

BACHELOR of ECONOMICS



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

AC201 Fundamental Accounting

Semester 1/2015

Course Package OY 04

Topic:

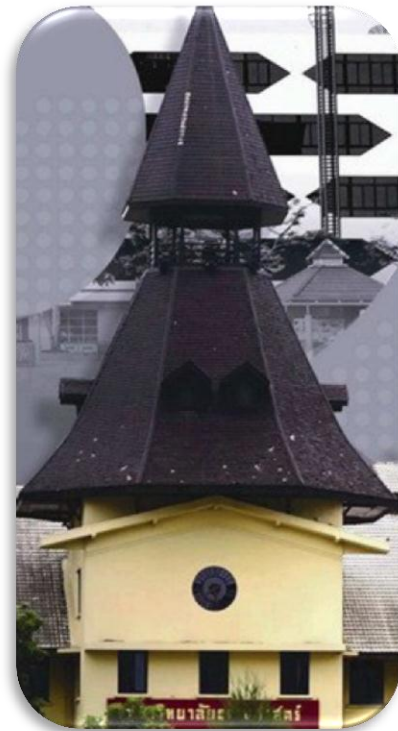
Reporting and Interpreting
Shareholders' Equity

Session:

Session OY 04

Instructor:

Assistant Professor Dr. Orapan Yolrabil



REPORTING AND INTERPRETING SHAREHOLDERS' EQUITY

Chapter Take-Aways

1. Explain the role of stock in the capital structure of a corporation.

The law recognizes corporations as separate legal entities. Owners invest in a corporation and receive capital stock that can be traded on established stock exchanges. Stock provides a number of rights, including the right to receive dividends.

2. Analyze the earnings per share ratio.

The earnings per share ratio facilitates the comparison of a company's earnings over time or with other companies' at a single point in time. By expressing earnings on a per share basis, differences in the size of companies become less important.

3. Describe the characteristics of common stock and analyze transactions affecting common stock.

Common stock is the basic voting stock issued by a corporation. Usually it has a par value, but no-par stock can be issued. Common stock offers some special rights that appeal to certain investors.

A number of key transactions involve capital stock: (1) initial sale of stock, (2) treasury stock transactions, (3) cash dividends, and (4) stock dividends and stock splits. Each is illustrated in this chapter.

4. Discuss dividends and analyze transactions.

The return associated with an investment in capital stock comes from two sources: appreciation and dividends. Dividends are recorded as a liability when they are declared by the board of directors (i.e., on the date of declaration). The liability is satisfied when the dividends are paid (i.e., on the date of payment).

5. Analyze the dividend yield ratio.

The dividend yield ratio measures the percentage of return on an investment from dividends. For most companies, the return associated with dividends is very small.

6. Discuss the purpose of stock dividends, stock splits, and report transactions.

Stock dividends are pro rata distributions of a company's stock to existing owners. The transaction involves transferring an additional amount into the common stock account. A stock split also involves the distribution of additional shares to owners but no additional amount is transferred into the common stock account. Instead, the par value of the stock is reduced.

7. Describe the characteristics of preferred stock and analyze transactions affecting preferred stock.

Preferred stock provides investors certain advantages including dividend preferences and a preference on asset distributions in the event the corporation is liquidated.

8. Discuss the impact of capital stock transactions on cash flows.

Both inflows (e.g., the issuance of capital stock) and outflows (e.g., the purchase of treasury stock) are reported in the Financing Activities section of the statement of cash flows. The payment of dividends is reported as an outflow in this section.

Key Ratios

The **earnings per share ratio** states the income of a corporation on a per share basis. The ratio is computed as follows:

$$\text{Earnings per Share} = \text{Net Income} \div \text{Average Number of Shares of Common Stock Outstanding}$$

The **dividend yield ratio** measures the dividend return on the current price of the stock. The ratio is computed as follows:

$$\text{Dividend Yield Ratio} = \text{Dividend per Share} \div \text{Market Price per Share}$$

Finding Financial Information

Balance Sheet

Under Current Liabilities

Dividends, once declared by the board of directors, are reported as a liability (usually current).

Under Noncurrent Liabilities

Transactions involving capital stock do not generate noncurrent liabilities.

Under Stockholders Equity

Typical accounts include:

- Preferred stock
- Common stock
- Capital in excess of par
- Retained earnings
- Treasury stock

Income Statement

Capital stock is never shown on the income statement. Dividends paid are not an expense. They are a distribution of income and are, therefore, not reported on the income statement.

Statement of Stockholders' Equity

This statement reports detailed information concerning stockholders' equity, including (1) amounts in each equity account, (2) number of shares outstanding, (3) impact of transactions such as earning income, payment of dividends, and purchase of treasury stock.

Statement of Cash Flows

Under Financing Activities

- + Cash inflows from initial sale of stock
- + Cash inflows from sale of treasury stock
- Cash outflows for dividends
- Cash outflows for purchase of treasury stock

Notes

Under Summary of Significant Accounting Policies

Usually, very little information concerning capital stock is provided in this summary.

