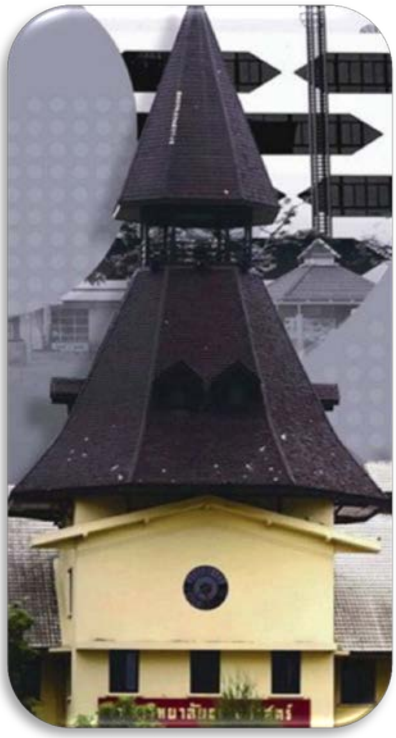
Thammasat University
Faculty of Economics
Bachelor of Economics (International Program)

AC201
Fundamental Accounting

Semester 2/2012



Course Materials

Topic:
Chapter 11 Reporting and Interpreting Shareholders' Equity

Session:
Session #11

Instructor:
Assistant Professor Dr. Orapan Yolrabil

CHAPTER 11: REPORTING AND INTERPRETING OWNERS' EQUITY

CHAPTER SUMMARY

This chapter discusses accounting for owners' equity for corporations. Each specific source of owners' equity should be accounted for separately. The two basic sources of owners' equity for a corporation are contributed capital (capital stock) and earned capital (retained earnings). Separate accounts are kept for each element of capital stock.

A corporation may purchase its own stock in the marketplace. Stock previously issued by the corporation and subsequently reacquired is known as treasury stock as long as the issuing corporation holds it. The purchase of treasury stock reduces corporate capital, and the subsequent resale of the treasury stock increases corporate capital.

The earnings of a corporation that are not retained for business expansion are distributed to the stockholders by means of dividends. Dividends are paid only after the board of directors of the corporation declares dividends. A cash dividend results in a decrease in assets (cash) and a commensurate decrease in stockholders' equity (retained earnings). In contrast, a stock dividend does not change assets, liabilities, or total stockholders' equity. A stock dividend results in a transfer of retained earnings to the permanent or contributed capital of the corporation. Therefore, a stock dividend affects only certain account balances within stockholders' equity. A stock split affects only the par value of the stock and the number of shares outstanding; the individual equity account balances are not changed.

Sole proprietorships and partnerships are discussed in Chapter Supplement A. Except for owners' equity items and details, accounting is basically unaffected by the type of business organization.

CHAPTER OBJECTIVES

LO1 Explain the role of stock in the capital structure of a corporation.
LO2 Analyze the earnings per share ratio.
LO3 Describe the characteristics of common stock and analyze transactions affecting common stock.
LO4 Discuss dividends and analyze transactions.
LO5 Analyze the dividend yield ratio.
LO6 Discuss the purpose of stock dividends, stock splits, and report transactions.
LO7 Describe the characteristics of preferred stock and analyze transactions affecting preferred stock.
LO8 Discuss the impact of capital stock transactions on cash flows.

CHAPTER OUTLINE

I. UNDERSTANDING THE BUSINESS

1. Corporations are the dominant form of business organization in the terms of volume of operations.
2. Participation in corporate ownership commences by purchasing stock.
3. Advantages of the corporate form of business:
   - **a.** Ease of Transfer: Stock ownership can be transferred (sold) easily through established markets (stock exchanges).
   - **b.** Limited liability for owners: The maximum a stockholder stands to lose is the investment in the stock.
   - **c.** Since a corporation is a separate legal entity, it enjoys continuity of life (separate from its owners).
   - **d.** Corporations have the ability to raise substantial amounts of capital through debt and equity issues.
   - **e.** Corporations offer the ability for owners to earn high returns on their investments. However, this is not without risk and can result in losses to owners.
4. There are two primary sources of stockholders' equity.
   - **a.** Contributed capital constitutes amounts received from shareholders in exchange for stock ownership. Components are:
     1. Par value derived from the sale of stock.
     2. Additional contributed capital (additional paid-in capital) in excess of par value.
   - **b.** Earned Capital – known as Retained Earnings –is the cumulative amount of net income since the organization of the corporation less the cumulative amount of dividends declared by the corporation since inception. (If the retained earnings account has a debit balance due to accumulated losses, it is called a retained deficit.)

II. LO1 EXPLAIN THE ROLE OF STOCK IN THE CAPITAL STRUCTURE OF A CORPORATION.

A. Introduction

1. The corporation is the only form of business recognized as a separate *legal* entity.
2. Creation and governance of corporations are highly regulated by law.
3. Corporations are created under state (not federal) laws. Each state has different laws for incorporation.

B. Benefits of Stock Ownership

1. The ownership of common stock conveys several rights:
   - **a.** A voice in management: Owners are granted the right to vote at stockholders' meetings on major issues concerning the management of the corporation including the election of the board of directors. In lieu of attending a meeting, a vote by proxy (absentee ballot) gives the stockholders' voting rights to a designated party.
   - **b.** Dividends: Owners may receive dividends (distributions of corporate profits).
   - **c.** Residual claim: Owners may receive distributions from the corporation upon liquidation.

C. Authorized, Issued, and Outstanding Shares

1. Authorized number of shares is the *maximum* number of shares that can be issued by a corporation as specified in its charter. This should be a larger number than a corporation plans to issue initially to provide for the option of selling stock in the future.
2. Issued number of shares is the total *cumulative* number of authorized shares that have been *sold to date* by the corporation. Unissued number of shares is the number of authorized shares that have not yet been sold to date.
3. Outstanding number of shares is the number of shares currently owned by stockholders ("out" there).

$$\text{Outstanding shares} = \text{Issued shares} - \text{Treasury stock shares}$$

4. Treasury stock is the number of shares that have been sold to investors and then reacquired by the corporation. If there is no treasury stock, the number of issued shares will equal the number of outstanding shares.

III. LO2 ANALYZE THE EARNINGS PER SHARE RATIO.

1. EPS is a measure of profitability.
2. Facilitates comparing companies of different sizes.

$$\text{Earnings Per Share} = \frac{\text{Net Income*}}{\text{Average Number of Shares of Common Stock Outstanding during the Period}}$$

* If there are Preferred dividends, the amount is subtracted from the Net Income in the numerator.

IV. LO3 DESCRIBE THE CHARACTERISTICS OF COMMON STOCK AND ANALYZE TRANSACTIONS AFFECTING COMMON STOCK.

A. General

1. There are two types of stock issues.
2. All corporations must issue common stock, but every corporation does not issue preferred stock.

B. Common Stock Transactions

1. Common stock is the residual equity (the "leftovers") of a corporation.
   - **a.** It ranks after preferred stock for dividends and liquidation distributions.
   - **b.** Common stockholders are the "risk takers" and, therefore, they are voting owners of a corporation.
2. Common stockholders receive dividends after the preferred stockholders receive their dividends. The board of directors, usually based on the company's profitability for common stockholders, determines dividend rates.
3. A corporation may issue two types of common shares: par value and no-par value.
   - **a.** Par value is an arbitrary, nominal, value established in the corporate charter.
     1. It has no relationship to the market value of the stock.
     2. The concept of par value was established as a protection for creditors by specifying a permanent amount of capital (legal capital) to be maintained by the corporation (not available for withdrawal by the owners). Though the definition of legal capital varies among states, it is usually considered to be the par value of stock outstanding.
   - **b.** No-par value stock does not have an amount per share specified in the charter.
     1. Some states require no-par stock.
     2. Legal capital is established by law. In the case of no-par value stock, legal capital is either the amount for which stock is originally sold or a stated value.

C. Initial Sale of Stock

1. When a corporation sells stock to the public, the transaction must be recorded in the accounts of the corporation. When stock sales are made for cash, Cash is debited and Common Stock is credited for par value.

