |
| Purchased 20,000 shares of treasury stock | Decrease by $900,000 | No change | Decrease by $900,000 | No change |
| Sold 5,000 shares | Increase by $250,000 | No change | Increase by $250,000 | No change |
| Sold 10,000 shares | Increase by $370,000 | No change | Increase by $370,000 | No change |

**M11–6.**

|  |  |  |
| --- | --- | --- |
| 200,000 X $0.65 | = | $130,000 |

**M11–7.**

April 15:

|  |  |  |
| --- | --- | --- |
| Retained Earnings (-SE) | 65,000 |  |
| Dividends Payable (+L) |  | 65,000 |

June 14:

|  |  |  |
| --- | --- | --- |
| Dividends Payable (-L) | 65,000 |  |
| Cash (-A) |  | 65,000 |

**M11–8.**

|  |  |  |  |
| --- | --- | --- | --- |
| Past Year | 200,000 shares × $2 | = | $400,000 |
| Current Year | 200,000 shares × $2 | = | $400,000 |
| Total to Preferred Stockholders |  |  | $800,000 |

**M11–9.**

|  |  |
| --- | --- |
| Stock Dividend | Stock Split |
| No change in assets | No change in assets |
| No change in liabilities | No change in liabilities |
| Increase in common stock | No change in common stock |
| No change in stockholders’ equity: decrease retained earnings and increase contributed capital by the same amount. | No change in stockholders’ equity |
| Decreases market value | Decrease in market value |

**M11–10.**

|  |  |  |
| --- | --- | --- |
| Retained Earnings (-SE) | 800,000 |  |
| Common Stock (+SE) |  | 800,000 |

**EXERCISES**

**E11–1.**

**Computation of End of Year Balance for Treasury Stock:**

Beginning balance 307,532,841

Net increase 75,874,824

Ending balance 383,407,665

**Computation of Shares Outstanding:**

Issued shares 2,109,316,331

Treasury stock ( 383,407,665)

Shares Outstanding 1,725,908,666

**E11–2.**

Req. 1 The number of authorized shares is specified in the corporate charter: 300,000.

Req. 2 Issued shares are the shares sold to the public: 160,000

Req. 3 Issued shares 160,000

Treasury stock (25,000)

Outstanding shares 135,000

**E11–3.**

Req. 1

|  |  |
| --- | --- |
| Stockholders’ Equity | |
| Contributed capital: |  | |
| Preferred stock, authorized 4,000 shares,  issued and outstanding, 3,000 shares | $ 24,000 | |
| Common stock, authorized 103,000 shares, issued and outstanding, 20,000 shares | 200,000 | |
| Capital in excess of par, preferred | 36,000 | |
| Capital in excess of stated value, no-par common | 120,000 | |
| Total contributed capital | 380,000 | |
| Retained earnings | 60,000 | |
| Total Stockholders’ Equity | $440,000 | |

Req. 2

The answer would depend on the profitability of the company and the stability of its earnings. The preferred stock has a 9% dividend rate. If the company earns more than 9%, the additional earnings would accrue to the current stockholders. If the company earns less than 9%, it would pay a higher rate to the preferred stockholders.

**E11–4.**

Req. 1 ($30 x 90,000 shares) - $1,600,000 = $1,100,000

Req. 2 $900,000 - $1,000,000 + $800,000 = $700,000

Req. 3 90,000 shares – 80,000 shares = 10,000 shares

Req. 4 EPS = $1,000,000 ÷ 80,000 = $12.50

**E11–5.**

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| a. | Cash (5,600 shares x $20) (+A) | 112,000 |  |  | |
|  | Common stock (5,600 shares x $10) (+SE) |  |  | 56,000 | |
|  | Capital in excess of par, common stock (+SE) |  |  | 56,000 | |
|  | Sold common stock at a premium. |  |  |  | |
|  |  | | | |
| b. | Cash (1,000 shares x $25) (+A) | 25,000 |  |  | |
|  | Common stock (1,000 shares x $10) (+SE) |  |  | 10,000 | |
|  | Capital in excess of par, common stock (+SE) |  |  | 15,000 | |
|  | Sold common stock at a premium. |  |  |  | |
|  |  | | | |

Req. 2

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Stockholders’ Equity | |  | | |
| Contributed capital: |  | |  | | |
| Common stock, par $10, authorized 11,500 shares,     outstanding 6,600 shares | $ 66,000 | | |  | | |
| Contributed capital in excess of par | 71,000 | | |  | | |
| Total contributed capital | 137,000 | | |  | | |
| Retained earnings | 12,000 | | |  | | |
| Stockholders’ equity | $149,000 | | |  | | |

**E11–6.**

Req. 1

Common stock, class A at par value: 118,529,925 X $0.01 = $1,185 (thousand)

Req. 2

(Note that this solution is based on the number of Class A common shares that are outstanding. We elect not to include the Class B shares because they are owned by the Dillard family. Usually, students do not question this assumption but when they do, it permits us to discuss reasons for issuing different types of common stock. In this case, owners of Class B shares are permitted to elect two-thirds of the board of directors, effectively letting the founding family maintain control of a public company).

Number of shares outstanding 2012: 118,529,925 shares issued minus 73,099,319 shares held as treasury stock = 45,430,606.

Number of shares outstanding 2011: 117,706,523 shares issued minus 61,740,439 shares held as treasury stock = 55,966,084.

Req. 3

(In thousands) Retained earnings for 2011: $3,107,344 minus net income for 2012 $463,909 plus dividends for 2012 $10,002 = $2,653,437

Req. 4

As of 2012, treasury stock had decreased corporate resources by $1,846,312 (thousand).

Req. 5

Treasury stock transactions decreased stockholders’ equity by $490,786 (thousand) ($1,846,312 - $1,355,526).

Req. 6

For 2012, treasury stock cost per share: $1,846,312 (thousand) ÷ 73,099,319 shares = $25.26.