Under a Separate Note

Most companies report information about their stock option plans and information about major transactions such as stock dividends or significant treasury stock transactions. An historical summary of dividends paid per share is typically provided. Also, dividends in arrears on preferred stock, if any, would be reported in a note.

Chapter Outline

Notes

1. Explain the role of stock in the capital structure of a corporation.

Ownership of a Corporation

A. Benefits of Stock Ownership

1. Owners of common stock receive a number of benefits:
 - a. A voice in management - Vote at the annual stockholders' meeting with a number of votes equal to the number of shares owned
 - b. Dividends - A proportional share of the distribution of profits
 - c. Residual claim - A proportional share of the distribution of remaining assets upon the liquidation of the company

2. Analyze the earnings per share ratio.

B. Authorized, Issued, and Outstanding Shares

1. Authorized number of shares - Maximum number of shares of a corporation's capital stock that can be issued as specified in the charter
2. Issued shares - Total number of shares of stock that have been sold
3. Outstanding shares - Total number of shares of stock that are owned by stockholders on any particular date
 - a. Treasury stock - Stock that has been bought back
 - b. When a company buys back its stock, a difference is created between the number of issued shares and the number of outstanding shares (that is, shares currently held by individual stockholders)
 - c. Treasury stock is included in "issued" but not in "outstanding"

C. Key Ratio Analysis: Earnings per Share (EPS)

1. Earnings per Share (EPS) = $\text{Net Income} \div \text{Average Number of Common Shares Outstanding}$
2. Measures how well a company is performing
3. Useful in comparing companies of different sizes
4. While an effective and widely used measure of profitability, it can be misleading if there are significant differences in the market values of shares being compared

3. Describe the characteristics of common stock and analyze transactions affecting common stock.

II. Common Stock Transactions

A. Terminology

1. All corporations must issue common stock, but only some issue preferred stock
2. Common stock - Basic voting stock issued by a corporation
3. Par value - Nominal value per share of capital stock specified in the charter; basis for legal capital
4. Legal capital - Permanent amount of capital defined by state law that must remain invested in the business; serves as a cushion for creditors
5. No-par value stock - Capital stock that has no par value specified in the corporate charter

B. Initial Sale of Stock

1. Two names applied to transactions involving the initial sale of a company's stock to the public:
 - a. Initial public offering (IPO) – The very first sale of a company's stock to the public (i.e., when the company first "goes public")
 - b. Seasoned new issue – Additional sales of new stock to the public once a company's stock has been traded on established markets

2. The Kroger Co. sold 100,000 shares of its \$1 par value stock for \$20 per share

Dr. Cash (+A)	2,000,000	
Cr. Common Stock (+SE)		100,000
100,000 x \$1		
Capital in Excess of Par (+SE)		1,900,000

Assets = Liabilities + Stockholders' Equity

Cash (A) + 2,000,000 = Common Stock (SE) + 100,000 + Capital in Excess of Par (SE) + 1,900,000

3. The common stock account is credited for the number of shares sold times the par value per share and the capital in excess of par account is credited for the remainder
 - a. If corporate charter does not specify a par value, stated value is used in the same manner
 - b. If no par or stated value, entire proceeds from the sale will be entered in the common stock account

C. Sale of Stock in Secondary Markets

1. When a company sells stock to the public, the transaction is between the issuing corporation and the buyer
2. Subsequent to the initial sale, investors can sell shares to other investors without directly affecting the corporation
3. If an investor sold 1,000 shares of The Kroger Co. stock to another investor, The Kroger Co. would not record a journal entry

D. Stock Issued for Employee Compensation

1. Advantage of the corporate form is the ability to separate the management of a business from its ownership
2. Separation can be a disadvantage because some managers may not act in the owners' best interests; problem can be overcome in a number of ways:
 - a. Compensation packages can be developed to reward managers for meeting goals important to stockholders
 - b. Another strategy is to offer managers stock options, which permit them to buy stock at a fixed price

- i. The options specify that shares could be bought at the then-current market price
- ii. Granting a stock option is a form of compensation, even if the grant price and the current stock price are the same
- iii. A stock option is a risk-free investment
 - If you hold a stock option and the stock price declines, you have lost nothing
 - If the stock price increases, you can exercise your option at the low grant price and sell the stock at the higher price for a profit

E. Repurchase of Stock

1. Treasury stock – A corporation's own stock that has been issued but subsequently reacquired and is still being held by that corporation

2. The Kroger Co. bought 100,000 shares of its stock in the open market when it was selling for \$20 per share

Dr. Treasury Stock (–SE)	2,000,000	
Cr. Cash (–A)		2,000,000

Assets = Liabilities + Stockholders' Equity

Cash (A) – 2,000,000 = Treasury Stock (SE) – 2,000,000

3. Treasury Stock account is a contra-equity account,; it is subtracted from total stockholders' equity
4. When a company sells its treasury stock:
 - a. GAAP does not permit a corporation to report income or losses from investments in its own stock
 - b. Transactions with the owners are not normal profit-making activities

5. The Kroger Co. re-sold 10,000 shares of treasury stock for \$30 per share (purchased at \$20 per share)

Dr. Cash (+A)	300,000	
Cr. Treasury Stock (+SE)		200,000
	(10,000 x \$20)	
Capital in Excess of Par		100,000
	(+SE)	

