Accounting for Corporations

Collection

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Introduction

Most large businesses are organized as corporations. In contrast, most small businesses are organized as proprietorships, partnerships, or limited liability companies. A corporation is defined as “an artificial being, invisible, intangible, and existing only in contemplation of law.” This definition is the foundation for the prevailing legal interpretation that a corporation is an entity separate and distinct from its owners. A corporation is created by law, and its continued existence depends upon the statutes of the state in which it is incorporated. As a legal entity, a corporation has most of the rights and privileges of a person. The major exceptions relate to privileges that only a living person can exercise, such as the right to vote or to hold public office. A corporation is subject to the same duties and responsibilities as a person. For example, it must abide by the laws, and it must pay taxes.

Two common ways to classify corporations are by **purpose** and by **ownership**. A corporation may be organized for the purpose of making a profit, or it may be not for- profit. For-profit corporations include such well-known companies as McDonald’s, Nike, PepsiCo, and Google. Not-for-profit corporations are organized for charitable, medical, or educational purposes.

Examples are the Salvation Army and the American Cancer Society.

Classification by ownership differentiates publicly held and privately held corporations. A **publicly held corporation** may have thousands of stockholders. Its stock is regularly traded on a national securities exchange such as the New York Stock Exchange. Examples are IBM, Caterpillar, and General Electric.

In contrast, a **privately held corporation** usually has only a few stockholders, and does not offer its stock for sale to the general public. Privately held companies are generally much smaller than publicly held companies, although some notable exceptions exist. Cargill Inc., a private corporation that trades in grain and other commodities, is one of the largest companies in the United States.

Characteristics of a corporation

A number of characteristics distinguish corporations from proprietorships and partnerships. We explain the most important of these characteristics below.

1- Separate legal existence

As an entity separate and distinct from its owners, the corporation acts under its own name rather than in the name of its stockholders. Nike may buy, own, and sell property. It may borrow money and may enter into legally binding contracts in its own name. It may also sue or be sued, and it pays its own taxes.

Remember that in a partnership the acts of the owners (partners) bind the partnership. In contrast, the acts of its owners (stockholders) do not bind the corporation unless such owners are **agents** of the corporation. For example, if you owned shares of Nike stock, you would not have the right to purchase inventory for the company unless you were designated as an agent of the corporation.

2- Limited liability of stockholders

Since a corporation is a separate legal entity, creditors have recourse only to corporate assets to satisfy their claims. The liability of stockholders is normally limited to their investment in the corporation. Creditors have no legal claim on the personal assets of the owners unless fraud has occurred. Even in the event of bankruptcy, stockholders' losses are generally limited to their capital investment in the corporation.

3- Transferable ownership rights

Shares of capital stock give ownership in a corporation. These shares are transferable units. Stockholders may dispose of part or all of their interest in a corporation simply by selling their stock.

Remember that the transfer of an ownership interest in a partnership requires the consent of each owner. In contrast, the transfer of stock is entirely at the discretion of the stockholder. It does not require the approval of either the corporation or other stockholders.

The transfer of ownership rights between stockholders normally has no effect on the daily operating activities of the corporation. Nor does it affect the corporation's assets, liabilities, and total ownership equity. The transfer of these ownership rights is a transaction between individual owners. After it first issues the capital stock, the company does not participate in such transfers.

4- Ability to acquire capital

It is relatively easy for a corporation to obtain capital through the issuance of stock. Investors buy stock in a corporation to earn money over time as the share price grows, and because a stockholder has limited liability and shares of stock are readily transferable. Also, individuals can become stockholders by investing relatively small amounts of money. In sum, the ability of a successful corporation to obtain capital is virtually unlimited.