**E11–7.**

Req. 1

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| a. | Cash (50,000 shares x $50) (+A) | 2,500,000 |  |  | | |
|  | Common stock (50,000 shares x $2) (+SE) |  |  | 100,000 | | |
|  | Capital in excess of par, common stock (+SE) |  |  | 2,400,000 | | |
|  | Sold common stock at a premium. |  |  |  | | |
|  |  | | | |
| b. | Treasury stock (2,000 shares x $52) (+XSE, -SE) | 104,000 |  |  | |
|  | Cash (-A) |  |  | 104,000 | |
|  | Bought treasury stock. |  |  |  | |
|  |  | | | |

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| Stockholders’ Equity | |  | |
| Contributed capital: |  | |  | | |
| Common stock, par $2, authorized 80,000 shares,     issued 50,000 shares | $ 100,000 | | | |  | |
| Contributed capital in excess of par | 2,400,000 | | | |  | |
| Total contributed capital | 2,500,000 | | | |  | |
| Treasury stock | (104,000 | | | | ) | |
| Stockholders’ equity | $2,396,000 | | | |  | |

**E11–8.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Shareholders’ equity (deficit) in thousands: |  |  | 2010 |  |  |  | 2011 |  |
| Common stock, par value $.01 per share; 100,000,000 shares authorized, 33,981,509 shares issued and outstanding at December 31, 2010, 34,150,389 shares issued and outstanding at December 31, 2011 |  |  | 340 |  |  |  | 342 |  |
| Additional paid-in capital |  |  | 198,304 |  |  |  | 200,524 |  |
| Accumulated deficit |  |  | (118,282 | ) |  |  | (98,733 | ) |
|  |  |  |  |  |  |  |  |  |
| Total shareholders’ equity |  |  | 80,362 |  |  |  | 102,133 |  |

**E11–9.**

|  |  |
| --- | --- |
| Stockholders’ Equity | |
| Contributed capital: |  | |
| Preferred stock, 8%, par $50, authorized 59,000 shares,    issued and outstanding, 20,000 shares | $1,000,000 | | |
| Common stock, par $10, authorized 98,000 shares,     issued, 78,000 shares | 780,000 | | |
| Capital in excess of par, preferred stock | 600,000 | | |
| Capital in excess of par, common stock | 780,000 | | |
| Treasury stock | (80,000) | | |
| Retained earnings\* | 160,000 | | |
| Total stockholders’ equity | $3,240,000 | | |

\*($210,000 – $50,000 = $160,000.)

**E11–10.**

Req. 1

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| a. | Cash (20,000 shares x $20) (+A) | 400,000 |  |  |
|  | Common stock, no-par (+SE) |  |  | 400,000 |
|  | . |  |  |  |
| b. | Cash (6,000 shares x $40) (+A) | 240,000 |  |  |
|  | Common stock, no-par (+SE) |  |  | 240,000 |
|  |  | |  |  |
| c. | Cash (7,000 shares x $30) (+A) | 210,000 |  |  |
|  | Preferred stock (7,000 shares x $10) (+SE) |  |  | 70,000 |
|  | Capital in excess of par, preferred (+SE) |  |  | 140,000 |
|  |  |  |  |  |

Req. 2

Yes, it is ethical as long as there is a full disclosure of relevant information. In any arm’s length transaction, an informed buyer will pay the market value of the stock.

**E11–11.**

Req. 1

Number of preferred shares issued: $100,000 ÷ $10 = 10,000

Req. 2

Number of preferred shares outstanding: 10,000 shares issued minus 500 shares held as treasury stock = 9,500.

Req. 3

Average sales price per share of preferred stock when issued: ($100,000 + $15,000) ÷ 10,000 shares = $11.50.

Req. 4

Decreased corporate resources by $9,500 - $1,500 = $8,000.

Req. 5

Treasury stock transactions decreased stockholders’ equity by $8,000 (same as the decrease in corporate resources in *4* above).

Req. 6

Treasury stock cost per share: $9,500 ÷ 500 shares = $19.00.

Req. 7

Total stockholders’ equity: $741,000.

Req. 8

Issue price of common stock $600,000 ÷ 8,000 shares = $75.00.

**E11–12.**

Req. 1

The number of shares that have been issued is computed by dividing the common stock account ($4,008 million) by the par value of the shares ($1 per share) or approximately 4,008,000,000 shares.

Req. 2

|  |  |  |
| --- | --- | --- |
| Retained earnings end of 2011 | $70,682,000,000 |  |
| Net income for 2012 | 10,756,000,000 |  |
| Dividends for 2012 | (5,811,600,000 | ) |
| Retained earnings end of 2012 | $75,626,400,000 |  |

The amount of retained earnings is an estimate because we do not know the exact number of shares outstanding (because we do not know the number of shares in treasury stock). This number is needed to determine the amount of dividends paid during 2012. We based the dividends on the estimate calculated in the previous requirement.

**E11–13.**

Req. 1

|  |  |
| --- | --- |
| Assets | - $133,750,000 |
| Stockholders’ Equity | - $133,750,000 |

The treasury stock account is a contra equity account, meaning that it subtracts from the total stockholders’ equity. Cash also decreases on the balance sheet by the same amount.

Req. 2

Many companies repurchase common stock in order to develop an employee bonus plan that provides workers with shares of the company’s stock as part of their compensation. Because of SEC regulations concerning newly issued shares, companies find it cheaper to give their employees shares of stock that were purchased from stockholders than to issue new shares. In this case, the company mentions the goal of enhancing shareholders’ value. If the company maintains its current level of income, earnings per share will increase with fewer shares outstanding. The management expects that the increase in EPS will be reflected in an increase in stock price.

Req. 3

Shares that are held in treasury stock do not participate in dividend payments. As a result, the purchase of treasury stock will reduce the amount of dividends that the company must pay in future years.

**E11–14.**

Req. 1

|  |  |
| --- | --- |
| Stockholders’ Equity | |
| Contributed capital: |  |
| Common stock, authorized 100,000 shares, issued 34,000 shares, of which 2,000 shares are held as treasury stock | $680,000 |
| Capital in excess of par | 163,000 |
| Total contributed capital | 843,000 |
| Retained earnings | 89,000 |
| Total | 932,000 |
| Less: Cost of treasury stock | 25,000 |
| Total Stockholders’ Equity | $907,000 |

Req. 2

The dividend yield ratio is 2.24% ([$16,000 ÷ 32,000 shares] ÷ $22.29). While this yield seems small, it is a typical return on common stock. Investors receive a return from both dividends and stock price appreciation.