Cash	xxx	
Common Stock		xxx

2. Any additional amount in excess of par is credited to Capital in Excess of Par Value.

Cash	xxx	
Common Stock		xxx
Capital in Excess of Par Value		xxx

3. In the case of no-par common stock that has no stated value, the total proceeds received at the issue are debited to Cash and credited to No-Par Common Stock. The capital in excess of par value account is not used under these circumstances.
4. There are two types of initial stock offerings to the public.
   - **a.** An initial public offering (IPO) involves the very first sale of a company's stock to the public (when a company first goes public).
   - **b.** A seasoned new issue is a subsequent sale of new stock (not previously issued) to the public after an IPO.

E. Sale of Stock in Secondary Markets

1. After the issue of stock by a corporation, shares may be exchanged (traded) in secondary markets such as the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), and the NASDAQ market.
2. These subsequent sales *only affect the books of the investors involved*.
    - **a.** No transactions are recorded on the corporation's books.
    - **b.** However, corporate management is very alert to stock trading prices in the secondary market.

F. Stock Issued for Employee Compensation

1. Executive compensation packages are often developed to reward managers for meeting goals that are important to shareholders.
    - **a.** Stock options are often part of these compensation packages.
    - **b.** Stock options permit the holders to buy stock at a fixed price (grant price).
        1. If the stock prices decline below the grant price, holders will not exercise the option.
        2. If the stock price increases over the grant price, holders can exercise the options at a "low" price and hold the stock or sell it for a gain.
    - **c.** Stock option plans have increased substantially over the past few years. These plans provide a very popular way to reward managers.

G. Repurchase of Stock

1. Treasury stock is previously issued stock that is reacquired by the issuing corporation. Treasury stock is:
    - **a.** Held by the corporation.
    - **b.** Have no ownership rights.
    - **c.** It is not outstanding stock so it has no right to vote or to receive dividends.
    - **d.** It is not an asset to the corporation.
    - **e.** Treasury stock is a contra equity account (it reduces total stockholders' equity).
2. The cost method records treasury stock at its cost:

Treasury Stock	xxx	
Cash		xxx

    - **a.** This transaction *reduces* assets and *reduces* stockholders' equity.
3. Balance Sheet effects:
    - **a.** If a company has treasury stock on its balance sheet date, the amount of treasury stock is *subtracted* in the stockholders' equity section.
    - **b.** A disclosure note if required.
    - **c.** A restriction is placed on retained earnings to the extent of the treasury stock cost to preclude dividend declarations of that amount.
4. Resale of Treasury Stock
    - **a.** When treasury stock shares are resold, Cash is debited and treasury stock is credited (reduced by the <u>cost</u> of the proportional number of shares resold).
    - **b.** If treasury stock is acquired and resold for the same amount, that is the extent of the journal entry.
    - **c.** If the acquisition and resale amounts differ, additional elements appear in the journal entry.
        1. Treasury stock is resold for *more* than its cost (an economic gain):
            - a. Capital in Excess of Par is *credited* for the difference.
            - b. A gain results in an overall *increase* in stockholders' equity.
        2. Treasury stock is resold for *less* than its cost (an economic loss):
            - a. Capital in Excess of Par is *debited* for the difference.
            - b. If that account balance is not adequate to absorb this difference, Retained Earnings is reduced to the extent needed.
            - c. A loss results in an overall *decrease* in stockholders' equity.
5. Neither the purchase nor the sale of treasury stock affects the *issued* or *unissued* number of shares. Treasury stock only affects the number of shares *outstanding*.

V. LO4 DISCUSS DIVIDENDS AND ANALYZE TRANSACTIONS.

A. Investors buy stock to receive a return on their investment in the form of stock price appreciation and/or dividends.

1. Dividends are created when the board of directors of a corporation declares them. There is no legal obligation of a corporation to pay dividends until they are declared.
2. Types of dividends:
   - **a.** Cash dividends. (Without a qualifier, the term dividend means a "cash" dividend.)
   - **b.** Property dividends (noncash assets).
   - **c.** Stock dividends (the company's own capital stock).

B. There are two requirements to be met for cash dividends to be declared and paid.

1. Sufficient retained earnings are needed. State laws often limit cash dividends to the amount of retained earnings (less any amount of treasury stock).
2. Sufficient cash is needed.
   - **a.** Retained earnings do *not* equal cash.
   - **b.** Cash is needed for continuing operations and for operational asset acquisitions. There must be adequate cash after these commitments are met in order to pay dividends.

C. Three important dates for dividends:

1. Date of declaration:
   - **a.** The date that the board of directors *officially* approves the dividend.
   - **b.** For a cash dividend, a liability is credited at that time (Dividends Payable).
   - **c.** The debit may be made to a Dividends Declared or simply "Dividend" account or directly to the Retained Earnings account.
   - **d.** Dividends Declared is a *contra equity* account that is closed to Retained Earnings.
2. Date of record:
   - **a.** The date on which the corporation prepares a list of current stockholders based on stockholder ownership records. This list indicates to whom dividend checks will be sent.
   - **b.** No journal entry is required on this date.
3. Date of payment:
   - **a.** The date that dividend checks are disbursed.
   - **b.** The liability account is debited (reduced), and the Cash account is credited (reduced).
   - **c.** This is the date on which the dividend liability is *liquidated*.

VI. LO5 ANALYZE THE DIVIDEND YIELD RATIO.

1. A measure of profitability.
2. Measures the dividend return on the current price of stock.
3. Must be considered in conjunction with stability and increase in the price of common stock.

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

VII. LO6 DISCUSS THE PURPOSE OF STOCK DIVIDENDS, STOCK SPLITS, AND REPORT TRANSACTIONS.

A. Stock Dividends

1. A stock dividend is a distribution of *additional* shares of a corporation's own capital stock on a prorata basis (to maintain the same percentage of shares previously held) to its stockholders at no cost.
   - **a.** Usually consist of common stock issued to holders of common stock.
   - **b.** Common for rapidly expanding companies that want to retain their assets to finance expansion.
2. Balance Sheet effects:
   - **a.** Does not create a liability when it is declared.
   - **b.** Does not reduce assets when it is distributed.
   - **c.** Total stockholders' equity does not change.
     1. A portion of retained earnings is changed into contributed capital. This is called capitalizing earnings.
     2. When retained earnings are reclassified to contributed capital, it *reduces* the amount available for future dividends.

3. Stock dividends are classified based on their size. The size of the stock dividend dictates the accounting treatment.
    a. A large stock dividend involves the distribution of additional shares that is more than 20-25% of the currently outstanding shares. This is the most common.
        1. *Par value* is used to record large stock dividends.
        2. Retained Earnings is debited and common stock is credited for the par value.
        3. Large stock dividends have a greater market price reaction than small stock dividends.
    b. A small stock dividend involves the distribution of additional shares that is less than 20-25% of the currently outstanding shares.
        1. *Market value* is used to record small stock dividends.
        2. Retained Earnings is debited for the market value of the shares, common stock is credited for the par value, and the difference is credited to Capital in Excess of Par Value.

B. Stock Splits
1. Stock splits are *not* dividends, but stock splits and stock dividends have similar effects on the stockholder but are quite different in terms of their impact on the stockholders' equity accounts.
    a. Each stockholder will own additional shares of stock.
    b. The effects on the issuing company are quite different.
2. A stock split does not require a journal entry by the corporation.
    a. Instead, the old shares are returned to the corporation and new shares are issued.
    b. The stock split is accomplished by *reducing* the par value per share and *increasing* the number of shares issued.
    c. Retained Earnings is unaffected.
    d. A disclosure note is required.

VIII. LO7 DESCRIBE THE CHARACTERISTICS OF PREFERRED STOCK AND ANALYZE TRANSACTIONS AFFECTING PREFERRED STOCK.

A. Preferred Stock
1. Combines some of the features of bonds and common stock.
    a. Typically lacks the control feature of common stock in that it usually does not have voting rights.
    b. Often used to raise corporate capital without diluting common stockholders' control.
2. Generally, preferred stock is less risky than common stock because of its preference to receive dividends and asset distributions (upon liquidation) before common stockholders.
3. Most preferred stock has a fixed dividend rate such as a specified percent of par or a specified amount per share.