5- Continuous life

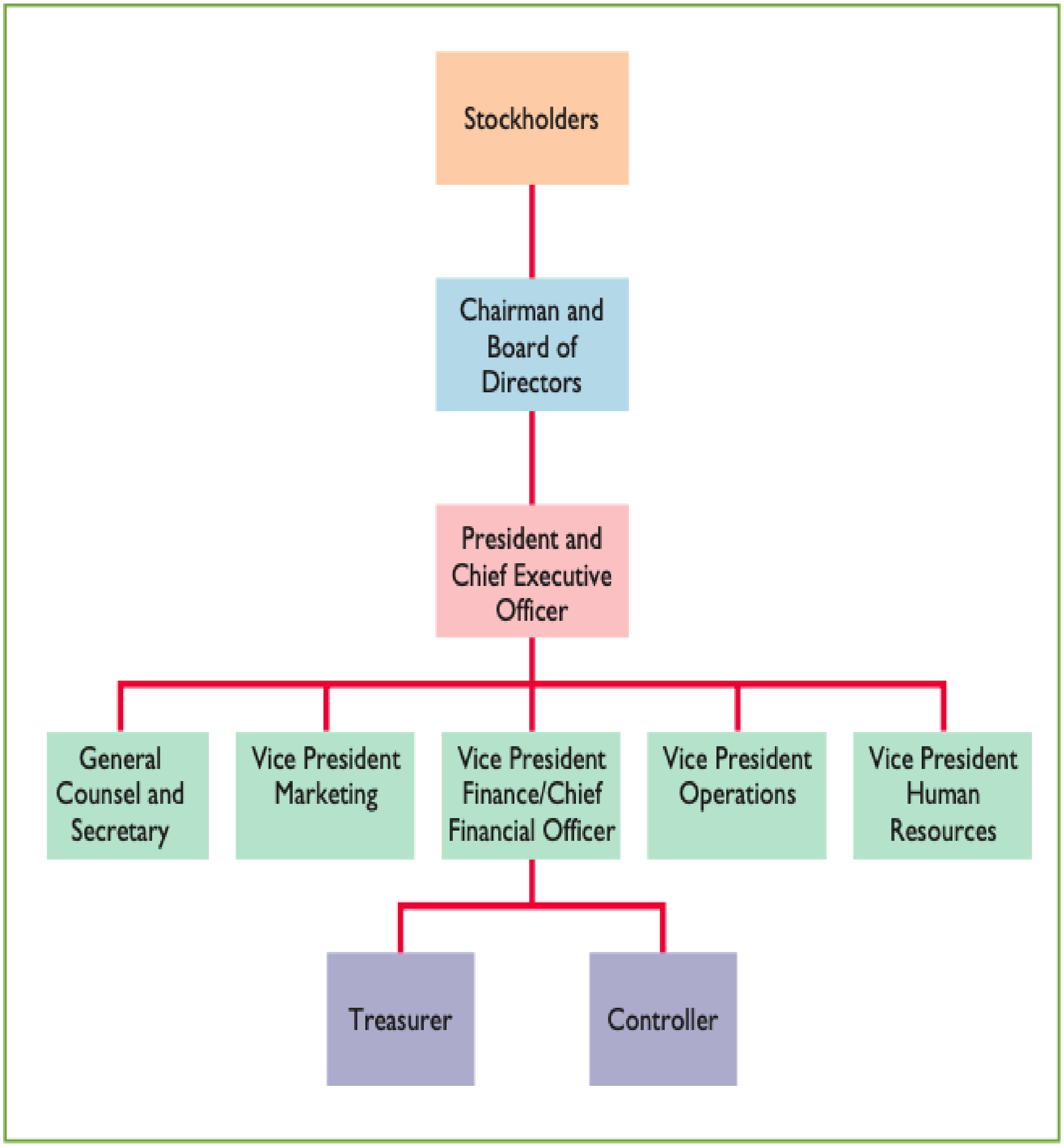
The life of a corporation is stated in its charter. The life may be perpetual, or it may be limited to a specific number of years. If it is limited, the company can extend the life through renewal of the charter. Since a corporation is a separate legal entity, its continuance as a going concern is not affected by the withdrawal, death, or incapacity of a stockholder, employee, or officer. As a result, a successful company can have a continuous and perpetual life.

6- Corporation management

Stockholders legally own the corporation. However, they manage the corporation indirectly through a board of directors they elect. The board, in turn, formulates the operating policies for the company. The board also selects officers, such as a president and one or more vice presidents, to execute policy and to perform daily management functions. The board is also required to monitor management's actions more closely.

Illustration 1-1 presents a typical organization chart showing the delegation of responsibility.

Illustration 1-1



The chief executive officer (CEO) has overall responsibility for managing the business. As the organization chart shows, the CEO delegates responsibility to other officers. The chief accounting officer is the **controller**. The controller's responsibilities include (1) maintaining the accounting records, (2) maintaining an adequate system of internal control, and (3) preparing financial statements, tax returns, and internal reports. The **treasurer** has custody of the corporation's funds and is responsible for maintaining the company's cash position.

The organizational structure of a corporation enables a company to hire professional managers to run the business. On the other hand, the separation of ownership and management often reduces an owner's ability to actively manage the company.

7- Government regulations

A corporation is subject to numerous state and federal regulations. For example, state laws usually prescribe the requirements for issuing stock, the distributions of earnings permitted to stockholders, and the effects of retiring stock. Federal securities laws govern the sale of capital stock to the general public. Also, most publicly held corporations are required to make extensive disclosure of their financial affairs to the Securities and Exchange Commission (SEC) through quarterly and annual reports. In addition, when a corporation lists its stock on organized securities exchanges, it must comply with the reporting requirements of these exchanges. Government regulations are designed to protect the owners of the corporation.

8- <u>Additional taxes</u>

Owners of proprietorships and partnerships report their share of earnings on their personal income tax returns. The individual owner then pays taxes on this amount. Corporations, on the other hand, must pay federal and state income taxes **as a separate legal entity**. These taxes are substantial.

In addition, stockholders must pay taxes on cash dividends (pro rata distributions of net income). Thus, many argue that the government taxes corporate income **twice (double taxation)**—once at the corporate level, and again at the individual level.

In summary, the advantages and disadvantages of a corporation compared to a proprietorship and a partnership are:

Advantages	Disadvantages
Separate legal existence	Corporation management—separation of ownership and management
Limited liability of stockholders	Government regulations
Transferable ownership rights	Additional taxes
Ability to acquire capital	
Continuous life	
Corporation management—professional managers	

Forming a corporation

A corporation is formed by grant of a state **charter**. The charter is a document that describes the name and purpose of the corporation, the types and number of shares of stock that are authorized to be issued, the names of the individuals that formed the company, and the number of shares that these individuals agreed to purchase. Regardless of the number of states in which a corporation has operating divisions, it is incorporated in only one state.

It is to the company's advantage to incorporate in a state whose laws are favorable to the corporate form of business organization. For example, although General Motors has its headquarters in Michigan, it is incorporated in New Jersey. In fact, more and more corporations have been incorporating in states with rules that favor existing management. For example, Gulf Oil changed its state of incorporation to Delaware to thwart possible unfriendly takeovers. There, certain defensive tactics against takeovers can be approved by the board of directors alone, without a vote by shareholders.

Upon receipt of its charter from the state of incorporation, the corporation establishes **by-laws**. The by-laws establish the internal rules and procedures for conducting the affairs of the corporation. Corporations engaged in interstate commerce must also obtain a

license from each state in which they do business. The license subjects the corporation's operating activities to the general corporation laws of the state.

Costs incurred in the formation of a corporation are called **organization costs**. These costs include legal and state fees, and promotional expenditures involved in the organization of the business. **Corporations expense organization costs as incurred.** To determine the amount and timing of future benefits is so difficult that it is standard procedure to take a conservative approach of expensing these costs immediately.