Treasury stock does not receive dividends. As a result, dividends should be paid on 32,000 shares.

**E11–15.**

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| a. | Treasury stock (200 shares x $20) (+XSE, -SE) | 4,000 |  |  | |
|  | Cash (-A) |  |  | 4,000 | |
|  | Bought treasury stock. |  |  |  | |
|  |  | | | |
| b. | Cash (40 shares x $25) (+A) | 1,000 |  |  | |
|  | Treasury stock (40 shares x $20) (-XSE, +SE) |  |  | 800 | |
|  | Capital in excess of par (+SE) |  |  | 200 | |
|  | Sold treasury stock. |  |  |  | |
|  |  | | | |
| c. | Cash (30 shares x $15) (+A) | 450 |  |  | |
|  | Capital in excess of par (-SE) | 150 |  |  | |
|  | Treasury stock (30 shares x $20) (-XSE, +SE) |  |  | 600 | |
|  | Sold treasury stock. |  |  |  | |

Req. 2

It is not possible to make a “profit” or “loss” on treasury stock transactions. Therefore, these transactions do not affect the income statement.

**E11–16.**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| Feb. 1: |  |  |  |
| Treasury stock, common (160 shares x $20) (+XSE, -SE) | 3,200 |  |  |
| Cash (-A) |  |  | 3,200 |
|  |  |  |  |
| July 15: |  |  |  |
| Cash (80 shares x $21) (+A) | 1,680 |  |  |
| Treasury stock, common (-XSE, +SE) |  |  | 1,600 |
| Capital in excess of par (+SE) |  |  | 80 |
|  |  |  |  |
| Sept. 1: |  |  |  |
| Cash (50 shares x $19) (+A) | 950 |  |  |
| Capital in excess of par (-SE) | 50 |  |  |
| Treasury stock, common (50 shares x $20) (-XSE, +SE) |  |  | 1,000 |
| . |  |  |  |

Req. 2

Dividends are not paid on treasury stock. Therefore, the amount of total cash dividends paid is reduced when treasury stock is purchased.

Req. 3

The sale of treasury stock for more or less than its original purchase price does not have an impact on net income. The transaction affects only balance sheet accounts. The cash received from the sale of treasury stock is a cash inflow which would affect the Statement of Cash Flows in the financing activities section.

**E11–17.**

Req. 1

Case 1: When companies unexpectedly announce increases in dividends, stock prices typically increase. Depending on course objective, the instructor may want to discuss research in finance concerning dividend policy.

Case 2: Stock price is based on expectations. If the increase in operating performance was not expected, the stock price should increase. It is not necessary to increase dividends to have a favorable stock price reaction.

Case 3: Stock dividends do not provide any economic value but they may have a signal effect and are often associated with increases in cash dividends. As a result, stock dividends do not appear to directly cause an increase in stock price but are often associated with factors that do impact favorably on price.

Req. 2

Stock prices react to underlying economic events and not changes in reporting methods, per se. Markets are relatively effective in recognizing the difference between profits generated by operations and profits generated by the use of liberal accounting policies.

**E11–18.**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Req. 1 | | Preferred (5,000 Shares) | | |  | Common (50,000 Shares) | | |  | Total |
| a) | Noncumulative: |  |  |  |  |  |  |  |  |  |
|  | Preferred ($50,000 x 10%) |  | $ 5,000 |  |  |  |  |  |  | $ 5,000 |
|  | Balance to common ($85,000 – $5,000) |  |  |  |  |  | $80,000 |  |  | 80,000 |
|  |  |  | $ 5,000 |  |  |  | $80,000 |  |  | $85,000 |
|  | Per share |  | $1.00 |  |  |  | $1.60 |  |  |  |
| b) | Cumulative: |  |  |  |  |  |  |  |  |  |
|  | Preferred, arrears ($50,000 x 10% x 2 years) |  | $ 10,000 |  |  |  |  |  |  | $ 10,000 |
|  | Preferred, current year ($50,000 x 10%) |  | 5,000 |  |  |  |  |  |  | 5,000 |
|  | Balance to common ($85,000 – $10,000 – $5,000) |  |  |  |  |  | $70,000 |  |  | 70,000 |
|  |  |  | $15,000 |  |  |  | $70,000 |  |  | $85,000 |
|  | Per share |  | $3.00 |  |  |  | $1.40 |  |  |  |

Req. 2

The total dividend amount and dividends per share of common stock were less under the second assumption because the preferred stock preferences increased while at the same time the total dividend amount remained stable.

Req. 3

Larger total dividend distributions are more favorable for the common stockholders.

**E11–19.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Item |  | Effect of Cash Dividend (Preferred) |  | Effect of Stock Dividend (Common) |
| Assets |  | –No effect on declaration date.  –Decreased by the amount of the dividend ($7,200) on payment date. |  | No effect because no assets are disbursed. |
| Liabilities |  | –Increased on declaration date ($7,200).  –Decreased on payment date ($7,200). |  | No effect—no entry on declaration date because no contractual liability is created (no assets are disbursed). |
| Stockholders’ equity |  | Decreased by the amount of the dividend (retained earnings decreased by $7,200). |  | –Total stockholders’ equity not changed.  –Retained earnings reduced and contributed capital increased by same amount ($120,000). |

**E11–20.**

July 15

|  |  |  |  |
| --- | --- | --- | --- |
| Retained earnings (-SE) | 119,900,000 |  |  |
| Cash (-A) |  |  | 119,900,000 |
| Declaration and payment of preferred dividends. |  |  |  |
| Retained earnings (-SE) | 691,688,600 |  |  |
| Cash (-A) |  |  | 691,688,600 |
| Declaration and payment of common dividends. |  |  |  |