B. Dividends on Preferred Stock
1. Investors in preferred stock give up some rights (voting) compared to common stock.
2. Preferred Stock enjoys a *preference* in dividends.
3. Dividends must be allocated between *preferred shareholders* and *common shareholders*. Two dividend preferences are:
    a. *Current Dividend Preference*
        1. Preferred stock always has a right to be paid dividends before any dividends can be paid on common stock.
        2. Once this current preference is met, dividends may be paid to common stock.
    b. *Cumulative Dividend Preference*
        3. Some preferred stock carries the additional feature of *accumulating* any dividend amounts not paid or declared in a previous year.
        4. Dividends In Arrears are these "unsatisfied" accumulations.
        5. Stock with this feature is called Cumulative Preferred Stock.

4. Impact of Dividends in Arrears
   a. Dividends in arrears are not liabilities.
      1. Dividends must be declared to become a liability.
      2. Any preferred stock arrearage must be disclosed in the notes to the financial statements.
         a. When preferred stock is cumulative, the arrearages and the current preference must be allocated to preferred stock before any dividends are available to common stock.
         b. If preferred stock is noncumulative, no dividend arrearage can exist.
5. Restrictions on Retained Earnings
   a. Restrictions on retained earnings require full-disclosure on the financial statements or in the notes.
   b. Items that can place restrictions on retained earnings include debt covenants and preferred dividends in arrears. These restrictions place a limit on the ability of a company to pay dividends to its owners.
   c. Analysts are particularly interested in retained earnings restrictions because of the impact on a company's dividend policy.

IX. LO8 DISCUSS THE IMPACT OF CAPITAL STOCK TRANSACTIONS ON CASH FLOWS.

	Effect on Cash Flows from Financing Activities
Issuance of Capital Stock	Increase
Purchase of Treasury Stock	Decrease
Sale of Treasury Stock	Increase
Payment of Cash Dividends	Decrease

X. CHAPTER SUPPLEMENT A: ACCOUNTING FOR OWNERS' EQUITY FOR SOLE PROPRIETORSHIPS AND PARTNERSHIPS.

A. Owner's Equity for a Sole Proprietorship
1. The proprietor (the only owner) has a *capital* account and a *drawing* (withdrawals) account.
   a. *Owner's capital account*
      1. Used to record owner investments in the business.
      2. Also used to accumulate income and losses of the business.
      3. The net of revenues, expenses, gains and losses are closed to the capital account at the end of the accounting period.
      4. The capital account reflects the cumulative total of all owner investments and earnings less withdrawals to date.
   b. *Owner's withdrawal account*
      1. Used to record asset withdrawals by the owner during the year.
      2. Used to record the owner's "salary" since this is not considered to be an expense of the business.
2. A sole proprietorship is not a taxable entity for income tax purposes.
   a. Owner is taxed on his/her personal income tax return for the *net income* of the proprietorship.
   b. Owner's Equity on the balance sheet represents the *ending* capital account balance.

B. Owners' Equity for a Partnership
1. A partnership consists of two or more parties carrying on business with a profit motive. Most states have adopted this definition from the Uniform Partnership Act.
2. The mutual understanding and consent of the partners should be contained in a written partnership agreement. The document should specify the details of formation, division of profits and losses, management responsibilities, transfer of interests, disposition of assets upon liquidation, and procedures to be followed in the case of a partner's death.
3. Partnerships provide ease of formation and partner control. However, unlimited liability allows creditors to take personal assets of partners (except for limited partners) to satisfy partnership obligations.

5. Accounting for a partnership:

- **a.** Each partner has a *capital* account and a *withdrawal* account.
  1. Each partner's *capital account* is used to record owner investments of that partner.
     - a. Also used to accumulate income and losses attributable to that partner.
     - b. The partner's capital account reflects the *cumulative investments and earnings net of losses and withdrawals to date*.
  2. Each partner has a withdrawal account to reflect withdrawals of assets from the business during the year.
     - a. It is used to record the partner's "salary" since this is not considered to be an expense of the business.
- **b.** There are a variety of profit/loss allocation procedures.
  1. They may be based on the partners' investment ratios, time and expertise devoted to the operations of the business, or a combination of these factors.
  2. The allocation may instead be done equally between the partners.
- **c.** A partnership is *not a taxable entity* for income tax purposes. Rather, each partner is taxed for his/her distributive share of income.
- **d.** The Owners' Equity on the balance sheet represents the ending capital account balance for each partner. A detailed schedule to arrive at these balances should be presented for full-disclosure.

CHAPTER 11: REPORTING AND INTERPRETING SHAREHOLDERS' EQUITY

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Corporate Form of Organization

- **A Corporation is an entity created by law that is separate from its owners.**
  - Owners of corporations are called shareholders or shareholders.

Advantages of Corporate Characteristics

- Separate legal entity
- Limited liability of shareholders
- Transferable ownership rights
- Continuous life
- Lack of mutual agency for shareholders
- Ease of capital accumulation

Disadvantages of Corporate Characteristics

- Government regulation
- Corporate taxation

Shareholders of Corporations

- **Rights of shareholders:**
  - Vote at the shareholders' meetings.
  - Sell or otherwise dispose of their share.
  - Purchase their proportionate of any ordinary share later issued by the corporation. This preemptive right protects shareholders' proportionate interest in the corporation.
  - Receive dividends.
  - Share in any asset remaining after creditors are paid when the corporation is liquidated.



AC201 Fundamental Accounting

Basics of Capital share

- **Number of shares:**
  - Authorized shares – Total amount of share that a corporation is authorized to issue.
    - Authorized shares are the maximum number of shares that a corporation is allowed to issue.
  - Issued shares – Shares that are sold to shareholders.
    - Issued shares are those that a corporation sells or otherwise transfers to shareholders. Unissued shares have no right or privileges until they are issued.
  - Outstanding shares – Corporation's share held by its shareholders.
    - Outstanding shares are shares that a corporation has issued and that are still in circulation.
  - Treasury shares – Corporation's own share that it reacquired and still holds.
    - Treasury share is not outstanding because it consist of shares that a corporation has issued but that it has bought back and there by put out of circulation.

Basics of Capital share

- **Classes of share:**
  - Preferred share– share with a priority status over ordinary shareholders.
    - Preferred share gives its owners preference over ordinary shareholders, usually in terms of receiving dividends and in terms of claims to assets if the corporation is liquidated.
  - Ordinary share– Corporation's basic ownership share.
    - Ordinary share is also called residual equity, which means that if the corporation is liquidated, the claims of all creditors and usually those of preferred shareholders rank ahead of the claims of ordinary shareholders
- **Par Value of share:**
  - Par value is an amount assigned per share by the corporation when the share is authorized.

AC201 Fundamental Accounting

Basics of Share Capital

- **Shareholders' Equity:**
  - Shareholders' equity consists of (1) paid-in (or contributed capital) and (2) retained earnings.
    - Paid-in capital is the total amount of cash and other assets the corporation receives from its shareholders in exchange for share.
    - Retained earnings is the cumulative profit and loss retained by a corporation.

Paid-in Capital

Ordinary share	
	Normal Balance

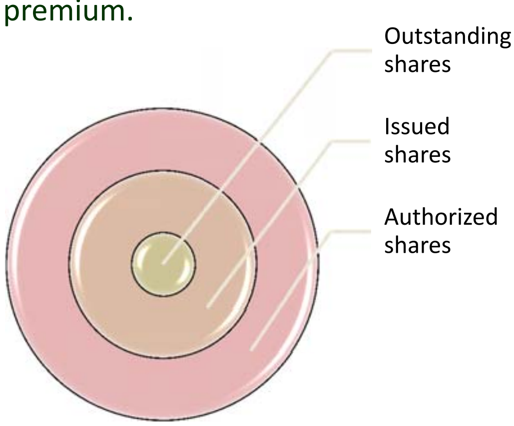
Share premium	
	Normal Balance

Retained Earnings	
	Normal Balance

Note:
Paid-in capital comes from share-related transactions, whereas retained earnings comes from operations.

Issuance of share

- **When a corporation issues par value share, the appropriate share capital account (usually ordinary share or preferred share) is credited for the par value regardless of whether the proceeds are more or less than the par value.**
  - When a corporation issues share at a price greater than par value, as is usually the case, the proceeds in excess of par are credited to an account called share premium.