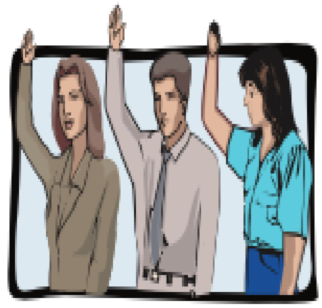
Ownership rights of stockholders

When chartered, the corporation may begin selling ownership rights in the form of shares of stock. When a corporation has only one class of stock, it is **common stock**. Each share of common stock gives the stockholder the ownership rights pictured in Illustration 1-2. The articles of incorporation or the by-laws state the ownership rights of a share of stock.

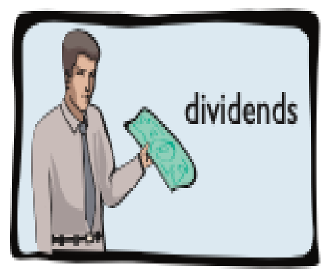
Illustration 1-2

Stockholders have the right to:

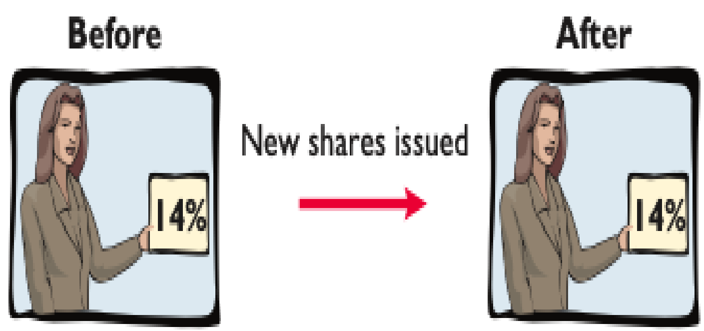
1. Vote in election of board of directors at annual meeting and vote on actions that require stockholder approval.



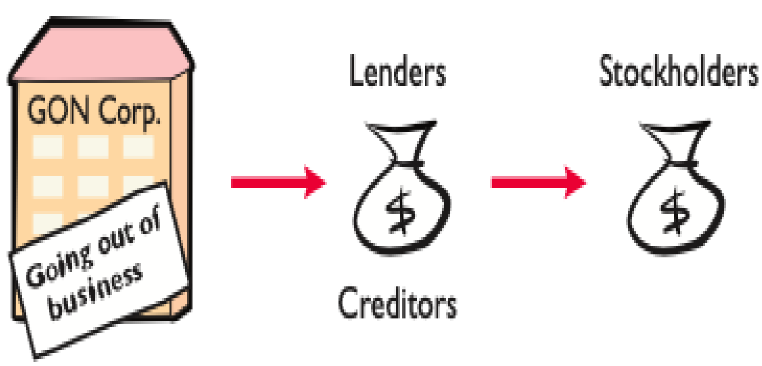
2. Share the corporate earnings through receipt of dividends.



3. Keep the same percentage ownership when new shares of stock are issued (**preemptive right**[1]).



4. Share in assets upon liquidation in proportion to their holdings. This is called a **residual claim:** owners are paid with assets that remain after all creditors' claims have been paid.



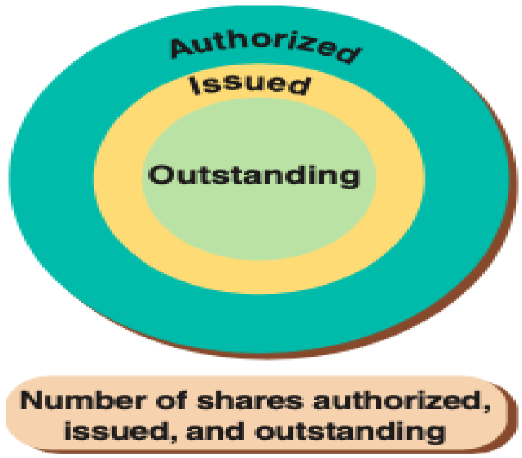
Proof of stock ownership is evidenced by a form known as a **stock certificate**. The face of the certificate shows the name of the corporation, the stockholder's name, the class and special features of the stock, the number of shares owned, and the signatures of authorized corporate officials. Prenumbered certificates facilitate accountability. They may be issued for any quantity of shares.

Stock issue considerations

In considering the issuance of stock, a corporation must resolve a number of basic questions: How many shares should it authorize for sale? How should it issue the stock? At what price should it issue the shares? What value should the corporation assign to the stock? These questions are addressed in the following sections.

Characteristics of stock

The number of shares of stock that a corporation is *authorized* to issue is stated in its charter. The term *issued* refers to the shares issued to the stockholders. A corporation may reacquire some of the stock that it has issued. The stock remaining in the hands of stockholders is then called outstanding stock. The relationship between authorized, issued, and outstanding stock is shown in the following graphic.



Corporations have limited liability and, thus, creditors have no claim against stockholders' personal assets. To protect creditors, however, some states require corporations to maintain a minimum amount of paid-in capital. This minimum amount, called *legal capital,* usually includes the par or stated value of the shares issued.

Authorized stock

The charter indicates the amount of stock that a corporation is **authorized** to sell.

The total amount of **authorized stock** at the time of incorporation normally anticipates both initial and subsequent capital needs. As a result, the number of shares authorized generally exceeds the number initially sold. If it sells all authorized stock, a corporation must obtain consent of the state to amend its charter before it can issue additional shares.

The authorization of capital stock does not result in a formal accounting entry. This event has no immediate effect on either corporate assets or stockholders' equity. However, the number of authorized shares is often reported in the stockholders' equity section. It is then simple to determine the number of unissued shares that the corporation can issue without amending the charter: subtract the total shares issued from the total authorized. For example, if Advanced Micro was authorized to sell 100,000 shares of common stock and issued 80,000 shares, 20,000 shares would remain unissued.