Computation of shares outstanding:

|  |  |
| --- | --- |
| Shares issued | 387,514,300 |
| Treasury stock | 41,670,000 |
| Shares outstanding | 345,844,300 |

Dividends paid:

345,844,300 x $2 = $691,688,600

**E11–21.**

Req. 1

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | Stockholders’ Equity | | | | | |
|  |  | Before Stock Dividend | |  |  | After Stock Dividend | |
| Contributed capital: |  |  |  |  |  |  |  |
| Common stock, authorized 65,000 shares |  |  |  |  |  |  |  |
| Outstanding: 30,000 shares, par $12 |  | $360,000 |  |  |  |  |  |
| Outstanding: 48,000 shares, par $12 |  |  |  |  |  | $576,000 |  |
| Capital in excess of par value |  | 120,000 |  |  |  | 120,000 |  |
| Retained earnings |  | 580,000 |  |  |  | 364,000 |  |
| Total stockholders’ equity |  | $1,060,000 |  |  |  | $1,060,000 |  |

Req. 2

|  |  |  |
| --- | --- | --- |
| **Item** |  | **Effects of Stock Dividend** |
| Assets |  | No change because no assets were disbursed. |
| Liabilities |  | No change because no liability was created (no assets were to be disbursed). |
| Stockholders’ equity |  | –Total stockholders’ equity not changed.  –Retained earnings was reduced by the amount of the dividend.  –The common stock account was increased by the same amount. |

**E11–22.**

April 13, 2012

|  |  |  |  |
| --- | --- | --- | --- |
| Retained earnings (-SE) | 1,686,000,000 |  |  |
| Dividends payable (+L) |  |  | 1,686,000,000 |

3,000 (million) shares x $0.562= $1,686,000,000

April 27, 2012

No journal entry required.

May 15, 2012

|  |  |  |  |
| --- | --- | --- | --- |
| Dividends payable (-L) | 1,686,000,000 |  |  |
| Cash (-A) |  |  | 1,686,000,000 |

**E11–23.**

Comparative results:

|  |  |  |  |
| --- | --- | --- | --- |
| Items | Before Dividend and Split | After Stock Dividend | After Stock Split |
| Common stock account | $600,000 | $900,000 | $600,000 |
| Par per share | $1 | $1 | $0.83 |
| Shares outstanding | 600,000 | 900,000 | 720,000 |
| Capital in excess of par | $ 900,000 | $900,000 | $ 900,000 |
| Retained earnings | $ 700,000 | $ 400,000 | $ 700,000 |
| Total stockholders’ equity | $2,200,000 | $2,200,000 | $2,200,000 |

Comments: Neither the stock dividend nor stock split changed total stockholders’ equity because neither involved the disbursement of assets. The stock dividend capitalized retained earnings and increased the common stock account by the same amount; it increased shares outstanding but did not change par value per share. The stock split did not change any account balances; its only effects were to (1) increase shares outstanding and (2) decrease par value per share.

**E11–24.**

Comparative results:

|  |  |  |  |
| --- | --- | --- | --- |
| Items | Before Dividend and Split | After Stock Dividend | After Stock Split |
| Common stock account | $640,000 | $896,000 | $640,000 |
| Par per share | $8 | $8 | $ 4.80 |
| Shares outstanding | 80,000 | 112,000 | 133,333 |
| Capital in excess of par | $ 280,000 | $ 280,000 | $ 280,000 |
| Retained earnings | $ 2,100,000 | $ 1,844,000 | $ 2,100,000 |
| Total stockholders’ equity | $3,020,000 | $3,020,000 | $3,020,000 |

Comments: Neither the stock dividend nor stock split changed total stockholders’ equity because neither involved the disbursement of assets. The stock dividend reduced retained earnings and increased the common stock account by the same amount; it increased shares outstanding but did not change par value per share. The stock split did not change any account balances; its only effects were to (1) increase shares outstanding and (2) decrease par value per share.

**E11–25.**

Req. 1

A corporation does not need to earn net income in a given year in order to declare and pay dividends. There are two requirements 1) the balance of retained earnings should be sufficient to pay dividends, and 2) there must be sufficient cash on hand.

Req. 2

Clearly the board determined that the balances in retained earnings and cash were sufficient to pay dividends. The board probably analyzed cash flow for the current year and the future to determine whether the payment of dividends would create any problems in subsequent years. The board also probably took into consideration the impact of skipping a dividend. If the company did not pay a dividend, many investors might assume that the board concluded that the company might lose money for several years. This lack of confidence could have a significant impact on the price of the company’s stock. By paying a dividend, the company sent a signal to the market that the board had confidence in the long-term health of the company.

**PROBLEMS**

**P11–1.**

|  |  |  |
| --- | --- | --- |
| 1. | Shares authorized (given) | 200,000 |
|  | Shares issued ($2,125,000 ÷ $17) | 125,000 |
|  | Shares outstanding (125,000 – 3,000) | 122,000 |

2. Capital in excess of par: $2,125,000 – (125,000 shares issued x $10 par) = $875,000.

3. Earnings per share: $240,340 ÷ 122,000 shares = $1.97

1. Dividend per share: $123,220 ÷ 122,000 shares = $1.01.

5. Treasury stock: Stockholders’ equity, as a deduction in the amount of 3,000 shares x $20 cost = $60,000.

6. Stock split, 100%: Par value per share after the split, $10 ÷ 2 = $5. Outstanding shares before split (per 1 above), 122,000 x 2 = 244,000 shares outstanding after the split.

7. Entry for the stock split—None, because the total par value amount before and after the split is the same; retained earnings are not capitalized in a stock split.