Assets = Liabilities + Stockholders' Equity

Cash (A) + 300,000 = Treasury Stock (SE) + 200,000 + Capital in Excess of Par (SE) + 100,000

6. Instead, The Kroger Co. re-sold the 10,000 shares of treasury stock for only \$15 per share (purchased at \$20 per share)

Dr. Cash (+A)	150,000	
Capital in Excess of Par	50,000	
	(–SE)	
Cr. Treasury Stock (+SE)		200,000
	(10,000 x \$20)	

Assets = Liabilities + Stockholders' Equity

Cash (A) + 150,000 = Capital in Excess of Par (SE) 100,000 (SE) – 50,000 + Treasury Stock (SE) + 200,000

4. Discuss dividends and analyze transactions.

III. Key Ratio Analysis: Dividends on Common Stock

A. Return on Stock Investments

1. Investors buy common stock because they expect a return on their investment
2. Return on investment can come in two forms:
 - a. Stock price appreciation
 - b. Dividends

5. Analyze the dividend yield ratio.

B. Key Ratio Analysis: Dividend Yield Ratio

1. Dividend Yield = Dividends per Share ÷ Market Price per Share
2. Ratio measures return on investment based on dividends
3. Often potential capital appreciation is a much more important consideration than dividend yield; analysts should also assess the future earnings potential of the company

C. Declaration and Payment of Dividends

1. Three important dates:
 - a. Declaration date – Date on which the board of directors officially approves a dividend; company records a liability related to the dividend on this date
 - b. Record date – Dividends can be paid only to the stockholders who own stock on that date; no entry
 - c. Payment date – Date on which a cash dividend is paid to the stockholders of record
2. On June 25, the board of The Kroger Co. declares a \$0.115 per share dividend on its 561 million outstanding shares

Dr. Retained Earnings (–SE)	64,515,000	
Cr. Dividends Payable		64,515,000
		(+L)

Assets = Liabilities + Stockholders' Equity
 $0 = \text{Dividends Payable (L)} + 64,515,000 + \text{Retained Earnings (SE)} - 64,515,000$
3. On December 1, The Kroger Co. pays the dividend

Dr. Dividends Payable (–L)	64,515,000	
Cr. Cash (–A)		64,515,000

Assets = Liabilities + Stockholders' Equity
 $\text{Cash (A)} - 64,515,000 = \text{Dividends Payable (L)} - 64,515,000$
4. Two fundamental requirements for payment of a cash dividend:
 - a. Sufficient retained earnings
 - b. Sufficient cash

6. Discuss the purpose of stock dividends, stock splits, and report transactions.

IV. Stock Dividends and Stock Splits

A. Stock Dividends

1. Stock dividend – A distribution of additional shares of a corporation's own stock to its stockholders on a pro rata basis at no cost to the stockholder
2. Value of a stock dividend is the subject of much debate
 - a. A stock dividend by itself has no economic value
 - i. All stockholders receive a pro rata distribution of shares, which means that each stockholder owns exactly the same portion of the company as before
 - ii. The stock market reacts immediately when a stock dividend is issued; stock price falls proportionally
 - b. In reality, the fall in price is not exactly proportional to the number of new shares issued
 - i. In some cases, the stock dividend makes the stock more attractive to new investors
 - ii. In other cases, stock dividends are associated with increases in cash dividends, which are attractive to some investors
3. When a stock dividend occurs, the company must transfer an amount out of the Retained Earnings account (or Capital in Excess of Par account, if there is not a sufficient balance in Retained Earnings); amount transferred depends on relative size of the stock dividend
 - a. Large stock dividend
 - i. Distribution of additional shares that amount to more than 20% –25% of outstanding shares
 - ii. Amount transferred to the Common Stock account is based on the par value of the shares issued
 - b. Small stock dividend
 - i. Distribution of additional shares that amount to less than 20% –25% of outstanding shares
 - ii. Amount transferred is the total market value of the shares issued, with the par value of the stock transferred to the Common Stock account and the excess transferred to the Capital in Excess of Par account
4. The Kroger Co. issued 400,000,000 shares as a large stock dividend

Dr. Retained Earnings (–SE)	400 mill
\$1 par x 400,000,000	
Cr. Common Stock (+SE)	400 mill

Assets = Liabilities + Stockholders' Equity
 0 = Retained Earnings (SE) - 400 mill + Common Stock (SE) + 400 mill
5. Stock dividends do not change total stockholders' equity; only the balances of some of the accounts that constitute stockholders' equity were changed

B. Stock Splits

1. Stock split – An increase in the total number of authorized shares by a specified ratio; it does not decrease retained earnings
2. Stock splits are similar to a stock dividend, but quite different in terms of their impact on the stockholders' equity accounts.
 - a. In a stock split, the total number of authorized shares is increased by a specified amount; in a 2-for-1 stock split, each share held is called in and two new shares are issued in its place
 - b. Stock split is accomplished by reducing the par or stated value per share of all authorized shares, so that their total par value is unchanged
 - i. If The Kroger Co. executes a 2-for-1 stock split, it reduces the par value of its stock from \$1 to \$0.50 and doubles the number of shares outstanding
 - ii. A stock split does not result in the transfer of a dollar amount to the Common Stock account; the reduction in the par value per share compensates for the increase in the number of shares
3. A stock dividend requires a journal entry; a stock split does not but is disclosed in the notes to the financial statements