Issuance of stock

A corporation can issue common stock **directly** to investors. Or, it can issue the stock **indirectly** through an investment banking firm that specializes in bringing securities to the attention of prospective investors. Direct issue is typical in closely held companies. Indirect issue is customary for a publicly held corporation.

In an indirect issue, the investment banking firm may agree to **underwrite** the entire stock issue. In this arrangement, the investment banker buys the stock from the corporation at a stipulated price and resells the shares to investors. The corporation thus avoids any risk of being unable to sell the shares. Also, it obtains immediate use of the cash received from the underwriter. The investment banking firm, in turn, assumes the risk of reselling the shares, in return for an underwriting fee. For example, Google (the world's number-one Internet search engine) used underwriters when it issued a highly successful initial public offering, raising $1.67 billion. The underwriters charged a 3% underwriting fee (approximately $50 million) on Google's stock offering.

How does a corporation set the price for a new issue of stock? Among the factors to be considered are: (1) the company's anticipated future earnings, (2) its expected dividend rate per share, (3) its current financial position, (4) the current state of the economy, and (5) the current state of the securities market. The calculation can be complex and is properly the subject of a finance course.

<u>Market value of stock</u>

The stock of publicly held companies is traded on organized exchanges. The interaction between buyers and sellers determines the prices per share. In general, the prices set by the marketplace tend to follow the trend of a company's earnings and dividends. But factors beyond a company's control, such as an oil embargo, changes in interest rates, and the outcome of a presidential election, may cause day-to-day fluctuations in market prices.

The trading of capital stock on securities exchanges involves the transfer of **already issued shares** from an existing stockholder to another investor. These transactions have **no impact** on a corporation’s stockholders’ equity.

Par and no-par value stocks

Par value stock is capital stock to which the charter has assigned a value per share. Years ago, par value determined the **legal capital** per share that a company must retain in the business for the protection of corporate creditors; that amount was not available for withdrawal by stockholders. Thus, in the past, most states required the corporation to sell its shares at par or above.

However, par value was often immaterial relative to the value of the company’s stock—even at the time of issue. Thus, its usefulness as a protective device to creditors was questionable. For example, Loews Corporation’s par value is $0.01 per share, yet a new issue in 2010 would have sold at a **market value** in the $35 per share range. Thus, par has no relationship with market value; in the vast majority of cases, it is an immaterial amount. As a consequence, today many states do not require a par value. Instead, they use other means to protect creditors.

No-par value stock is capital stock to which the charter has not assigned a value. No-par value stock is fairly common today.

For example, Nike and Procter & Gamble both have no-par stock. In many states, the board of directors assigns a **stated value** to no-par shares.

Classes of stock

When only one class of stock is issued, it is called common stock. Each share of common stock has equal rights.

A corporation may also issue one or more classes of stock with various preference rights such as a preference to dividends. Such a stock is called a preferred stock. The dividend rights of preferred stock are stated either as dollars per share or as a percent of par. For example, a $50 par value preferred stock with a $4 per share dividend may be described as either:

preferred $4 stock, $50 par

or

preferred 8% stock, $50 par

Because they have first rights (preference) to any dividends, preferred stockholders have a greater chance of receiving dividends than common stockholders. However, since dividends are normally based on earnings, a corporation cannot guarantee dividends even to preferred stockholders.

The payment of dividends is authorized by the corporation's board of directors. When authorized, the directors are said to have *declared* a dividend.

Cumulative preferred stock has a right to receive regular dividends that were not declared (paid) in prior years. Noncumulative preferred stock does not have this right.

Cumulative preferred stock dividends that have not been paid in prior years are said to be in arrears. Any preferred dividends in arrears must be paid before any common stock dividends are paid. In addition, any dividends in arrears are normally disclosed in notes to the financial statements.

To illustrate, assume that a corporation has issued the following preferred and common stock:

1,000 shares of cumulative preferred $4 stock, $50 par

4,000 shares of common stock, $15 par

The corporation was organized on January 1, 2012 and paid no dividends in 2012 and 2013. In 2014, the corporation paid $22,000 in dividends, of which $12,000 was paid to preferred stockholders and $10,000 was paid to common stockholders as shown below.

Total dividends paid	$22,000
Preferred stockholders:	
2012 dividends in arrears (1,000 shares × $4) . ………… . ..	$4,000
2013 dividends in arrears (1,000 shares × $4) ……...	4,000
2014 dividend (1,000 shares × $4)	4,000
Total preferred dividends paid	(12,000)
Dividends available to common stockholders	$10,000

As a result, preferred stockholders received $12.00 per share ($12,000 ÷ 1,000 shares) in dividends, while common stockholders received $2.50 per share ($10,000 ÷ 4,000 shares).

In addition to dividend preference, preferred stock may be given preferences to assets if the corporation goes out of business and is liquidated. However, claims of creditors must be satisfied first. Preferred stockholders are next in line to receive any remaining assets, followed by the common stockholders.

Example 1-1

Sandpiper Company has 20,000 shares of cumulative preferred 1% stock of $100 par and 100,000 shares of $50 par common stock. The following amounts were distributed as dividends:

Year 1, $10,000; Year 2, 45,000; Year 3, 80,000

Determine the dividends per share for preferred and common stock for each year.

Solution

	Year 1	Year 2	Year 3
Amount distributed	$10,000	$45,000	$80,000
Preferred dividend (20,000 shares)	10,000	30,000*	20,000
Common dividend (100,000 shares)	$ 0	$15,000	$60,000
*($10,000 + $20,000)			
Dividends per share:			
Preferred stock	$0.50	$1.50	$1.00
Common stock	None	$0.15	$0.60

Corporate capital

Owners' equity is identified by various names: **stockholders' equity**, **shareholders' equity**, or **corporate capital**. The stockholders' equity section of a corporation's balance sheet consists of two parts: (1) paid-in (contributed) capital and (2) retained earnings (earned capital).