8. Entry for stock dividend (capitalize retained earnings for market value of $21 per share):

|  |  |  |  |
| --- | --- | --- | --- |
| Retained earnings (122,000 shares x 10% x $21) (-SE) | 256,200 |  |  |
| Common stock (122,000 shares x 10% x $10) (+SE) |  |  | 122,000 |
| Capital in excess of par  (122,000 shares x 10%) x ($21 – $10)(+SE) |  |  | 134,200 |

**P11–2.**

|  |  |
| --- | --- |
| Stockholders’ Equity | |
| Contributed capital: |  | |
| Preferred stock authorized 21,000 shares; issued and outstanding, 6,500 shares | $ 65,000 | |
| Common stock authorized 50,000 shares; issued and outstanding, 43,000 shares | 344,000 | |
| Capital in excess of par, preferred | 49,000 | |
| Capital in excess of par, common | 181,000 | |
| Total contributed capital | 639,000 | |
| Retained earnings | 96,000 | |
| Total stockholders’ equity | $735,000 | |

**P11–3.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| (a) | Cash (66,000 shares x $9)(+A) | 594,000 |  |  | |
|  | Common stock (66,000 shares x $5) (+SE) |  |  | 330,000 | |
|  | Contributed capital in excess of par, common (66,000 x $4) (+SE) |  |  | 264,000 | |
|  | . | | | |
| (b) | Cash (9,000 shares x $20) (+A) | 180,000 |  |  | |
|  | Preferred stock (9,000 shares x $10) (+SE) |  |  | 90,000 | |
|  | Contributed capital in excess of par, preferred (+SE) |  |  | 90,000 | |
|  | . | | | |
| (c) | Cash (1,000 shares x $20) + (2,500 shares x $10) (+A) | 45,000 |  |  | |
|  | Preferred stock (1,000 shares x $10) (+SE) |  |  | 10,000 | |
|  | Common stock (2,500 shares x $5) (+SE) |  |  | 12,500 | |
|  | Contributed capital in excess of par, preferred (+SE) |  |  | 10,000 | |
|  | Contributed capital in excess of par, common (+SE) |  |  | 12,500 | |
|  |  | | | |
|  |  |  |  |  | |

**P11–4.**

Req. 1 (in millions)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | | | | |
| (a) | Cash (+A) | 136.5 |  |  |
|  | Common stock (+SE) |  |  | 136.5 |
|  | . |  |  |  |

.

Req. 2 (in millions)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | | | | |
| (a) | Cash (+A) | 136.5 |  |  |
|  | Common stock (+SE) |  |  | 4.2 |
|  | Capital in excess of par (+SE)………………………………. |  |  | 132.3 |

Req. 3

In most cases, stockholders should not care whether stock is issued as par or no-par value stock. The various types of stock do not offer any real economic advantages to investors.

**P11–5.**

|  |
| --- |
| Stockholders’ Equity |
| Contributed capital: |  |
| Common stock, par $1, authorized 200,000 shares; issued 100,000 shares, of which 15,000 shares are held as treasury stock | $ 100,000 |
| Capital in excess of par | 1,115,000 |
| Total contributed capital | 1,215,000 |
| Retained earnings | 590,000 |
| Less: Treasury stock held (15,000 shares x $15) | (225,000) |
| Total stockholders’ equity | $1,580,000 |

**P11–6.**

Req. 1

A stock dividend is a dividend paid in additional stock of the issuing company while a cash dividend is paid in cash.

Req. 2

Stock dividends are classified as either large or small. A *large* stock dividend involves the distribution of additional shares that are more than 20–25% of the currently outstanding shares. A *small* stock dividend involves additional shares that are less than 20–25% of the outstanding shares.

Req. 3

The sale of treasury stock for more than cost has no impact on the reported income for a company. The sale does affect the Statement of Cash Flows because it is an inflow of cash from financing activities.

Req. 4

There are a number of strategic reasons why a corporation may want to purchase its own stock from existing stockholders. A common reason is the existence of an employee bonus plan that provides workers with shares of the company’s stock as part of their compensation. Because of Securities and Exchange Commission regulations concerning newly issued shares, most companies find that it is less costly to give their employees shares of stock that were purchased from stockholders than to issue new shares.

**P11–7.**

Req. 1

|  |  |  |
| --- | --- | --- |
| Treasury Stock (+XSE, -SE) | 113.3 |  |
| Cash (-A) |  | 113.3 |

Req. 2

|  |  |  |
| --- | --- | --- |
| Cash (+A) | 10.0 |  |
| Treasury Stock (-XSE, +SE) |  | 9.0 |
| Capital in Excess of Par (+SE) |  | 1.0 |

**P11–8.**

Req. 1

Case A—Preferred is noncumulative (total amount to distribute, $31,000):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Preferred (8,000 shares) | | |  | Common (35,000 shares) | | | Total |
| Preferred ($120,000 x 10%) |  | $ 12,000 |  |  |  |  |  | $ 12,000 |
| Balance to common ($31,000 – $12,000) |  |  |  |  |  | $19,000 |  | 19,000 |
|  |  | $ 12,000 |  |  |  | $19,000 |  | $31,000 |
| Per share |  | $1.50 |  |  |  | $0.54 |  |  |

Case B—Preferred is cumulative (total amount to distribute, $35,000):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Preferred: |  |  |  |  |  |  |  |  |
| Arrears ($120,000 x 10% x 2 years) |  | $ 24,000 |  |  |  |  |  | $ 24,000 |
| Current year ($120,000 x 10%) |  | 11,000 |  |  |  | –0– |  | 11,000 |
|  |  | $35,000 |  |  |  | –0– |  | $35,000 |
| Per share |  | $4.375 |  |  |  | $ –0– |  |  |

Case C—Preferred is cumulative (total amount to distribute, $90,000):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Preferred: |  |  |  |  |  |  |  |  |
| Arrears ($120,000 x 10% x 2 years) |  | $ 24,000 |  |  |  |  |  | $ 24,000 |
| Current year ($120,000 x 10%) |  | 12,000 |  |  |  |  |  | 12,000 |
| Balance to common ($90,000 – $36,000) |  |  |  |  |  | $54,000 |  | 54,000 |
|  |  | $36,000 |  |  |  | $54,000 |  | $90,000 |
| Per share |  | $4.50 |  |  |  | $1.54 |  |  |

**P11–8. (continued)**

Req. 2

|  |  |  |
| --- | --- | --- |
| Schedule of Comparative Differences (with comments) | | |
| Item | Amount of Dollar Increase (Decrease) | |
|  | Cash Dividend – Case C | Stock Dividend |
| Assets | $90,000 decrease to cash | No assets were disbursed. |
| Liabilities | Current liabilities increased $90,000 on declaration date and decreased $90,000 on payment date. The net effect is zero. | No effect – no contractual liability was created. |
| Stockholders’ equity | $90,000 decrease (debit to retained earnings). | No effect on total stockholders’ equity. Decreased retained earnings and increased common stock by same amount ($84,000). |

Summary comment:

(1) A cash dividend decreases assets and stockholders’ equity by the amount of the dividend because resources were disbursed.