C. Statement of Changes in Stockholders' Equity

1. Required by GAAP – purpose is to show changes in the key components of stockholders' equity, including common stock, paid-in capital, treasury stock, and retained earnings
2. Also reports accumulated other comprehensive gain (loss) – Certain items that bypass the income statement because they have not satisfied the revenue recognition criteria
 - a. Unrealized hold gains or losses from available-for-sale securities
 - i. Occur when a company holds stock in another company and is prepared to sell them when cash is needed
 - ii. Under GAAP, gains and losses are reported on the income statement only when the stock is sold
 - iii. Unrealized gains and losses that occur before the stock is sold are included in comprehensive income
 - b. Foreign currency translation gains and losses
 - i. When a company invests in a foreign country, the investment is made in that country's currency.
 - ii. The exchange rate between the U.S. dollar and foreign currencies changes on a daily basis, resulting in foreign currency translation gains and losses

- iii. These gains and losses are not recorded on the income statement until the foreign currency is converted back into U.S. dollars
- iv. The unrealized translation gains and losses are included in comprehensive income

7. Describe the characteristics of preferred stock and analyze transactions affecting preferred stock.

VI. Preferred Stock

- A. Issuance of Preferred Stock
 - 1. In addition to common stock, some corporations issue preferred stock
 - 2. Preferred stock differs from common stock based on a number of rights granted to the stockholders:
 - a. Preferred stock does not grant voting rights; one of the main reasons corporations issue preferred stock to raise equity capital
 - b. Preferred stock is less risky because holders receive priority payment of dividends and distribution of assets if the corporation goes out of business
 - c. Preferred stock typically has a fixed dividend rate
- B. Dividends on Preferred Stock
 - 1. Current dividend preference – Requires the current preferred dividend to be paid before any dividends are paid on the common stock
 - a. Always a feature of preferred stock.
 - b. After the current dividend preference has been met and if no other preference is operative, dividends can be paid to the common stockholders
 - 2. Cumulative dividend preference – Requires that if all or a part of the current dividend is not paid in full, the cumulative unpaid amount (known as dividends in arrears) must be paid before any common dividends can be paid
 - a. If preferred stock is noncumulative, dividends can never be in arrears; any preferred dividends that are not declared are permanently lost
 - b. Preferred stockholders are unwilling to accept this unfavorable feature; preferred stock is usually cumulative.

8. Discuss the impact of capital stock transactions on cash flows.

- C. Focus on Cash Flows – Financing Activities
 - 1. The cash proceeds from the issuance of capital stock are added in computing cash flows from financing activities
 - 2. The cash used to purchase of treasury stock is subtracted in computing cash flows from financing activities
 - 3. The cash proceeds from the sale of treasury stock are added in computing cash flows from financing activities
 - 4. The cash used to pay cash dividends is subtracted in computing cash flows from financing activities

- VI. Chapter Supplement: Accounting for Owners' Equity for Sole Proprietorships and Partnerships
- A. Owner's Equity for a Sole Proprietorship
1. Sole proprietorship – Unincorporated business owned by one person
 - a. Only two owners' equity accounts are needed:
 - i. A capital account for the proprietor
 - ii. A drawing (or withdrawal) account for the proprietor
 - b. The capital account of a sole proprietorship serves two purposes:
 - i. To record investments by the owner
 - ii. To accumulate periodic income or loss
 - c. The drawing account is used to record the owner's withdrawals of cash or other assets from the business; closed to the capital account at the end of each accounting period
 - d. The capital account reflects the cumulative total of all investments by the owner and all earnings of the entity less all withdrawals from the entity by the owner
 2. In most respects, the accounting for a sole proprietorship is the same as for a corporation.
 - a. Because a sole proprietorship does not pay income taxes, its financial statements do not reflect income tax expense or income taxes payable
 - b. Instead, the net income of a sole proprietorship is taxed when it is included on the owner's personal income tax return
 - c. Owner's salary is not recognized as an expense in a sole proprietorship; it is accounted for as a distribution of profits (i.e., a withdrawal)
- B. Owners' Equity for a Partnership
1. Partnership (per Uniform Partnership Act) – An association of two or more persons to carry on as co-owners of a business for profit
 - a. Agreement between the partners constitutes a partnership contract
 - i. Agreement should specify matters such as division of periodic income, management responsibilities, transfer or sale of partnership interests, disposition of assets upon liquidation, and procedures to be followed in case of the death of a partner
 - ii. If the partnership agreement does not specify these matters, the laws of the resident state are binding
 - b. Primary advantages:
 - i. Ease of formation
 - ii. Complete control by the partners
 - iii. Lack of income taxes on the business itself