The distinction between **paid-in capital** and **retained earnings** is important from both a legal and a financial point of view. Legally, corporations can make distributions of earnings (declare dividends) out of retained earnings in all states. However, in many states they cannot declare dividends out of paid-in capital. Management, stockholders, and others often look to retained earnings for the continued existence and growth of the corporation.

Paid-in capital

Paid-in capital is the total amount of cash and other assets paid into the corporation by stockholders in exchange for capital stock. The main source of **paid-in capital** is from issuing stock. As noted earlier, when a corporation has only one class of stock, it is **common stock**.

Retained earnings

Retained earnings is net income that a corporation retains for future use. Net income is recorded in Retained Earnings by a closing entry that debits Income Summary
and credits Retained Earnings. For example, assuming that net income for Delta Robotics in its first year of operations is $130,000, the closing entry is:

Income Summary	130,000	
Retained Earnings		130,000

(To close Income Summary and transfer net income to retained earnings)

If Delta Robotics has a balance of $800,000 in common stock at the end of its first year, its stockholders' equity section is as follows.

Stockholders' equity	
Paid-in capital	
Common stock	$800,000
Retained earnings	130,000
Total stockholders' equity	**$930,000**

Example 1-2

At the end of its first year of operation, Doral Corporation has $750,000 of common stock and net income of $122,000. Prepare (a) the closing entry for net income and (b) the stockholders' equity section at year-end.

Solution

(a) Income Summary 122,000

Retained Earnings 122,000

(To close Income Summary and transfer net income to retained earnings)

(b)

Stockholders' equity	
Paid-in capital	
Common stock	$750,000
Retained earnings	122,000
Total stockholders' equity	$872,000

<u>Exercise: Indicate whether each of the following statements is true or false.</u>

1. Similar to partners in a partnership, stockholders of a corporation have unlimited liability.

2. It is relatively easy for a corporation to obtain capital through the issuance of stock.

3. The separation of ownership and management is an advantage of the corporate form of business.

4. The journal entry to record the authorization of capital stock includes a credit to the appropriate capital stock account.

5. All states require a par value per share for capital stock.

<u>Solution</u>

1. False. The liability of stockholders is normally limited to their investment in the corporation.

2. True.

3. False. The separation of ownership and management is a disadvantage of the corporate form of business.

4. False. The authorization of capital stock does not result in a formal accounting entry.

5. False. Many states do not require a par value.

Chapter Two: Stocks and Dividends

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Issuing Stock

A separate account is used for recording the amount of each class of stock issued to investors in a corporation. For example, assume that a corporation is authorized to issue 10,000 shares of $100 par preferred stock and 100,000 shares of $20 par common stock. The corporation issued 5,000 shares of preferred stock and 50,000 shares of common stock at par for cash. The corporation's entry to record the stock issue is as follows:

Cash	1,500,000	
Preferred Stock		500,000
Common Stock		1,000,000
(Issued preferred stock and common stock at par for cash).		

Stock is often issued by a corporation at a price other than its par. The price at which stock is sold depends on a variety of factors, such as the following:

1. The financial condition, earnings record, and dividend record of the corporation.
2. Investor expectations of the corporation's potential earning power.
3. General business and economic conditions and expectations.

Premium on Stock

When stock is issued at a premium, Cash is debited for the amount received. Common Stock or Preferred Stock is credited for the par amount. The excess of the amount paid over par is part of the paid-in capital. An account entitled *Paid-In Capital in Excess of Par* is credited for this amount. To illustrate, assume that Caldwell Company issues 2,000 shares of $50 par preferred stock for cash at $55. The entry to record this transaction is as follows:

Cash	110,000	
Preferred Stock		100,000
Paid-In Capital in Excess of Par—Preferred Stock		10,000
(Issued $50 par preferred stock at $55).		

When stock is issued in exchange for assets other than cash, such as land, buildings, and equipment, the assets acquired are recorded at their fair market value. If this value cannot be determined, the fair market price of the stock issued is used. To illustrate, assume that a corporation acquired land with a fair market value that cannot be determined. In exchange, the corporation issued 10,000 shares of its $10 par common stock. If the stock has a market price of $12 per share, the transaction is recorded as follows:

Land	120,000	
Common Stock		100,000
Paid-In Capital in Excess of Par		20,000
(Issued $10 par common stock, valued at $12 per share, for land).		

When a corporation issues stock for less than par value, it debits the account Paid in Capital in Excess of Par—Common Stock if a credit balance exists in this account. If a credit balance does not exist, then the corporation debits to Retained Earnings the amount less than par. This situation occurs only rarely: Most states do not permit the sale of common stock below par value, because stockholders may be held personally liable for the difference between the price paid upon original sale and par value.

No-Par Stock

Sometimes, no-par preferred and common stock may be issued. When no-par stock is issued, Cash is debited, and Common Stock is credited for the proceeds. As no par stock is issued over time, this entry is the same even if the issuing price varies. To illustrate, assume that on January 9 a corporation issues

10,000 shares of no-par common stock at $40 a share. On June 27, the corporation issues an additional 1,000 shares at $36. The entries to record these issuances of the no-par stock are as follows:

Jan. 9	Cash		400,000	
		Common Stock		400,000
(Issued 10,000 shares of no-par common stock at $40).				
June 27	Cash		36,000	
		Common Stock		36,000
(Issued 1,000 shares of no-par common stock at $36).				