(2) A stock dividend does not change total assets or total stockholders’ equity because no resources are disbursed; only the internal content of stockholders’ equity is changed.

**P11–9.**

Req. 1

Heather feels some concern about whether Scott is looking in the right place on the Statement of Cash Flows (SCF) for dividends. She shouldn’t be concerned; dividends paid are reported in the financing activities section of the SCF.

While cash flows from operating activities have declined for the current year, the reduction has to do with the fact that cash flows were positively affected in the previous year by the one-time $2 billion reduction in inventory and accounts receivable. Heather is wrong when she implies that the company’s cash flows will not support the payment of dividends.

Req. 2

Dell has a very aggressive program to repurchase stock from investors. Some companies elect to pay out extra cash in dividends while others use the cash to repurchase their stock. Because fewer shares are outstanding, reported earnings per share will be higher which may be reflected in a higher stock price.

**P11–10.**

|  |  |  |
| --- | --- | --- |
| Item | Comparative Effects Explained | |
|  | Cash Dividend on Preferred | Stock Dividend on Common |
| a) Through December 31, 2014: | |  |
| Assets | None—No cash yet disbursed. | None—No entry (no assets to be disbursed). |
| Liabilities | Increased current liabilities by the amount of the dividend | None—No entry made on declaration date. |
| Stockholders’ equity | Decreased by the amount of the dividend. | None—No entry. |
| b) On February 15, 2015: | |  |
| Assets | Decreased by the amount of the dividend (credit cash $40,000). | None—No assets are disbursed. |
| Liabilities | Decreased by the amount of the dividend (debit dividends payable $40,000). | None—No liability was created. |
| Stockholders’ equity | No change since Dec. 31. The effect was recorded in the previous year. | (1) Total stockholders’ equity not changed.  (2) Retained earnings reduced by the amount of the dividend (i.e., par value of the stock issued, $156,000).  (3) Common stock is increased by the amount of the dividend. |
| c) Overall Effects From December 1 through February 15: | | |
| Assets | Decreased $40,000. | No effect. |
| Liabilities | No effect. | No effect. |
| Stockholders’ equity | Decreased $40,000. | No effect on total. |

**P11–11**.

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| March 9 | |  |  |  | |
| No journal entry is required for the declaration of a stock dividend. | | | | |
| May 21 |  | |  | | |
| No journal entry is required. |  | |  | | |
| June 18 (millions) |  | |  | | |
| Retained earnings\* (-SE) | 12,500 | |  | | |
| Common stock (+SE) |  | | 250 | | |
| Capital in excess of par (+SE) |  | | 12,250 | | |

\* 2,500 million shares x 10% x $50 = $12,500 million.

Req. 2

This simple question can give the instructor an excellent opportunity to discuss the relevancy of dividend policy. There is a strong theoretical argument to be made that dividend policy is irrelevant. There are several real world factors that make the question more difficult to answer (e.g., the impact of taxes, information content of dividends, and the clientele effect). The level of the discussion of this issue will depend on the amount of finance that has been introduced during the instructor’s lectures.

Req. 3

The board must consider the impact of the stock dividend and the increase in cash dividends on the price of the stock. They made the decision with the expectation that it would have a favorable impact on the long-term value of the stock.

**P11–12.**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| **Case A: Sole Proprietorship, closing entries:** |  |  |  |
| A, Capital | 20,000 |  |  |
| Individual revenue and expense accounts |  |  | 20,000 |
| A, Capital | 9,000 |  |  |
| A, Drawings |  |  | 9,000 |
| **Case B: Partnership, closing entries:** |  |  |  |
| A, Capital | 10,000 |  |  |
| B, Capital | 10,000 |  |  |
| Individual revenue and expense accounts |  |  | 20,000 |
| A, Capital | 5,000 |  |  |
| B, Capital | 7,000 |  |  |
| A, Drawings |  |  | 5,000 |
| B, Drawings |  |  | 7,000 |
| **Case C: Corporation, closing entry**: |  |  |  |
| Retained earnings | 20,000 |  |  |
| Individual revenue and expense accounts |  |  | 20,000 |

**P11–12. (continued)**

Req. 2

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Case A: Sole Proprietorship** | | | | | | | | | | | |
| Statement of Owner’s Equity | | | | | | | | | | | |
| A, Capital, January 1 | | | $52,000 | |  | |  | | | | |
| Less: Net loss | | | 20,000 | |  | |  | | | | |
| Total | | | 32,000 | |  | |  | | | | |
| Less: Withdrawals | | | 9,000 | |  | |  | | | | |
| A, Capital, December 31 | | |  | |  | | $23,000 | | | | |
| **Case B: Partnership** | | |  | |  | |  | | | | |
| Partners’ Equity | | | | | | | | | | | |
| A, Capital | | | $28,000 | |  | |  | | | | |
| B, Capital | | | 26,000 | |  | |  | | | | |
| Total Partners’ Equity | | |  | |  | | $54,000 | | | | |
| Statement of Partners’ Equity | | | | | | | | | | |
|  | A |  | | B |  | | Total | | | |
| Partners’ equity, January 1 | $43,000 |  | | $43,000 |  | | $86,000 | | | |
| Deduct: Net loss | 10,000 |  | | 10,000 |  | | 20,000 | | | |
| Total | 33,000 |  | | 33,000 |  | | 66,000 | | | |
| Deduct: Withdrawals | 5,000 |  | | 7,000 |  | | 12,000 | | | |
| Partners’ Equity, December 31 | $28,000 |  | | $26,000 |  | | $54,000 | | | |
| **Case C: Corporation** | | | | | | | | | | | |
| Stockholders’ Equity | | | | | | | | | | | |
| Contributed capital: | | |  | | |  | | |  | | | | |
| Common stock, par $10, authorized 30,000 shares, outstanding 14,000 shares | | | $140,000 | | |  | | |  | | | | |
| Capital in excess of par | | | 9,000 | | |  | | |  | | | | |
| Total contributed capital | | | 149,000 | | |  | | |  | | | | |
| Retained earnings | | | 42,000 | | |  | | |  | | | | |
| Total Stockholders’ Equity | | |  | | |  | | | $191,000 | | | | |
| Statement of Retained Earnings | | | | | | | | | |
| Retained earnings, balance Jan. 1 | | | | | | | | $62,000 | | | | |
| Less: Net loss | | | | | | | | 20,000 | | | | |
| Retained earnings, balance Dec. 31 | | | | | | | | $42,000 | | | | |