- c. Primary disadvantage:
 - i. Unlimited liability of each partner for the partnership's debts
 - ii. If the partnership does not have sufficient assets to satisfy outstanding debt, creditors of the partnership can seize the partners' personal assets
- 2. Accounting for a partnership follows the same underlying principles as any other form of business organization, except for those entries affecting equity
 - a. Separate capital and drawing accounts must be established for each partner
 - b. Investments by each partner are credited to that partner's capital account; withdrawals are debited to the respective partner's drawing account
 - c. The net income of a partnership is divided among the partners in accordance with the partnership agreement and credited to each account
 - d. The respective drawing accounts are closed to the partner capital accounts
 - e. After the closing process, each partner's capital account reflects the cumulative total of all of that partner's investments plus that partner's share of the partnership earnings less all that partner's withdrawals
- 3. The financial statements of a partnership follow the same format as those for a corporation except that:
 - a. The income statement includes an additional section entitled Distribution of Net Income
 - b. The partners' equity section of the balance sheet is detailed for each partner
 - c. The partnership has no income tax expense because partnerships do not pay income tax (partners must report their share of the partnership profits on their individual tax returns)
 - d. Salaries paid to the partners are not recorded as expenses but are treated as distributions of earnings



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1



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

2



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.



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.

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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.

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

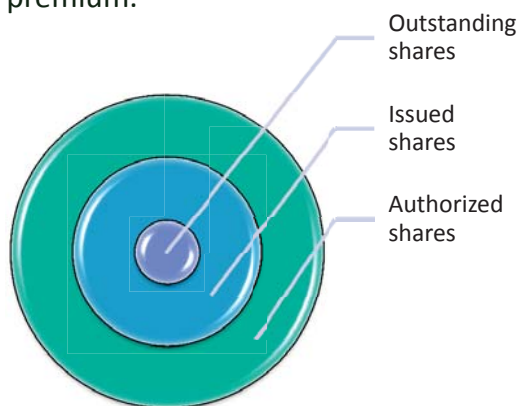
Paid-in Capital	
Ordinary share	
	<i>Normal Balance</i>
Share premium	
	<i>Normal Balance</i>
Retained Earnings	
	<i>Normal Balance</i>

6



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.



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Ordinary Share

Share Issuance:

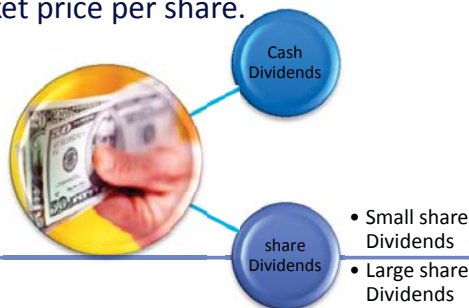
Case #1	Dr. Cash [A+]	300,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
Issued 30,000 shares of 10 Baht par value ordinary share at par			
Case #2	Dr. Cash [A+]	360,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
	Share premium [E+]		60,000
Issued 30,000 shares of 10 Baht par value ordinary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

8



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.



9



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			

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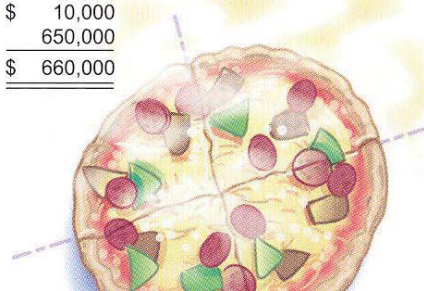
Stock Split and Stock Reverse

- **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

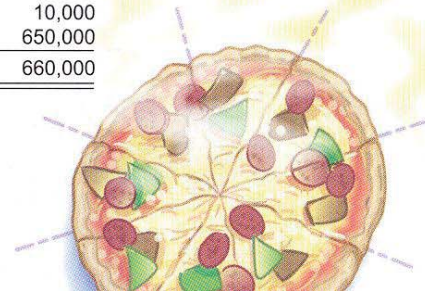
	Before a 2-for-1 Stock Split
Number of shares outstanding	1,000,000
Par value per share	\$ 0.01
Total par value outstanding	\$ 10,000
Retained earnings	650,000
Total stockholders' equity	\$ 660,000

Before a 2-for-1 Stock Split



After a 2-for-1 Stock Split

Number of shares outstanding	2,000,000
Par value per share	\$ 0.005
Total par value outstanding	\$ 10,000
Retained earnings	650,000
Total stockholders' equity	\$ 660,000



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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.

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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.