Ordinary Share

- **Share Issuance:**

Case #1	Dr. Cash [A+]	300,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
	Issued 30,000 shares of 10 Baht par value ordinary share at par		
Case #2	Dr. Cash [A+]	360,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
	Share premium [E+]		60,000
	Issued 30,000 shares of 10 Baht par value ordinary share at 12 Baht per share		
Case #3	Dr. Cash [A+]	240,000	
	Share discount [E-]	60,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
	Issued 30,000 shares of 10 Baht par value ordinary share at 8 Baht per share		

Dividend Policies

- **A dividend is a distribution among shareholders of the assets that a corporation's earnings have generated.**
  - Shareholders receive these assets, usually cash, in proportion to the number of shares they own.
    - The corporation's board of directors has sole authority to declare dividends.
- **Evaluating dividend policies:**
  - To evaluate the amount of dividends they receive, investors use the dividend yield ratio.
    - Dividend yield is computed by dividing the dividends per share by the market price per share.

Cash Dividends

- **Dividend payment involves three important dates:**
  - Declaration date – Date the board of directors vote to declare and pay a dividend.

Date of declaration	Dr. Cash dividend [E-]	30,000	
	Cr. Dividend payable [L+]		30,000
	Declared 1 Baht per ordinary share cash dividend		

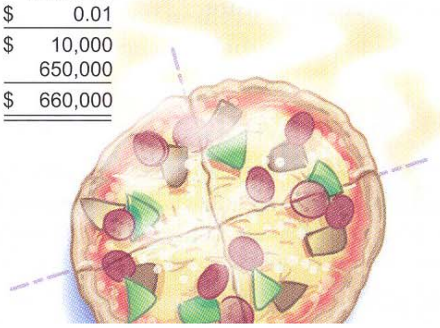
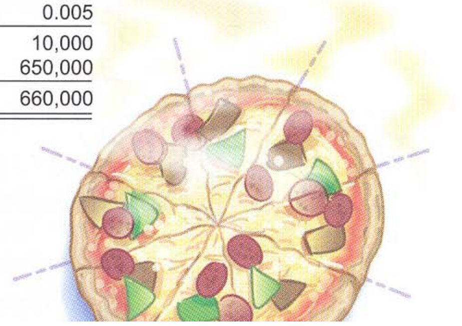
  - Date of record – Future date specified by the directors for identifying those shareholders listed in the corporation's records to receive dividends – NO ENTRY
  - Date of payment – Date when the corporation makes payment.

Date of payment	Dr. Dividend payable [L-]	30,000	
	Cr. Cash [A-]		30,000
	Paid cash dividend on ordinary shares		

Stock Split and Stock Reverse

- **A stock split is the distribution of additional shares to shareholders according to their percent ownership.**
  - Stock split reduces par value, but increases number of shares.
- **A stock reverse is the opposite of a share split.**
  - It increases both the price per share and the par value per share, but reduces number of shares.

Stockholders' Equity	Before a 2-for-1 Stock Split	After a 2-for-1 Stock Split
Number of shares outstanding	1,000,000	2,000,000
Par value per share	$ 0.01	$ 0.005
Total par value outstanding	$ 10,000	$ 10,000
Retained earnings	650,000	650,000
Total stockholders' equity	$ 660,000	$ 660,000

AC201 Fundamental Accounting

Preferred Share

- **Share Issuance:**
  - The preferred share issuance is recorded in a similar fashion as ordinary share issuance.
    - Preferred share differs from ordinary share based on a number of rights granted to the shareholders. The most significant differences are:
      - Preferred share does not grant voting rights.
        - » The main reason for preferred share issuance is to raise capital. Preferred share permits the company to raise funds without diluting ordinary shareholders' control.
      - Lower risk for preferred share.
        - » Generally, preferred share is less risky than ordinary share 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 shareholders upon dissolution, before any remaining assets can be distributed to the ordinary share.
      - Preferred share typically has a fixed dividend rate.
        - » The fixed dividend is attractive to certain investors who want a stable income from their investments.

Dividends on Preferred Share

- **Dividend preference of preferred share:**
  - Cumulative VS Noncumulative Dividend
    - **Cumulative preferred share** has a right to be paid both the current and all prior periods' unpaid dividends (dividend in arrears) before any dividend is paid to ordinary shareholders.
      - If the share is cumulative preferred share, the dividend amount per share accumulates from year to year, and the company must pay the whole amount before it pays any dividends on ordinary share.
    - **Noncumulative preferred share** confers no right to prior periods' unpaid dividends if they were not declared in those prior periods.
      - If the share is noncumulative preferred share and the board of directors fails to declare a dividend on it in any given year, the company is under no obligation to make up the missed dividend in future years.

Dividends on Preferred Share (Cont.)

- **Cash dividend on preferred share:**
  - Dividend per year = Dividend rate x Par value x Number of shares outstanding

	Dividend Declared	Cumulative Preferred Share *(6% x 100 Baht par x 2,000 shares outstanding)*	Ordinary Share
Year 1	12,000	12,000	0
Year 2	0	0	0
Year 3	40,000	24,000	16,000

	Dividend Declared	Noncumulative Preferred Share *(6% x 100 Baht par x 2,000 shares outstanding)*	Ordinary Share
Year 1	12,000	12,000	0
Year 2	0	0	0
Year 3	40,000	12,000	28,000

Treasury Share

- **Treasury share:**
  - A corporation’s reacquired shares are called treasury share.
    - It is, in fact, shares of its own that the corporation has bought back on the open market. The cost of these shares is treated not as an investment, but as a reduction in shareholders’ equity. By buying back the shares, the corporation reduces the ownership of the business.
  - Among the reasons a company may want to buy back its own share are the following:
    - It may want share to distribute to employees through share option plans.
    - It may be trying to maintain a favorable market for its share.
    - It may want to increase its earnings per share or share price per share.
    - It may want to have additional shares of share available for purchasing other companies.
    - It may want to prevent a hostile takeover.

Purchasing Treasury Share

- **Purchasing Treasury Share**
  - Purchasing treasury share reduces the corporation’s assets and equity by equal amounts. The treasury share will be recorded at cost.

Dr. Treasury share [E-]	11,500	
Cr. Cash [A-]		11,500
Purchased 1,000 treasury shares at 11.50 Baht per share		

  - The shareholders’ equity section of the Company’s balance sheet shows the cost of the treasury share as a deduction from the total contributed capital and retained earnings.
    - Note that the number of shares issued has not changed. However, the number of shares outstanding has decreased as a result of the transaction.

Reissuing Treasury Share

- **Sale of treasury share:**
  - Treasury shares can be sold at cost, above cost, or below cost.
    - When treasury shares are sold for an amount greater than their cost, the excess of the sales price over cost should be credited to paid-in capital, treasury share. No gain should be recorded.
    - When treasury shares are sold below their cost, the difference is deducted from paid-in capital, treasury share. If this account does not exist or if its balance is insufficient to cover the excess of cost over the reissue price, retained earnings absorbs the excess. No loss is recorded.



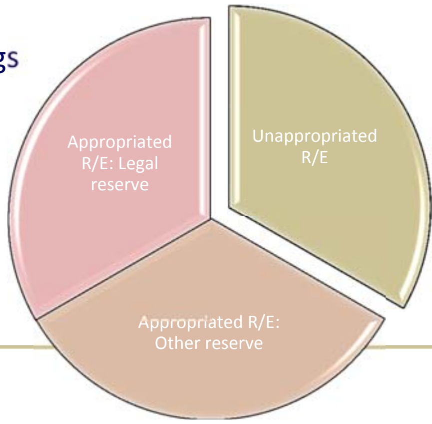
Reissuing Treasury share (Cont.)