**ALTERNATE PROBLEMS**

**AP11–1.**

Req. 1

|  |  |  |
| --- | --- | --- |
| Common Stock $1,500,000 / $1 | = | 1,500,000 shares |

|  |  |
| --- | --- |
| Issued Shares | 1,500,000 |
| Treasury Stock | (100,000) |
| Shares Outstanding | 1,400,000 |

Req. 2

The balance in the Capital in Excess of Par Account appears to be $118,500,000. [($80-$1) x 1,500,000 shares]

Req. 3

EPS on net income is $3.43 (rounded)

$4,800,000 / 1,400,000 shares = $3.43

Req. 4

Total dividends paid on common stock during the year is $2,800,000.

1,400,000 shares × $2.00 per share = $2,800,000

Req. 5

Treasury stock should be reported on the balance sheet under the major caption Stockholders’ Equity, as a deduction in the amount of $6,000,000.

100,000 shares × $60 per share = $6,000,000

**AP11–2.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| (a) | Cash (30,000 shares x $40) + (5,000 shares x $26) (+A) | 1,330,000 | |  | |  | | |
|  | Common stock, (30,000 shares x $40) (+SE) |  | |  | | 1,200,000 | | |
|  | Preferred stock (5,000 shares x $5) (+SE) |  | |  | | 25,000 | | |
|  | Capital in excess of par, preferred (5,000 shares x $21) (+SE) |  | |  | | 105,000 | | |
|  | Sold stock. |  | |  | |  | | |
|  |  |  | |  | |  | | |
| (b) | Cash (2,000 shares x $32) (+A) | 64,000 | |  | |  | | |
|  | Preferred stock (2,000 shares x $5) (+SE) |  | |  | | 10,000 | | |
|  | Contributed capital in excess of par, preferred  ($64,000 - $10,000) (+SE) |  | |  | | 54,000 | | |
|  | Sold preferred stock. | | | | | |
| (c) | Treasury stock, common (3,000 shares x $38) (+XSE, -SE) | 114,000 |  | |  | | |
|  | Cash (-A) |  |  | | 114,000 | | |
|  | Purchased treasury stock, common, at $38 per share. |  |  | |  | | |
|  |  |  |  | |  | | |
|  |  |  |  | |  | | |

**AP11–3.**

|  |
| --- |
| Stockholders’ Equity |
| Contributed capital: |  |
| Common stock, par $5, authorized 1,000,000 shares; issued 700,000 shares, of which 25,000 shares are held as treasury stock | $ 3,500,000 |
| Capital in excess of par, common | 34,300,000 |
| Total contributed capital | 37,800,000 |
| Retained earnings | 429,000 |
| Total | 38,229,000 |
| Less: Treasury stock held (25,000 shares x $50) | (1,250,000) |
| Total stockholders’ equity | $36,979,000 |

**AP11–4.**

Req. 1

Case A—Preferred is noncumulative (total amount to distribute, $25,000):

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Preferred (21,000 shares) | | | Common (500,000 shares) | | Total |
| Preferred ($210,000 x 8%) |  | $16,800 |  |  |  | $16,800 |
| Balance to common ($25,000 – $16,800) |  |  |  | $8,200 |  | 8,200 |
|  |  | $16,800 |  | $8,200 |  | $25,000 |
| Per share |  | $.80 |  | $.016 |  |  |

Case B—Preferred is cumulative (total amount to distribute, $25,000):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Preferred: |  |  |  |  |  |  |  |
| Arrears ($210,000 x 8% x 2 years = $33,600) |  | $25,000 |  |  |  |  | $25,000 |
| Current year ($210,000 x 8%) |  |  |  |  |  |  |  |
|  |  | $25,000 |  |  | –0– |  | $25,000 |
| Per share |  | $1.19 |  |  | $ –0– |  |  |

Case C—Preferred is cumulative (total amount to distribute, $75,000):

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Preferred: |  |  |  |  |  |  |
| Arrears ($210,000 x 8% x 2 years) |  | $33,600 |  |  |  | $33,600 |
| Current year ($210,000 x 8%) |  | 16,800 |  |  |  | 16,800 |
| Balance to common ($75,000 – $50,400) |  |  |  | $24,600 |  | 24,600 |
|  |  | $50,400 |  | $24,600 |  | $75,000 |
| Per share |  | $2.40 |  | $.049 |  |  |

Req. 2

|  |  |  |
| --- | --- | --- |
| Schedule of Comparative Differences (with comments) | | |
| Item | Amount of Dollar Increase (Decrease) | |
|  | Cash Dividend – Case C | Stock Dividend |
| Assets | $75,000 decrease | No assets were disbursed. |
| Liabilities | Current liabilities increased $75,000 on declaration date and decreased $75,000 on payment date. The net effect is zero. | No effect – no contractual liability was created. |
| Stockholders’ equity | $75,000 decrease (debit to retained earnings). | No effect on total stockholders’ equity. Decreased retained earnings and increased common stock by same amount. |

**AP11–4. (continued)**

Summary comment:

(1) A cash dividend decreases assets and stockholders’ equity by the amount of the dividend because resources were disbursed.