In some cases, no-par stock may be assigned a *stated value per share.* The stated value is recorded like a par value. Any excess of the proceeds over the stated value is credited to *Paid-In Capital in Excess of Stated Value.* To illustrate, assume that in the preceding example the no-par common stock is assigned a stated value of $25. The issuance of the stock on January 9 and June 27 is recorded as follows:

Jan. 9	Cash		400,000	
		Common Stock		250,000
		Paid-In Capital in Excess of Stated Value		150,000
(Issued 10,000 shares of no-par common stock at $40; stated value, $25).				
June 27	Cash		36,000	
		Common Stock		25,000
		Paid-In Capital in Excess of Stated Value		11,000
(Issued 1,000 shares of no-par common stock at $36; stated value, $25).				

Example 2-1

On March 6, Limerick Corporation issued for cash 15,000 shares of no-par common stock at $30. On April 13, Limerick issued at par 1,000 shares of preferred 4% stock, $40 par for cash. On May 19, Limerick issued for cash 15,000 shares of 4%, $40 par preferred stock at $42. Journalize the entries to record the March 6, April 13, and May 19 transactions.

Solution

Mar. 6	Cash	450,000	
	Common Stock (15,000 shares × $30).		450,000
Apr. 13	Cash	40,000	
	Preferred Stock (1,000 shares × $40).		40,000
May 19	Cash	630,000	
	Preferred Stock		600,000
	Paid-In Capital in Excess of Par (15,000 shares × $2).		30,000

Issuing Common Stock for Services or Noncash Assets

Corporations also may issue stock for services (compensation to attorneys or consultants) or for noncash assets (land, buildings, and equipment). In such cases, what
cost should be recognized in the exchange transaction. To comply with the **cost principle**, in a noncash transaction **cost is the cash equivalent price**. Thus, **cost is either the fair value of the consideration given up, or the fair value of the consideration received**, whichever is more clearly determinable. To illustrate, assume that attorneys have helped Jordan Company incorporate. They have billed the company $5,000 for their services. They agree to accept 4,000 shares of $1 par value common stock in payment of their bill. At the time of the exchange, there is no established market price for the stock. In this case, the fair value of the

consideration received, $5,000, is more clearly evident. Accordingly, Jordan Company makes the following entry.

Organization Expense	5,000	
Common Stock		4,000
Paid-in Capital in Excess of Par—Common Stock		1,000
(To record issuance of 4,000 shares of $1 par value stock to attorneys)		

Organization costs are expensed as incurred.

In contrast, assume that Athletic Research Inc. is an existing publicly held corporation. Its $5 par value stock is actively traded at $8 per share. The company issues 10,000 shares of stock to acquire land recently advertised for sale at $90,000. The most clearly evident value in this noncash transaction is the market price of the consideration given, $80,000. The company records the transaction as follows.

Land	80,000	
Common Stock		50,000
Paid-in Capital in Excess of Par—Common Stock		30,000
(To record issuance of 10,000 shares of $5 par value stock for land)		

As illustrated in these examples, **the par value of the stock is never a factor in determining the cost of the assets received**. This is also true of the stated value of no-par stock.

Example 2-2

Cayman Corporation begins operations on March 1 by issuing 100,000 shares of $10 par value common stock for cash at $12 per share. On March 15, it issues 5,000 shares of common stock to attorneys in settlement of their bill of $50,000 for organization costs. Journalize the issuance of the shares, assuming the stock is not publicly traded.

Solution

Mar. 1		
Cash	1,200,000	
Common Stock		1,000,000
Paid-in Capital in Excess of Par - Common Stock		200,000
(To record issuance of 100,000 shares at $12 per share)		
Mar. 15		
Organization Expense	50,000	
Common Stock		50,000
(To record issuance of 5,000 shares for attorneys' fees)		

Accounting for Treasury Stock

Treasury stock is a corporation's own stock that it has issued and subsequently reacquired from shareholders, but not retired. A corporation may acquire treasury stock for various reasons:

1. To reissue the shares to officers and employees under bonus and stock compensation plans.

2. To signal to the stock market that management believes the stock is underpriced, in the hope of enhancing its market value.

3. To have additional shares available for use in the acquisition of other companies.

4. To reduce the number of shares outstanding and thereby increase earnings per share.

Another infrequent reason for purchasing shares is that management may want to eliminate hostile shareholders by buying them out.

Many corporations have treasury stock. For example, in the United States approximately 70% of companies have treasury stock. In a recent year, Nike purchased more than 6 million treasury shares.

Purchase of Treasury Stock

Companies generally account for treasury stock by **the cost method**. This method uses the cost of the shares purchased to value the treasury stock. Under the cost method, the company debits **Treasury Stock** for the **price paid to reacquire the shares**. When the company disposes of the shares, it credits to Treasury Stock **the same amount** it paid to reacquire the shares.

To illustrate, assume that on January 1, 2012, the stockholders' equity section of
Mead, Inc. has 100,000 shares of $5 par value common stock outstanding (all issued at par value) and Retained Earnings of $200,000. The stockholders' equity section before purchase of treasury stock is as follows.

Stockholders' equity with no treasury stock

Mead, Inc.

Balance Sheet (partial)

Stockholders' equity	
Paid-in capital	
Common stock, $5 par value, 100,000 shares issued and outstanding	$500,000
Retained earnings	200,000
Total stockholders' equity	$700,000

On February 1, 2012, Mead acquires 4,000 shares of its stock at $8 per share. The
entry is:

Feb. 1	Treasury Stock	32,000	
	Cash		32,000
	(To record purchase of 4,000 shares of treasury stock at $8 per share)		

Note that Mead debits Treasury Stock for the cost of the shares purchased. Is the original paid-in capital account, Common Stock, affected? No, because the number of issued shares does not change. In the stockholders' equity section of the balance sheet, Mead deducts treasury stock from total paid-in capital and retained earnings. Treasury Stock is a **contra stockholders' equity account**. Thus, the acquisition of treasury stock reduces stockholders' equity.