- **Reissuing Treasury share:**

Reissue @ cost	Dr. Cash [A+]	1,150	
	Cr. Treasury share [E+]		1,150
	Received 11.50 Baht per share for 100 treasury shares costing 11.50 Baht		
Reissue above cost	Dr. Cash [A+]	4,800	
	Cr. Treasury share [E+]		4,600
	Paid-in capital -- Treasury stock [E+]		200
	Received 12 Baht per share for 400 treasury shares costing 11.50 Baht		
Reissue below cost	Dr. Cash [A+]	5,000	
	Paid-in capital -- Treasury share [E-]	200	
	Retained earnings [E-]	550	
	Cr. Treasury share [E+]		5,750
	Received 10 Baht per share for 500 treasury shares costing 11.50 Baht		

Retained Earnings

- **Retained earnings:**
  - The earnings of the corporation since its inception, less any losses, dividends, or transfers to contributed capital. Retained earnings are reinvested in the business. They are not a pool of funds to be distributed to the shareholders; instead, they represent the shareholders' claim to assets resulting from profitable operations.
    - Appropriated (or Restricted) retained earnings
      - Legal reserve
      - Other reserve
    - Unappropriated retained earnings



Financial Ratios: Equity Financing

- **Earnings per share**

$$\text{Earnings per share} = \frac{\text{Net income - Preferred dividend}}{\text{Weighted average common shares outstanding}}$$

- **Price-earnings ratio**

$$\text{Price-earnings} = \frac{\text{Price per share}}{\text{Earnings per share}}$$

- **Dividend yield**

$$\text{Dividend yield} = \frac{\text{Cash dividend per share}}{\text{Price per share}}$$

- **Book value per share**

$$\text{Book value per} = \frac{\text{Stockholders' equity}}{\text{Weighted average number of shares outstanding}}$$

- **Return on equity**

$$\text{Return on Equity} = \frac{\text{Net income}}{\text{Average Stockholders' Equity}}$$

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Example of Financial Statement Presentation & Disclosure: Share Capital
[Source: www.farmhouse.co.th]

President Bakery Public Company Limited
For the years ended 31 December 2010 and 2009

(Unit : Baht)

		Separate financial statements				
				Retained earnings		
	Note	Issued and paid-up share capital	Share premium	Appropriated - statutory reserve	Unappropriated	Total
Balance as at 31 December 2008		450,000,000	674,379,513	45,000,000	931,097,004	2,100,476,517
Net income for the year		-	-	-	507,727,852	507,727,852
Dividend payments	21	-	-	-	(241,650,000)	(241,650,000)
Balance as at 31 December 2009		450,000,000	674,379,513	45,000,000	1,197,174,856	2,366,554,369
Balance as at 31 December 2009		450,000,000	674,379,513	45,000,000	1,197,174,856	2,366,554,369
Net income for the year		-	-	-	616,116,538	616,116,538
Dividend payments	21	-	-	-	(273,150,000)	(273,150,000)
Balance as at 31 December 2010		450,000,000	674,379,513	45,000,000	1,540,141,394	2,709,520,907

A **statement of changes in shareholders' equity** lists the beginning and ending balances of each equity account and describes the changes that occur during the period.

BALANCE SHEETS (CONTINUED)

President Bakery Public Company Limited
As at 31 December 2010 and 2009

(Unit : Baht)

	Note	Financial statements in which the equity method is applied		Separate financial statements	
		2010	2009	2010	2009
Shareholders' equity					
Share capital					
Registered, issued and fully paid-up					
45,000,000 ordinary shares of Baht 10 each		450,000,000	450,000,000	450,000,000	450,000,000
Share premium		674,379,513	674,379,513	674,379,513	674,379,513
Retained earnings					
Appropriated - statutory reserve	18	45,000,000	45,000,000	45,000,000	45,000,000
Unappropriated		1,542,733,677	1,199,078,351	1,540,141,394	1,197,174,856
Total shareholders' equity		2,712,113,190	2,368,457,864	2,709,520,907	2,366,554,369
Total liabilities and shareholders' equity		3,765,063,406	3,157,284,049	3,762,471,123	3,155,380,554

18. STATUTORY RESERVE

Pursuant to Section 116 of the Public Limited Companies Act B.E. 2535, the Company is required to set aside to a statutory reserve at least 5 percent of its net income after deducting accumulated deficit brought forward (if any), until the reserve reaches 10 percent of the registered capital. The statutory reserve is not available for dividend distribution.

20. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net income for the year by the weighted average number of ordinary shares in issue during the year.

27. CAPITAL MANAGEMENT

The primary objective of the Company's capital management is to ensure that it has an appropriate financing structure and preserves the ability to continue its business as a going concern.

According to the balance sheet as at 31 December 2010, the Company's debt-to-equity ratio was 0.4:1 (2009: 0.3:1).

21. DIVIDEND PAYMENTS

During the years ended 31 December 2010 and 2009, the Company had dividend payments as follows:

	Approved by	Total dividends	Dividend per share	Paid on
		(Thousand Baht)	(Baht)	
For the year 2010				
Final dividend on 2009 income	Annual General Meeting of the shareholders on 26 April 2010	141,750	3.15	25 May 2010
Interim dividend on income for the six-month period ended 30 June 2010	The meeting of the Company's Board of Directors No. 8/2010 on 25 August 2010	131,400	2.92	24 September 2010
Total dividend payments for 2010		273,150		
For the year 2009				
Final dividend on 2008 income	Annual General Meeting of the shareholders on 24 April 2009	129,150	2.87	22 May 2009
Interim dividend on income for the six-month period ended 30 June 2009	The meeting of the Company's Board of Directors No. 9/2009 on 16 September 2009	112,500	2.50	15 October 2009
Total dividend payments for 2009		241,650		

EXERCISES

Available with McGraw-Hill's Homework Manager

E11-1 LO1 Philip Morris

Computing Shares Outstanding

The annual report for Philip Morris Companies, Inc., disclosed that 4 billion shares of common stock have been authorized. At the end of last year, 2,805,961,317 shares had been issued and the number of shares in treasury stock was 380,474,028. During the current year, no additional shares were issued, but additional shares were purchased for treasury stock and shares were sold from treasury stock. The net change was a decrease of 5,047,286 shares of treasury stock. Determine the number of shares outstanding at the end of the current year.

E11-2 LO1

Computing Number of Shares

The charter of Mansfield Corporation specifies that it may issue 200,000 shares of common stock. Since the company was incorporated, it has sold a total of 160,000 shares to the public but bought back a total of 20,000. The par value of the stock is $3 and the stock was sold at an average price of $16. When the stock was bought back from the public, the market price was $20.

Required:

1. Determine the authorized shares.
2. Determine the issued shares.
3. Determine the outstanding shares.

E11-3 LO1, 3, 7

Determining the Effects of the Issuance of Common and Preferred Stock

Kelly, Incorporated, was issued a charter on January 15, 2009, that authorized the following capital stock:

Common stock, no-par, 103,000 shares.

Preferred stock, 9 percent, par value $8 per share, 4,000 shares.

The board of directors established a stated value on the no-par common stock of $10 per share. During 2009, the following selected transactions were completed in the order given:

a. Sold and issued 20,000 shares of the no-par common stock at $16 cash per share.
b. Sold and issued 3,000 shares of preferred stock at $20 cash per share.
c. At the end of 2009, the accounts showed net income of $40,000.

Required:

1. Prepare the stockholders' equity section of the balance sheet at December 31, 2009.
2. Assume that you are a common stockholder. If Kelly needed additional capital, would you prefer to have it issue additional common stock or additional preferred stock? Explain.

Reporting Stockholders Equity

E11-4
LO1, 3

The financial statements for Texas Media Corporation included the following selected information:

Common Stock	$1,600,000
Retained earnings	$900,000
Net income	$1,000,000
Shares issued	90,000
Shares outstanding	80,000
Dividends declared and paid	$800,000

The common stock was sold at a price of $20 per share.

Required:

1. What is the amount of capital in excess of par?
2. What was the amount of retained earnings at the beginning of the year?
3. How many shares are in treasury stock?
4. Compute earnings per share.

Reporting Stockholders' Equity and Determining Dividend Policy

E11-5
LO1, 3, 4

Butler Corporation was organized in 2009 to operate a financial consulting business. The charter authorized the following capital stock: common stock, par value $10 per share, 11,500 shares. During the first year, the following selected transactions were completed:

a. Sold and issued 5,600 shares of common stock for cash at $20 per share.
b. Sold and issued 1,000 shares of common stock for cash at $25 per share.
c. At year-end, the accounts reflected a $6,000 loss. Because a loss was incurred, no income tax expense was recorded.

Required:

1. Give the journal entry required for each of these transactions.
2. Prepare the stockholders' equity section as it should be reported on the year-end balance sheet.
3. Can the company pay dividends at this time? Explain.

Finding Amounts Missing from the Stockholders' Equity Section

E11-6
LO1, 3
Dillard's

The stockholders' equity section on the balance sheet of Dillard's, a popular department store, is shown below. The company earned net income of $122,726,000 and declared and paid dividends of $12,987,000 in 2006.