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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	Ordinary Share
		(6% x 100 Baht par x 2,000 shares outstanding)	
Year 1	15,000	12,000	3,000
Year 2	3,000	3,000	0
Year 3	28,000	21,000	7,000

	Dividend Declared	Noncumulative Preferred Share	Ordinary Share
		(6% x 100 Baht par x 2,000 shares outstanding)	
Year 1	15,000	12,000	3,000
Year 2	3,000	3,000	0
Year 3	28,000	12,000	16,000

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Example on dividend distribution

Company A has the following shares outstanding:

- Cumulative Preferred Shares: 5%, 100 Baht par, 2,000 shares outstanding
- Noncumulative Preferred Shares: 6%, 100 Baht par, 5,000 shares outstanding
- Ordinary Shares: 10 Baht par, 10,000 shares outstanding

The company declared the following amount of dividend in Year 20X1-20X3

- Year 20X1 – 8,000 Baht
- Year 20X2 – 30,000 Baht
- Year 20X3 – 100,000 Baht
- Year 20X4 – 4,000 Baht
- Year 20X5 – 30,000 Baht

Priority in Dividend Distribution:

1. Dividend in arrears → Cumulative PS
2. Current year dividend → Cumulative PS
3. Current year dividend → Noncumulative PS
4. Remaining amount → Ordinary share

	Cumulative PS	Noncumulative PS	Ordinary share
Year 20X1	8000	0	0
Year 20X2	12000	18000	0
Year 20X3	10000	30000	60000
Year 20X4	4000	0	0
Year 20X5	16000	14000	0

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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.

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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.

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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.



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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			

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Example on Treasury Share

- 1. Company A acquired the treasury shares on Jan. 1, 20X1 at 50 baht per share for 10,000 shares.
- 2. On Jun. 1, 20X2, the company reissued 2,000 shares for 45 baht price.
- 3. On Dec. 15, 20X2, the company reissued 5,000 shares for 52 baht price.

Date	General Journal	Debit	Credit
Jan. 1, 20X1	Dr. Treasury share	500,000	
	Cr. Cash		500,000
Jun. 1, 20X2	Dr. Cash	90,000	
	Retained earnings	10,000	
	Cr. Treasury share		100,000
Dec. 15, 20X2	Dr. Cash	260,000	
	Cr. Treasury share		250,000
	Paid-in capital – Treasury share		10,000

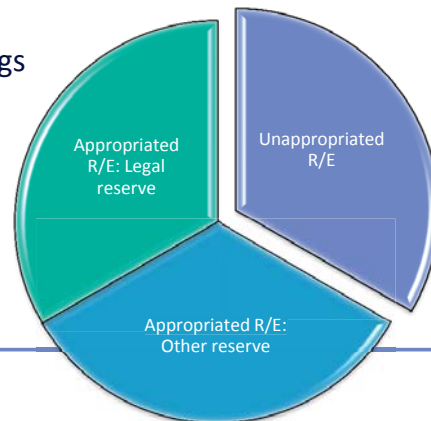
20



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



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Financial Ratios: Equity Financing

Earnings per share

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

Price-earnings ratio

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

Dividend yield

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

Book value per share

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

Return on equity

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

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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)

Share Capital

[Source: www.farmhouse.co.th]

		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).

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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.

Slide 25

	Net income (loss)	Statutory/Legal reserve
Year 1	100	5.00 = 100 x 5%
Year 2	200	10.00 = 200 x 5%
Year 3	(300)	- N/A
Year 4	400	5.00 = (400-300) x 5%
Year 5	500	25.00 = 500 x 5%
Year 6	600	30.00 = 600 x 5%
Year 7	700	25.00 = 100 - 75
Statutory/Legal Reserve		100.00 Not available for dividend distribution
Registered Capital		1,000.00

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21. DIVIDEND PAYMENTS

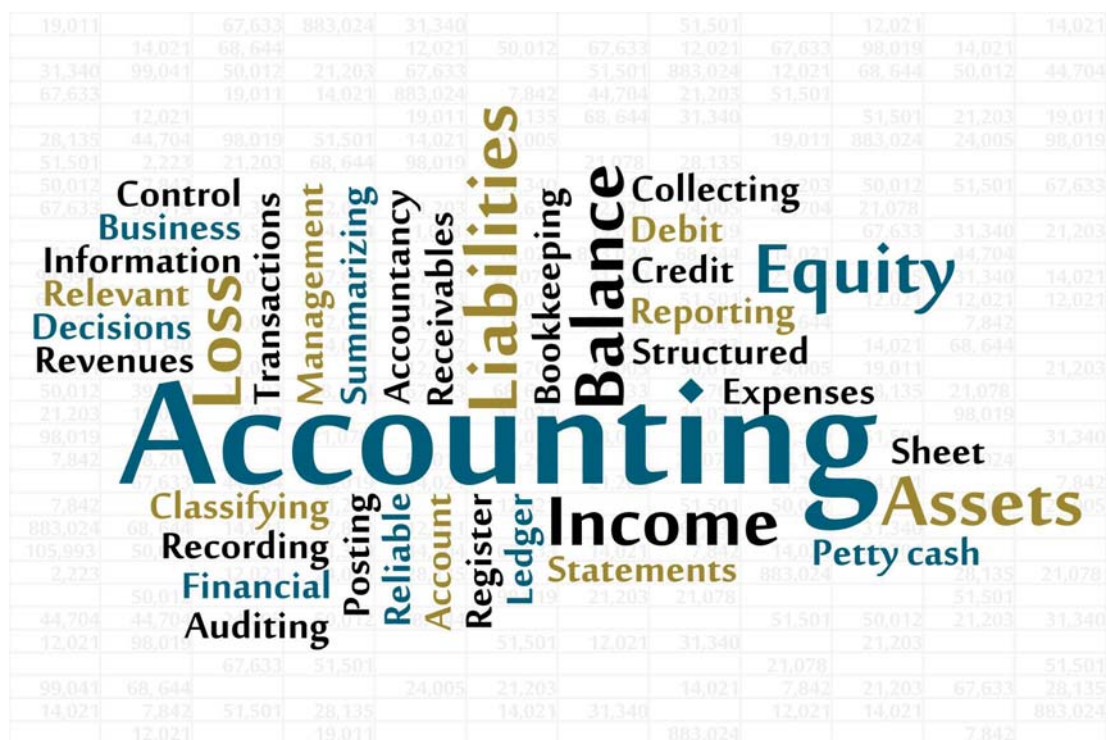
During the years ended 31 December 2010 and 2009, the Company had dividend payments as follows:

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		

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Equity Financing

Comparison between debt financing and equity financing:

	Debt financing	Equity financing
Classification		
Sources of funds		
Cost of funds		
Tax benefits		
Maturity dates		
Dilutive effects		

Types of business organization:

	Sole proprietorship	Partnership	Corporation
Owner(s)			
Business life			
Responsibility for business liability			
Risk burden			

Share capital:				
1. Number of shares				
	Authorized Registered shares		shares	<i>max no. of shares</i>
	Issued shares		shares	<i>sold</i>
	Unissued shares		shares	<i>unsold</i>
	Treasury shares		shares	<i>buy back</i>
	Outstanding shares		shares	<i>dividend payment</i>
2. Types of shares				
		Preference shares Preferred stock		Ordinary shares Common stock
	Preference			
	Dividend rate			
	Voting right			
	Type			
	Required			

3. Journal entries

3.1. Share issuance

Date	General Journal	Debit	Credit
CASE 1: At par			
	<i>Issued 700,000 shares with ₱10 par at a price of ₱10 per share</i>		
CASE 2: At premium			
	<i>Issued 700,000 shares with ₱10 par at a price of ₱12 per share</i>		
CASE 3: At discount			
	<i>Issued 700,000 shares with ₱10 par at a price of ₱8 per share</i>		

3.2. Dividend distribution

Date	General Journal	Debit	Credit
Date of declaration			
	<i>Declared ₱1 cash dividend to 700,000 ordinary shares outstanding.</i>		
Date of record			
	<i>Recorded the list of shareholders who are entitled to receive dividend.</i>		
Date of payment			
	<i>Paid cash dividend declared to the shareholders who are in the list at the date of record.</i>		

Dividend allocation

Example #1:

Company A has the following shares outstanding:

(1) 10%, \$100-par preferred shares. There are 2,000 shares outstanding.

(2) \$10-par ordinary shares. There are 10,000 shares outstanding.

CASE 1: Cumulative preferred shares

Year	Dividend declared	Cumulative preferred shares	Ordinary shares
20X1	35,000		
20X2	8,000		
20X3	50,000		

CASE 2: Noncumulative preferred shares

Year	Dividend declared	Noncumulative preferred shares	Ordinary shares
20X1	35,000		
20X2	8,000		
20X3	50,000		

Example #2:

Company A has the following shares outstanding:

(1) 10%, \$100-par noncumulative preferred shares. There are 2,000 shares outstanding.

--- *NonPS Div per year* = $10\% \times \$100 \times 2,000 \text{ shares} = \$20,000$

(2) 5%, \$50-par cumulative preferred shares. There are 10,000 shares outstanding.

--- *CumPS Div per year* = $5\% \times \$50 \times 10,000 \text{ shares} = \$25,000$

(3) \$10-par ordinary shares. There are 10,000 shares outstanding.

Year	Dividend declared	Cumulative preferred shares	Noncumulative preferred shares	Ordinary shares
20X1	30,000			
20X2	10,000			
20X3	85,000			

3.3. Treasury shares

Date	General Journal	Debit	Credit
Date of reacquisition			
	Reacquired 150,000 treasure shares at price of ₦20 per share.		
Date of reissuance #1			
	Reissued 30,000 treasury shares at a price of ₦20 per share.		
Date of reissuance #2			
	Reissued 60,000 treasury shares at a price of ₦22 per share.		
Date of reissuance #3			
	Reissued 50,000 treasury shares at a price of ₦15 per share.		

Retained earnings:

The retained earnings consist of 2 components:

1. Appropriated retained earnings -- legal reserve and others
2. Unappropriate retained earnings

	Year 20X1	Year 20X2	Year 20X3
Beginning balance of retained earnings	0	350,000	950,000
+ Profit for the period	500,000	800,000	1,200,000
- Dividend declared	(150,000)	(200,000)	(350,000)
= Ending balance of retained earnings	350,000	950,000	1,800,000

Appropriated Retained Earnings -- Legal 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 profit 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.

Example:

Registered Capital
Required legal reserve (10%)

1,000 Authorized shares 1,000 shares and
100 the par value is \$1 per share.