(2) A stock dividend does not change total assets or total stockholders’ equity because no resources are disbursed; only the internal content of stockholders’ equity is changed.

**Comprehensive Review Problem (Chapter 9, 10, 11)**

**Case A**

Req. 1

Preferred stock dividend --- $2,160 = 3,000 shares x $8 x 9%

Common stock dividend---$7,840 = $10,000 - $2,160

Req. 2

35,000 shares (40,000 shares issued – 5,000 shares treasury stock)

Req. 3

The sale of treasury stock does not affect the income statement. Rogers would record an increase in cash from the sale. In stockholders’ equity, the treasury stock account would be reduced by the cost of the shares sold with the difference between the cash collected and the cost of the shares recorded as an increase in capital in excess of par.

Req. 4

A journal entry is not required to record a stock split. Instead, the par value of the stock is adjusted. After a 2-for-1 stock split, the par value for Rogers stock would be $5 per share.

**Case B**

|  |
| --- |
| **Working Capital** |
| Remain the same |
| Decrease |
| Remain the same |
| Remain the same |

**Case C**

|  |  |  |  |
| --- | --- | --- | --- |
| Req. 1 |  |  |  |
| $1,000,000 x 0.6139 | $ 613,900 |  |  |
| $50,000 x 7.7217 | 386,085 |  |  |
| Issue price | $999,985 |  | (at par)\* |
| \*$15 rounding error---issue price is par value, or $1,000,000 |  |  |  |
| **Comprehensive Review Problem (continued)**  Req. 2 |  |  |  |
| $1,000,000 x 0.6756 | $ 675,600 |  |  |
| $50,000 x 8.1109 | 405,545 |  |  |
| Issue price | $1,081,145 |  |  |
| Req. 3 |  |  |  |
| $1,000,000 x 0.5584 | $ 558,400 |  |  |
| $50,000 x 7.3601 | 368,005 |  |  |
| Issue price | $ 926,405 |  |  |

**Case D**

Req. 1

Computations:

Interest:

|  |  |  |
| --- | --- | --- |
| $1,000,000 x 5% | = | $ 50,000 |

Present value:

|  |  |  |
| --- | --- | --- |
| $1,000,000 x 0.4564 | = | 456,400 |
| $ 50,000 x 13.5903 | = | 679,515 |
| Issue price | = | $1,135,915 |

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 1,135,915 |  |  |
| Premium on Bonds Payable (+L) |  |  | 135,915 |
| Bonds Payable (+L) |  |  | 1,000,000 |

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 1,125,000 |  |  |
| Common stock (+SE) |  |  | 45,000 |
| Capital in excess of par, common stock (+SE) |  |  | 1,080,000 |

**CASES AND PROJECTS**

*FINANCIAL REPORTING AND ANALYSIS CASES*

**CP11–1.**

Req. 1 There are 55,718 (thousand) shares in treasury stock.

Req. 2 The dividend per share for the current year was $0.44.

Req. 3 The Company bought treasury in the amount of $15,160,000 during the current year.

Req. 4 Par value is $.01 per share

**CP11–2**.

Req. 1 200,000,000 shares authorized; 144,633,007 shares issued and outstanding.

Req. 2 The company does not pay dividends.

Req. 3 The company does not have any treasury stock.

Req. 4 No, the company has not issued a stock dividend or stock split over the reporting period.

Req. 5 Par value is $0.0001.

**CP11–3.**

Req.1

The stock price of a company will immediately adjust downward. Each share is worth less after a split because there are more shares outstanding. Some companies believe that higher stock prices might make the stock less attractive to some investors. By splitting the stock, the stock price is lowered making the stock potentially more attractive to some investors.

Req. 2

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Urban Outfitters | | American Eagle | |
| Dividends per share  Market price per share | 0  $37 | 0% | 0.44  $21 | 2.1% |

Req. 3

Many investors are interested in the appreciation of stock rather than the amount of dividends. Note that although American Eagle paid dividends, its dividend yield ratio is low; thus, investors would still be relying on American Eagle’s stock appreciating in value.

Req. 4

|  |  |  |  |
| --- | --- | --- | --- |
|  | Retail | Pharmaceuticals | Telecommunications |
| Dividend  Yield | 2.3% | 3.8% | 4.8% |
| Example  Company | Wal Mart | Eli Lilly | AT&T |

The dividend yield ratio increases across the three industry groups. An investor that wants regular dividend payments would be more interested in investing in AT&T than a retail store. Often these investors are retirees that use the income stream from dividends to supplement their income after they stop working.

**CP11–4.**

Number of common shares outstanding.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Total par value | = | $298.3 million | | = | 119.32 million shares | | | |
| Par per share |  | 2.50 | |
| Less treasury stock | | |  | | | (12.8 million) |  | shares | |
|  | | | 106.52 million |  |

106.52 million shares x $1 per share = $106.52 million

*CRITICAL THINKING CASES*

**CP11–5.**

The payment of a stock dividend is a cosmetic solution with no cash flow effects. If the stock is valued by the market for its steady dividends, a stock dividend will not prevent a negative response. Unfortunately, there is no easy way to solve this problem. We find that most students think the priority should be on maintaining the long-term health of the company.

**CP11–6.**

We do not have an easy answer to this question. We use this case to discuss corporate governance and responsibilities.

*FINANCIAL REPORTING AND ANALYSIS PROJECTS*

**CP11–7.**

Student response depends on the company selected.

*CONTINUING CASE*

**CC11–1**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| Treasury Stock (+XSE, -SE)) | 100,000,000 |  |  |
| Cash (-A) |  |  | 100,000,000 |

Req. 2

**August 2**

|  |  |  |  |
| --- | --- | --- | --- |
| Retained earnings (-SE) | 7,872,000 |  |  |
| Dividend payable (+L) |  |  | 7,872,000 |
| **August 13**  No entry  **August 29** |  |  |  |
| Dividend payable (-L) | 7,872,000 |  |  |
| Cash (-A) |  |  | 7,872,000 |
|  |  |  |  |

Computation of dividend:

49.2 million shares (outstanding) x $0.16 = $7,872,000