Stockholders' equity (in thousands):	2006	2005
Common stock, Class A—115,237,382 and 114,581,524 shares issued; ? and ? shares outstanding	?	1,146
Common stock, Class B (convertible)—4,010,929 shares issued and outstanding	40	40
Additional paid-in capital	749,068	739,620
Retained earnings	2,429,065	?
Less treasury stock, at cost, Class A—39,953,949 and 35,386,849 shares	(809,637)	(708,769)

Required:

Complete the following statements and show your computations.

1. Common stock, class A at par value for 2006 was ______ .
2. The number of shares of common stock outstanding was ______ in 2005 and in 2006 ______ .

3. Retained earnings for 2005 was ________.
4. Have the treasury stock transactions in 2006 (a) increased corporate resources or (b) decreased resources ? ________ By how much?________.
5. For 2006, the treasury stock transactions increased (decreased) stockholders' equity by ________.
6. For 2006, how much did the treasury stock held cost per share? $________.
7. For 2006, total stockholders' equity is $________.

E11-7
LO1, 3

Reporting Stockholders' Equity

Travis Corporation was organized in 2009 to operate a tax preparation business. The charter authorized the following capital stock: common stock, par value $2 per share, 80,000 shares. During the first year, the following selected transactions were completed:

a. Sold and issued 50,000 shares of common stock for cash at $50 per share.
b. Bought 1,000 shares from a stockholder for cash at $52 per share.

Required:

1. Give the journal entry required for each of these transactions.
2. Prepare the stockholders' equity section as it should be reported on the year-end balance sheet.

E11-8
LO1, 3, 7

Reporting Stockholders' Equity

Ruth's Chris Steakhouse is the largest upscale steakhouse company in the United States, based on total company- and franchisee-owned restaurants. The company's menu features a broad selection of high-quality USDA Prime grade steaks and other premium offerings. There were 100 Ruth's Chris restaurants, of which 50 were company-owned and 50 were franchisee-owned, including 10 international franchisee-owned restaurants in Mexico, Hong Kong, Taiwan, and Canada. Information from the company's annual report is shown below:

a. Common stock, par value $0.01, 100,000,000 shares authorized, 23,074,496 issued and outstanding at December 31, 2005; 23,237,630 issued and outstanding at December 31, 2006.
b. Additional paid-in capital $162, 567,000 in 2005 and $166,489,000 in 2006.
c. Accumulated deficit $122,533,000 in 2005.
d. Net income in 2006 was $23,790,000. No dividends were paid.

Required:

Prepare the stockholders' equity section of the balance sheet at December 31, 2006.

E11-9
LO1, 3, 7

Determining the Effects of Transactions on Stockholders' Equity

Carter Corporation was organized in January 2009 to operate several car repair businesses in a large metropolitan area. The charter issued by the state authorized the following capital stock:

Common stock, $10 par value, 98,000 shares.

Preferred stock, $50 par value, 8 percent, 59,000 shares.

During January and February 2009, the following stock transactions were completed:

a. Sold 78,000 shares of common stock at $20 per share and collected cash.
b. Sold 20,000 shares of preferred stock at $80 per share; collected the cash and immediately issued the stock.
c. Bought 4,000 shares of common stock from a current stockholder for $20 per share.

Required:

Net income for 2009 was $90,000; cash dividends declared and paid at year end were $30,000. Prepare the stockholders' equity section of the balance sheet at December 31, 2009.

E11-10
LO3, 7

Recording Stockholders' Equity Transactions

Electronic Teacher Corporation obtained a charter at the start of 2009 that authorized 52,000 shares of no-par common stock and 23,000 shares of preferred stock, par value $10. The corporation was organized by four individuals who purchased a total of 20,000 shares of the common stock. The remaining shares were to be sold to other individuals at $37 per share on a cash basis. During 2009, the following selected transactions occurred:

a. Collected $20 per share cash from the four organizers and issued 5,000 shares of common stock to each of them.
b. Sold and issued 6,000 shares of common stock to an outsider at $40 cash per share.
c. Sold and issued 7,000 shares of preferred stock at $30 cash per share.

Required:

1. Give the journal entries indicated for each of these transactions.
2. Is it ethical to sell stock to outsiders at a higher price than the amount paid by the organizers?

Finding Amounts Missing from the Stockholders' Equity Section

E11-11
LO3, 7

The stockholders' equity section on the December 31, 2009, balance sheet of Chemfast Corporation follows:

Stockholders' Equity	
Contributed capital	
Preferred stock (par $20; authorized 10,000 shares, ? issued, of which 500 shares are held as treasury stock)	$100,000
Common stock (no-par; authorized 20,000 shares, issued and outstanding 8,000 shares)	600,000
Contributed capital (includes $1,500 from treasury stock transactions)	16,500
Retained earnings	34,000
Cost of treasury stock, preferred	(9,500)

Required:

Complete the following statements and show your computations.

1. The number of shares of preferred stock issued was ______ .
2. The number of shares of preferred stock outstanding was ______ .
3. The average sale price of the preferred stock when issued was $______ per share.
4. Have the treasury stock transactions (a) increased corporate resources or (b) decreased resources ? ______ By how much?______ .
5. The treasury stock transactions increased (decreased) stockholders' equity by ______ .
6. How much did the treasury stock held cost per share? $______ .
7. Total stockholders' equity is $______ .
8. The average issue price of the common stock was $______ .

Finding Information Missing from an Annual Report

E11-12
LO1, 3, 4

Procter & Gamble is a $38 billion company that sells products that are part of most of our daily lives, including Mr. Clean, Cheer, Crest, Vicks, Scope, Pringles, Folgers, Vidal Sassoon, Zest, and Charmin. The annual report for P&G contained the following information:

a. Retained earnings at the end of 2005 totaled $31,004 million.
b. Net income for 2006 was $8,684 million.
c. Par value of the stock is $1 per share.
d. Cash dividends declared in 2006 were $1.15 per share.
e. The Common Stock, Par Value account totaled $3,976 million at the end of 2006 and $2,977 at the end of 2005.

Required: *(Assume that no other information concerning stockholders' equity is relevant.)*

1. Estimate the number of shares outstanding at the end of 2006.
2. Estimate the amount of retained earnings at the end of 2006.

Analyzing the Repurchase of Stock

E11-13
LO3, 4
Phelps Dodge

The business section of *The New York Times* recently contained the following article:

The Phelps Dodge Corporation, one of the world's largest copper producers, said yesterday that it would repurchase up to five million shares of its common stock in the open market and through private transactions. The company, based in Phoenix, said it recently completed a program announced last September to buy back 2.5 million shares. Phelps Dodge said the purchases were being made to enhance shareholders' value. The company has about 70.7 million shares outstanding. Shares of Phelps Dodge fell 37.5 cents, to $53.50, on the New York Stock Exchange yesterday.

Required:

1. Determine the impact of the stock repurchase on the financial statements.
2. Why do you think the board decided to repurchase the stock?
3. What impact will this purchase have on the company's future dividend obligations?

E11-14
LO1, 3, 4, 5

Preparing a Statement of Stockholders' Equity and Evaluating Dividend Policy

The following account balances were selected from the records of Blake Corporation at December 31, 2009, after all adjusting entries were completed:

Common stock (par $20; 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
Dividends declared and paid in 2009	16,000
Retained earnings, January 1, 2009	75,000
Treasury stock at cost (2,000 shares)	25,000

Net income for the year was $30,000. Restriction on retained earnings equal to the cost of treasury stock held is required by law in this state. The stock price is currently $22.29 per share.

Required:

1. Prepare the stockholders' equity section of the balance sheet at December 31, 2009.
2. Compute and evaluate the dividend yield ratio. Determine the number of shares of stock that received dividends.

E11-15
LO3

Recording Treasury Stock Transactions and Analyzing Their Impact

During 2009 the following selected transactions affecting stockholders' equity occurred for Jacobs Corporation:

a. Apr. 1 Purchased in the market 200 shares of the company's own common stock at $20 per share.
b. Jun. 14 Sold 40 shares of treasury stock for $25 cash per share.
c. Sept. 1 Sold 30 shares of treasury stock for $15 cash per share.

Required:

1. Give journal entries for each of these transactions.
2. Describe the impact, if any, that these transactions have on the income statement.