	Profit or loss	Legal reserve
Year 1	100	
Year 2	200	
Year 3	(300)	
Year 4	400	
Year 5	500	
Year 6	600	
Year 7	700	
Year 8	800	
Year 9	900	
Year 10	1,000	
Total		

Financial Statement Presentation:Information:

Company A issued 700,000 ordinary shares with a par value of ₪10 per share at a price of ₪12 per share on Jan. 1, 20X1.

Later, the Company reacquired 10,000 shares of treasury shares at a cost of ₪20 per share.

Note that this is the first year of operations and the company reported profit for the year of ₪800,000 and declared dividend ₪50,000.

Statement of Financial Position [PARTIAL]			
Shareholders' equity			
Share capital			
Ordinary shares			
Share premium - Ordinary shares			
Retained earnings			
Appropriated retained earnings - Statutory reserve			
Unappropriate retained earnings			
Less: Treasury shares			
Total shareholders' equity			

Statement of Changes in Equity						
	Share capital		Retained earnings		Treasury shares	Total
	Ordinary shares	Share premium	Appropriated -- Legal reserve	Unappropriated		
Beginning balance						
+ Share issuance						
- Treasury shares reacquisition						
+ Profit for the year						
+ - Legal reserve appropriation						
- Dividend declared						
Ending balance						

EXERCISES



Available with McGraw-Hill's Homework Manager

E11-1 Computing Shares Outstanding

L01

Philip Morris

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 Computing Number of Shares

L01

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 Determining the Effects of the Issuance of Common and Preferred Stock

L01, 3, 7

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
L01, 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
L01, 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
L01, 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
L01, 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
L01, 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
L01, 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
L03, 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:

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

Required:

- Give the journal entries indicated for each of these transactions.
- 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
L03, 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.

- The number of shares of preferred stock issued was _____.
- The number of shares of preferred stock outstanding was _____.
- The average sale price of the preferred stock when issued was \$_____ per share.
- Have the treasury stock transactions (a) increased corporate resources or (b) decreased resources? _____ By how much? _____.
- The treasury stock transactions increased (decreased) stockholders' equity by _____.
- How much did the treasury stock held cost per share? \$_____.
- Total stockholders' equity is \$_____.
- The average issue price of the common stock was \$_____.

Finding Information Missing from an Annual Report

E11-12
L01, 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:

- Retained earnings at the end of 2005 totaled \$31,004 million.
- Net income for 2006 was \$8,684 million.
- Par value of the stock is \$1 per share.
- Cash dividends declared in 2006 were \$1.15 per share.
- 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.)

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

Analyzing the Repurchase of Stock

E11-13
L03, 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
L01, 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
L03

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
L03, 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
L04, 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

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

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

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

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.

E11-18
L04, 7



E11-19
L04, 7



E11-20
L04, 7
Sears



E11-21
L05
Cinergy



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
L06

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
L03



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
L06

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

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

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

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:

E11-25
L06
GameStop

E11-26
L06

E11-27
L04
Ford Motor Co.



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 Analyzing Dividends in Arrears

L07

Archon



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	<u>\$420,000</u>

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 $(\$20 \times 90,000 \text{ shares}) - \$1,600,000 = \$200,000$

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

Req. 3 $90,000 \text{ shares} - 80,000 \text{ shares} = 10,000 \text{ shares}$

Req. 4 $\text{EPS} = \$1,000,000 \div 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	<u>\$131,000</u>

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: $115,237,382 \times \$0.01 = \underline{\$1,152 \text{ (thousand)}}$

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: $\$809,637,000 \div 39,953,949 \text{ shares} = \underline{\$20.26}$.

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	<u>\$2,448,000</u>

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	<u>(122,533)</u>	<u>(98,743)</u>
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	<u>\$3,140,000</u>

*(\$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: $\$100,000 \div \$20 = \underline{5,000}$

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: $(\$100,000 + \$15,000) \div 5,000 \text{ shares} = \underline{\$23.00}$.

Req. 4

Decreased corporate resources by $\$9,500 - \$1,500 = \underline{\$8,000}$.

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: $\$9,500 \div 500 \text{ shares} = \underline{\$19.00}$.

Req. 7

Total stockholders' equity: \$741,000.

Req. 8

Issue price of common stock $\$600,000 \div 8,000 \text{ 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	<u>\$907,000</u>

Req. 2

The dividend yield ratio is 2.24% $(\$16,000 \div 32,000 \text{ shares}) \div \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 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.

	Preferred (5,000 Shares)	Common (30,000 Shares)	Total
Req. 1			
a) Noncumulative:			
Preferred (\$50,000 x 10%)	\$ 5,000		\$ 5,000
Balance to common (\$65,000 – \$5,000)		\$60,000	60,000
	<u>\$ 5,000</u>	<u>\$60,000</u>	<u>\$65,000</u>
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
	<u>\$15,000</u>	<u>\$50,000</u>	<u>\$65,000</u>
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

	<i>Stockholders' Equity</i>	
	<i>Before Stock Dividend</i>	<i>After Stock Dividend</i>
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	<u>\$1,216,000</u>	<u>\$1,216,000</u>

Req. 2

<u>Item</u>	<u>Effects of Stock Dividend</u>
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.

E11-23.

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.