The stockholders' equity section of Mead, Inc. after purchase of treasury stock is as follows.

Mead, Inc.
Balance Sheet (partial)

Stockholders' equity	
Paid-in capital	
Common stock, $5 par value, 100,000 shares issued and 96,000 shares outstanding	$500,000
Retained earnings	200,000
Total paid-in capital and retained earnings	700,000
Less: Treasury stock (4,000 shares)	**32,000**
Total stockholders' equity	$668,000

Mead discloses in the balance sheet both the number of shares issued (100,000) and the number in the treasury (4,000). The difference is the number of shares of stock outstanding (96,000). The term **outstanding stock** means the number of shares of issued stock that are being held by stockholders.

Some maintain that companies should report treasury stock as an asset because it can be sold for cash. Under this reasoning, companies should also show unissued stock as an asset, clearly an erroneous conclusion. Rather than being an asset, treasury stock reduces stockholder claims on corporate assets. This effect is correctly shown by reporting treasury stock as a deduction from total paid-in capital and retained earnings.

Disposal of Treasury Stock

Treasury stock is usually sold or retired. The accounting for its sale differs when treasury stock is sold above cost than when it is sold below cost.

Sale of treasury stock above cost

If the selling price of the treasury shares is equal to their cost, the company records the sale of the shares by a debit to Cash and a credit to Treasury Stock. When the selling price of the shares is greater than their cost, the company credits the difference to Paid-in Capital from Treasury Stock.

To illustrate, assume that on July 1, Mead sells for $10 per share the 1,000 shares of its treasury stock, previously acquired at $8 per share. The entry is as follows.

July 1	Cash	10,000	
	Treasury Stock		8,000
	Paid-in Capital from Treasury Stock		2,000
(To record sale of 1,000 shares of treasury stock above cost)			

Mead does not record a $2,000 gain on sale of treasury stock for two reasons: (1) Gains on sales occur when **assets** are sold, and treasury stock is not an asset. (2) A corporation does not realize a gain or suffer a loss from stock transactions with its own stockholders. Thus, companies should not include in net income any paid-in capital arising from the sale of treasury stock. Instead, they report Paid-in Capital from Treasury Stock separately on the balance sheet, as a part of paid-in capital.

Sale of treasury stock below cost

When a company sells treasury stock below its cost, it usually debits to Paid-in Capital from Treasury Stock the excess of cost over selling price. Thus, if Mead, Inc. sells an additional 800 shares of treasury stock on October 1 at $7 per share, it makes the following entry.

Oct. 1	Cash	5,600	
	Paid-in Capital from Treasury Stock		800
	Treasury Stock		6,400
(To record sale of 800 shares of treasury stock below cost)			

Observe the following from the two sales entries: (1) Mead credits Treasury Stock at cost in each entry. (2) Mead uses Paid-in Capital from Treasury Stock for the difference between cost and the resale price of the shares. (3) The original paid-in capital account, Common Stock, is not affected. **The sale of treasury stock increases both total assets and total stockholders' equity.**

After posting the foregoing entries, the treasury stock accounts will show the following balances on October 1.

Treasury Stock

Feb. 1	32,000	July 1	8,000
		Oct. 1	6,400
Oct. 1 Bal.	17,600		

Paid-in Capital from Treasury Stock

Oct. 1	800	July 1	2,000
		Oct. 1 Bal.	1,200

When a company fully depletes the credit balance in Paid-in Capital from Treasury
Stock, it debits to Retained Earnings any additional excess of cost over selling price. To illustrate, assume that Mead, Inc. sells its remaining 2,200 shares at $7 per share on December 1. The excess of cost over selling price is $2,200 [2,200 3 ($8 2 $7)]. In this case, Mead debits $1,200 of the excess to Paid-in Capital from Treasury Stock. It debits
the remainder to Retained Earnings. The entry is:

Dec. 1	Cash	15,400	
	Paid-in Capital from Treasury Stock	1,200	
	Retained Earnings	1,000	
	Treasury Stock		17,600
(To record sale of 2,200 shares of treasury stock at $7 per share)			

Example 2-3

Santa Anita Inc. purchases 3,000 shares of its $50 par value common stock for $180,000 cash on July 1. It will hold the shares in the treasury until resold. On November 1, the corporation sells 1,000 shares of treasury stock for cash at $70 per share. Journalize the treasury stock transactions.

Solution

July 1		
Treasury Stock	180,000	
Cash		180,000
(To record the purchase of 3,000 shares at $60 per share)		
Nov. 1		
Cash	70,000	
Treasury Stock		60,000
Paid-in Capital from Treasury Stock		10,000
(To record the sale of 1,000 shares at $70 per share)		

Example 2-4

Assume that a corporation has the following paid-in capital on January 1:

Common stock, $25 par (20,000 shares authorized and issued)	$500,000
Excess of issue price over par	150,000
	$650,000

On February 13, the corporation purchases 1,000 shares of its common stock at $45 per share. The entry to record the purchase of the treasury stock is as follows:

Feb. 13	Treasury Stock	45,000	
	Cash		45,000
(Purchased 1,000 shares of treasury stock at $45).			

On April 29, the corporation sells 600 shares of the treasury stock for $60. The entry to record the sale is as follows:

Apr. 29		
Cash	36,000	
Treasury Stock		27,000
Paid-In Capital from Sale of Treasury Stock		9,000
(Sold 600 shares of treasury stock at $60).		

A sale of treasury stock may result in a decrease in paid-in capital. To the extent that Paid-In Capital from Sale of Treasury Stock has a credit balance, it is debited for any such decrease. Any remaining decrease is then debited to the retained earnings account.