E11-16
LO3, 4, 8

Recording Treasury Stock Transactions and Analyzing Their Impact

During 2009 the following selected transactions affecting stockholders' equity occurred for Italy Corporation:

a. Feb. 1 Purchased in the open market 160 shares of the company's own common stock at $20 cash per share.
b. Jul. 15 Sold 80 of the shares purchased on February 1 for $21 cash per share.
c. Sept. 1 Sold 50 more of the shares purchased on February 1 for $19 cash per share.

Required:

1. Give the indicated journal entries for each of the transactions.
2. What impact does the purchase of treasury stock have on dividends paid?
3. What impact does the sale of treasury stock for an amount higher than the purchase price have on net income and the statement of cash flows?

E11-17
LO4, 6

Analyzing the Impact of Dividend Policy

McDonald and Associates is a small manufacturer of electronic connections for local area networks. Consider three independent situations.

Case 1: McDonald increases its cash dividends by 50 percent, but no other changes occur in the company's operations.

Case 2: The company's income and cash flows increase by 50 percent, but this does not change its dividends.

Case 3: McDonald issues a 50 percent stock dividend, but no other changes occur.

Required:

1. How do you think each situation would affect the company's stock price?
2. If the company changed its accounting policies and reported higher net income, would the change have an impact on the stock price?

Computing Dividends on Preferred Stock and Analyzing Differences

E11-18
LO4, 7

The records of Hoffman Company reflected the following balances in the stockholders' equity accounts:

Common stock, par $12 per share, 30,000 shares outstanding.

Preferred stock, 10 percent, par $10 per share, 5,000 shares outstanding.

Retained earnings, $216,000.

On September 1, 2009, the board of directors was considering the distribution of a $65,000 cash dividend. No dividends were paid during the previous two years. You have been asked to determine dividend amounts under two independent assumptions (show computations):

a. The preferred stock is noncumulative.
b. The preferred stock is cumulative.

Required:

1. Determine the total and per share amounts that would be paid to the common stockholders and to the preferred stockholders under the two independent assumptions.
2. Write a brief memo to explain why the dividends per share of common stock were less for the second assumption.
3. What factor would cause a more favorable per share result to the common stockholders?

Determining the Impact of Dividends

E11-19
LO4, 7

Average Corporation has the following capital stock outstanding at the end of 2009:

Preferred stock, 6 percent, par $15, outstanding shares, 8,000.

Common stock, par $8, outstanding shares, 30,000.

On October 1, 2009, the board of directors declared dividends as follows:

Preferred stock: Full cash preference amount, payable December 20, 2009.

Common stock: 50 percent common stock dividend issuable December 20, 2009.

On December 20, 2009, the market prices were preferred stock, $40, and common stock, $32.

Required:

Explain the overall effect of each of the dividends on the assets, liabilities, and stockholders' equity of the company.

Recording the Payment of Dividends

E11-20
LO4, 7
Sears

A recent annual report for Sears disclosed that the company paid preferred dividends in the amount of $119.9 million. It declared and paid dividends on common stock in the amount of $2 per share. During the year, Sears had 1,000,000,000 shares of common authorized; 387,514,300 shares had been issued; 41,670,000 shares were in treasury stock. Assume that the transaction occurred on July 15.

Required:

Prepare a journal entry to record the declaration and payment of dividends.

Evaluating the Dividend Yield Ratio

E11-21
LO5
Cinergy

Cinergy is a utility company that provides gas and electric service in Ohio, Kentucky, and Indiana. The company's dividend yield is 6.6 percent. Starbucks, a well-known retailer of coffee products, does not pay dividends, resulting in a dividend yield of 0.0 percent. Both companies are approximately the same size with market values of $5 billion.

Required:

1. Based on this limited information, why do you think the dividend policies of the two companies are so different?
2. Will the two companies attract different types of investors? Explain.

E11-22 **Analyzing Stock Dividends**
LO6

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

Common stock (par $12; authorized 65,000 shares, outstanding 30,000 shares)	$360,000
Capital in excess of par	120,000
Retained earnings	736,000

On February 1, 2009, the board of directors declared a 60 percent stock dividend to be issued April 30, 2009. The market value of the stock on February 1, 2009, was $15 per share.

Required:

1. For comparative purposes, prepare the Stockholders' Equity section of the balance sheet (a) immediately before the stock dividend and (b) immediately after the stock dividend. (*Hint:* Use two amount columns for this requirement.)
2. Explain the effects of this stock dividend on assets, liabilities, and stockholders' equity.

E11-23 **Recording Dividends**
LO3

P&G

Two billion times a day, Proctor & Gamble (P&G) brands touch the lives of people around the world. The company has one of the largest and strongest portfolios of trusted, quality brands, including Pampers, Tide, Bounty, Pringles, Folgers, Charmin, Downy, Crest, and Clairol Nice 'n Easy. The P&G community consists of nearly 98,000 employees working in almost 80 countries worldwide. The company has 5,000 million shares of common stock authorized and 2,500 million shares issued and outstanding. Par value is $1 per share. The company issued the following press release:

CINCINNATI, January 9, 2007—The Procter & Gamble Company (NYSE: PG) declared a quarterly dividend of thirty-one cents ($ .31) per share on the Common Stock payable on February 15, 2007 to shareholders of record at the close of business on January 19, 2007. P&G has been paying dividends without interruption since incorporation in 1890.

Required:

Prepare journal entries as appropriate for each date mentioned in the press release.

E11-24 **Comparing Stock Dividends and Splits**
LO6

On July 1, 2009, Jones Corporation had the following capital structure:

Common stock (par $3)	$600,000
Capital in excess of par	900,000
Retained earnings	700,000
Treasury stock, none	

Required:

Complete the following comparative tabulation based on two independent cases:

Case 1: The board of directors declared and issued a 50 percent stock dividend when the stock was selling at $5 per share.

Case 2: The board of directors voted a 6-to-5 stock split (i.e., a 20 percent increase in the number of shares). The market price prior to the split was $5 per share.

Items	Before Dividend and Split	After Stock Dividend	After Stock Split
Common stock account	$	$	$
Par per share	$ 3	$	$
Shares outstanding	#	#	#
Capital in excess of par	$900,000	$	$
Retained earnings	700,000	$	$
Total stockholders' equity	$	$	$

Recording a Stock Dividend

E11-25
LO6
GameStop

GameStop issued the following press release when the company's stock was selling for $27 per share:

GRAPEVINE, Texas—(BUSINESS WIRE)—Feb. 12, 2007—GameStop Corp. (NYSE: GME), the world's largest video game and entertainment software retailer, today announced that its Board of Directors approved a two-for-one stock split of the Company's common stock to be effected in the form of a stock dividend.

Each shareholder of record at the close of business on February 20, 2007, will receive one additional share of GameStop common stock for every outstanding share held on the record date. The additional shares will be distributed on March 16, 2007.

"As GameStop continues to rapidly grow, we wanted to make our stock more attractive to a broader range of potential investors. This stock split also reinforces the confidence that the Board and I have in the GameStop buy, sell, trade strategy and the future of video game growth worldwide," indicated R. Richard Fontaine, Chairman and Chief Executive Officer.

The stock split is GameStop's first since becoming a publicly traded company in February 2002. GameStop had approximately 76 million common shares outstanding as of February 3, 2007. Upon completion of the split, the outstanding shares of GameStop's common stock (par value $0.01) will increase to approximately 152 million.

Required:

1. Give any journal entries that would be required.
2. Describe the impact that this transaction will have on future cash dividends.

Comparing Stock Dividends and Splits

E11-26
LO6

Sally Corporation has 80,000 shares of common stock (par value $8) outstanding.

Required:
Complete the following comparative tabulation based on two independent cases:

Case 1: The board of directors declared and issued a 40 percent stock dividend when the stock was selling at $15 per share. The dividend will be accounted for as a large stock dividend.

Case 2: The board of directors voted a 5-to-3 stock split (i.e., a 66.67 percent increase in the number of shares). The market price prior to the split was $15 per share.

Items	Before Dividend and Split	After Stock Dividend	After Stock Split
Common stock account	$	$	$
Par per share	$ 8	$	$
Shares outstanding	#	#	#
Capital in excess of par	$280,000	$	$
Retained earnings	$1,300,000	$	$
Total stockholders' equity	$	$	$

Evaluating Dividend Policy

E11-27
LO4
Ford Motor Co.

Ford Motor Company is an internationally known manufacturer of automobiles and trucks. The company recently lost over $12 billion in a single year of operations. Despite that staggering loss, the company issued the following press release:

DEARBORN, Mich., July 13 /PRNewswire-FirstCall/—The Board of Directors of Ford Motor Company (NYSE: F) today declared a third quarter dividend of 5 cents per share on the company's common stock. The dividend, which is payable on Sept. 1 to shareholders of record on Aug. 2 is a reduction of 5 cents per share from the dividend paid in the second quarter.

Required:

1. Explain why Ford can pay dividends despite its loss.
2. What factors did the board of directors consider when it declared the dividends?

E11-28 **L07** **Archon**

Analyzing Dividends in Arrears

Archon Corporation operates the Pioneer Hotel & Gambling Hall in Nevada. In addition, the company owns real estate on Las Vegas Boulevard South (the "Strip") in Las Vegas, Nevada, and investment properties in Dorchester, Massachusetts, and Gaithersburg, Maryland. An investor found the following note contained in the Archon annual report:

The Company has not declared dividends on its preferred stock since fiscal 1996. Dividends of approximately $1.5 million, $1.5 million, $1.6 million, $1.5 million and $1.6 million for fiscal 2006, 2005, 2004, 2003, and 2002, respectively, have not been declared and are in arrears. Total accumulated preferred stock dividends in arrears for the five preceding years ended on September 30, 2006 are $12.3 million, $10.8 million, $9.5 million, $8.2 million and $7.3 million, respectively.

The investor who read the note suggested that the Archon preferred stock would be a good investment because of the large amount of dividend income that would be earned when the company started paying dividends again: "As the owner of the stock, I'll get dividends for the period I hold the stock plus some previous periods when I didn't even own the stock." Do you agree? Explain.

EXERCISES

E11–1.

Computation of End of Year Balance for Treasury Stock:

Beginning balance	380,474,028	
Net decrease		(5,047,286)
Ending balance		375,426,742

Computation of Shares Outstanding:

Issued shares	2,805,961,317
Treasury stock	(375,426,742)
Shares Outstanding	2,430,534,575

E11–2.

Req. 1 The number of authorized shares is specified in the corporate charter: 200,000.
Req. 2 Issued shares are the shares sold to the public: 160,000
Req. 3

Issued shares	160,000
Treasury stock	(20,000)
Outstanding shares	140,000

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
Contributed capital in excess of par, preferred	36,000
Contributed capital in excess of stated value, no-par common	120,000
Total contributed capital	$380,000
Retained earnings	40,000
Total Stockholders' Equity	$420,000

Req. 2

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

E11–4.

Req. 1 ($20 x 90,000 shares) - $1,600,000 = $200,000
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
	Contributed 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
	Contributed 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 (deficit)	(6,000)
Stockholders' equity	$131,000

Req. 3

The company has a negative balance in retained earnings, which, in most cases, would preclude the payment of dividends. Dividends are a distribution of earnings to the owners. In the absence of retained earnings, dividends should not be paid.

E11–6.

Req. 1

Common stock, class A at par value: 115,237,382 X $0.01 = $1,152 (thousand)

Req. 2

Number of shares outstanding 2006: 115,237,382 shares issued minus 39,953,949 shares held as treasury stock = 75,283,433.

Number of shares outstanding 2005: 114,581,524 shares issued minus 35,386,849 shares held as treasury stock = 79,194,675.

Req. 3

(In thousands) Retained earnings for 2006: $2,429 065 minus net income for 2006 $122,726 plus dividends for 2006 $12,987 = $2,319,326

Req. 4

As of 2006, treasury stock had decreased corporate resources by $809,637.

Req. 5

For 2006, treasury stock transactions decreased stockholders' equity by $100,868 ($708,769 - $809,637).

Req. 6

For 2006, treasury stock cost per share: $809,637,000 ÷ 39,953,949 shares = $20.26.

Req. 7

For 2006, total stockholders' equity: $2,369,689.

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
Contributed capital in excess of par, common stock (+SE)		2,400,000
Sold common stock at a premium.		
b. Treasury stock (1,000 shares x $52) (+XSE, -SE)	52,000	
Cash (-A)		52,000
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	(52,000)
Stockholders' equity	$2,448,000

E11–8.

Shareholders' equity (deficit) in thousands:	2005	2006
Common stock, par value $.01 per share; 100,000,000 shares authorized, 23,074,496 shares issued and outstanding at December 31, 2005, 23,237,630 shares issued and outstanding at December 31, 2006	231	232
Additional paid-in capital	162,567	166,489
Accumulated deficit	(122,533)	(98,743)
Total shareholders' equity	40,265	67,978

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
Contributed capital in excess of par, preferred stock	600,000
Contributed capital in excess of par, common stock	780,000
Treasury stock	(80,000)
Retained earnings*	60,000
Total stockholders' equity	$3,140,000

*($90,000 – $30,000 = $60,000.)

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
	Contributed 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 ÷ $20 = 5,000

Req. 2

Number of preferred shares outstanding: 5,000 shares issued minus 500 shares held as treasury stock = 4,500.

Req. 3

Average sales price per share of preferred stock when issued: ($100,000 + $15,000) ÷ 5,000 shares = $23.00.

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 ($3,976 million) by the par value of the shares ($1 per share) or approximately 3,976,000,000 shares.

Req. 2

Retained earnings end of 2005	$31,004,000,000
Net income for 2006	8,684,000,000
Dividends for 2006	(4,572,400,000)
Retained earnings end of 2006	$35,115,600,000

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 2006. 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
Contributed 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

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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 sale of treasury stock is a cash inflow which would affect the Statement of Cash Flows.

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 (30,000 Shares)	Total
a) Noncumulative:			
Preferred ($50,000 x 10%)	$ 5,000		$ 5,000
Balance to common ($65,000 – $5,000)		$60,000	60,000
	$ 5,000	$60,000	$65,000
Per share	$1.00	$2.00	
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 ($65,000 – $10,000 – $5,000)		$50,000	50,000
	$15,000	$50,000	$65,000
Per share	$3.00	$1.67	

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

Cinergy is a utility company that is very established. They have very little opportunity for growth and they have stable business operations. Therefore, they have the ability to have a high dividend yield. On the other hand, Starbucks is a fairly new company with a high opportunity for growth. Due to the fact that they are retaining all of their earnings to invest into their growth, they have a 0.0% dividend yield.

Req. 2

The companies will attract two different types of investors. Cinergy will attract investors who want and/or need current income, such as someone who is retired. Starbucks will attract investors who want appreciation on their stock price, such as someone who is planning for their retirement in 25 years.

E11–22.

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
Contributed capital in excess of par value	120,000	120,000
Retained earnings	736,000	520,000
Total stockholders' equity	$1,216,000	$1,216,000

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 stockaccount was increased by the same amount.

E11–23.
January 9, 2007

Retained earnings (-SE)	775,000,000	
Dividends payable (+L)		775,000,000

2,500 (million) shares x $0.31= $775,000,000

January 19, 2007
No journal entry required.
February 15, 2007

Dividends payable (-L)	775,000,000	
Cash (-A)		775,000,000

E11–24.
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	$3	$3	$2.50
Shares outstanding	#200,000	#300,000	#240,000
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.

E11–25.
Req. 1

February 12, 2007---No entry
February 20, 2007---No entry
March 16, 2007

Retained earnings (-SE)	760,000	
Common stock (+SE)		760,000

Req. 2
Without additional information, one cannot determine the impact on future cash dividends. In some cases, the company will maintain its dividend per share payout, in which case total dividends will increase. In other cases, the company may reduce the dividends per share and maintain the same total payout. In the case of GameStock, the company is not currently paying cash dividends, so there is no immediate effect.

E11–26.
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	$ 1,300,000	$ 1,044,000	$ 1,300,000
Total stockholders' equity	$2,220,000	$2,220,000	$2,220,000

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.

E11–27.
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.

E11–28.
The fact that dividends are in arrears indicates that the company has been experiencing some financial difficulty. Most companies do not want to suspend dividend payments because it will erode investor confidence. Typically, companies are experiencing severe cash flow problems when they take this type of drastic action. The investor assumed that he would get a large cash payment "when Archon started paying dividends again." The student should have realized that he was making a large assumption; a financially troubled company may never pay dividends again.