To illustrate, assume that on October 4, the corporation sells the remaining 400 shares of treasury stock for $40 per share. The entry to record the sale is as follows:

Oct. 4		
Cash	16,000	
Paid-In Capital from Sale of Treasury Stock	2,000	
Treasury Stock		18,000
(Sold 400 shares of treasury stock at $40).		

The October 4 entry shown above decreases paid-in capital by $2,000. Since Paid-in Capital from Sale of Treasury Stock has a credit balance of $9,000, the entire $2,000 was debited to Paid-in Capital from Sale of Treasury Stock.

No dividends (cash or stock) are paid on the shares of treasury stock. To do so would result in the corporation earning dividend revenue from itself.

Example 2-5

On May 3, Buzz Off Corporation reacquired 3,200 shares of its common stock at $42 per share. On July 22, Buzz Off sold 2,000 of the reacquired shares at $47 per share. On August 30, Buzz Off sold the remaining shares at $40 per share. Journalize the transactions of May 3, July 22, and August 30.

May 3		
Treasury Stock (3,200 × $42)	134,400	
Cash		134,400
July 22		
Cash (2,000 × $47)	94,000	
Treasury Stock (2,000 × $42)		84,000
Paid-In Capital from Sale of Treasury Stock [2,000 × ($47 – $42)]		10,000
Aug. 30		
Cash (1,200 × $40)	48,000	
Paid-In Capital from Sale of Treasury Stock	2,400	
Treasury Stock (1,200 × $42)		50,400

Dividends

A dividend is a corporation's distribution of cash or stock to its stockholders on a pro rata (proportional to ownership) basis. Pro rata means that if you own 10% of the common shares, you will receive 10% of the dividend. Dividends can take four forms: cash, property, scrip (a promissory note to pay cash), or stock. Cash dividends predominate in practice. Also, companies declare stock dividends with some frequency. These two forms of dividends will be the focus of discussion in this chapter.

Investors are very interested in a company's dividend practices. In the financial press, **dividends are generally reported quarterly as a dollar amount per share**. (Sometimes they are reported on an annual basis.) For example, Nike's **quarterly** dividend rate in the fourth quarter of 2010 was 27 cents per share; the dividend rate for the fourth quarter of 2010 for GE was 12 cents, and for ConAgra Foods it was 28 cents.

Cash Dividends

A **cash dividend** is a pro rata distribution of cash to stockholders. For a corporation
to pay a cash dividend, it must have:

1. Retained earnings. The legality of a cash dividend depends on the laws of the state in which the company is incorporated. Payment of cash dividends from retained earnings is legal in all states. In general, cash dividend distributions from only the balance in common stock (legal capital) are illegal. A dividend declared out of paid-in capital is termed a **liquidating dividend**. Such a dividend reduces or "liquidates" the amount originally paid in by stockholders. Statutes vary considerably with respect to cash dividends based on paid-in capital in excess of par or stated value. Many states permit such dividends.

2. Adequate cash. The legality of a dividend and the ability to pay a dividend are two different things. For example, Nike, with retained earnings of over $4.8 billion, could legally declare a dividend of at least $4.8 billion. But Nike's cash balance is only $1.8 billion. Before declaring a cash dividend, a company's board of directors must carefully consider both current and future demands on the company's cash resources. In some cases, current liabilities may make a cash dividend inappropriate. In other cases, a major plant expansion program may warrant only a relatively small dividend.

3. A declaration of dividends. A company does not pay dividends unless its board of directors decides to do so, at which point the board "declares" the dividend. The board of directors has full authority to determine the amount of income to distribute in the form of a dividend and the amount to retain in the business. Dividends do not accrue like interest on a note payable, and they are not a liability until declared.

The amount and timing of a dividend are important issues for management to consider. The payment of a large cash dividend could lead to liquidity problems for the company. On the other hand, a small dividend or a missed dividend may cause unhappiness among stockholders. Many stockholders expect to receive a reasonable cash payment from the company on a periodic basis. Many companies declare and pay cash dividends quarterly. On the other hand, a number of high-growth companies pay no dividends, preferring to conserve cash to finance future capital expenditures.

Entries for cash dividends

Three dates are important in connection with dividends: (1) the declaration date, (2) the record date, and (3) the payment date. Normally, there are two to four weeks between each date. Companies make accounting entries on the declaration date and the payment date.

On the **declaration date**, the board of directors formally declares (authorizes) the cash dividend and announces it to stockholders. Declaration of a cash dividend **commits the corporation to a legal obligation**. The obligation is binding and cannot be rescinded. The company makes an entry to recognize the increase in Cash Dividends and the increase in the liability Dividends Payable.

To illustrate, assume that on December 1, 2012, the directors of Media General declare a 50¢ per share cash dividend on 100,000 shares of $10 par value common stock. The dividend is $50,000 (100,000 X 50¢). The entry to record the declaration is:

<u>Declaration Date</u>

Dec. 1	Cash Dividends	50,000	
	Dividends Payable		50,000
(To record declaration of cash dividend)			

Media General debits the account Cash Dividends. Cash dividends decrease retained earnings. We use the specific title Cash Dividends to differentiate it from other types of dividends, such as stock dividends. Dividends Payable is a current liability: It will normally be paid within the next several months.

When using a dividend account, the company transfers the balance of that account to Retained Earnings at the end of the year by a closing entry. Whichever account is used for the dividend declaration, the effect is the same: Retained earnings decreases, and a current liability increase. *For homework problems, you should use the Cash Dividends account for recording dividend declarations.*

At the **record date**, the company determines ownership of the outstanding shares

for dividend purposes. The stockholders' records maintained by the corporation supply this information. In the interval between the declaration date and the record date, the corporation updates its stock ownership records. For Media General, the record date is December 22. No entry is required on this date because the corporation's liability recognized on the declaration date is unchanged.

Record Date

Dec. 22	No entry necessary

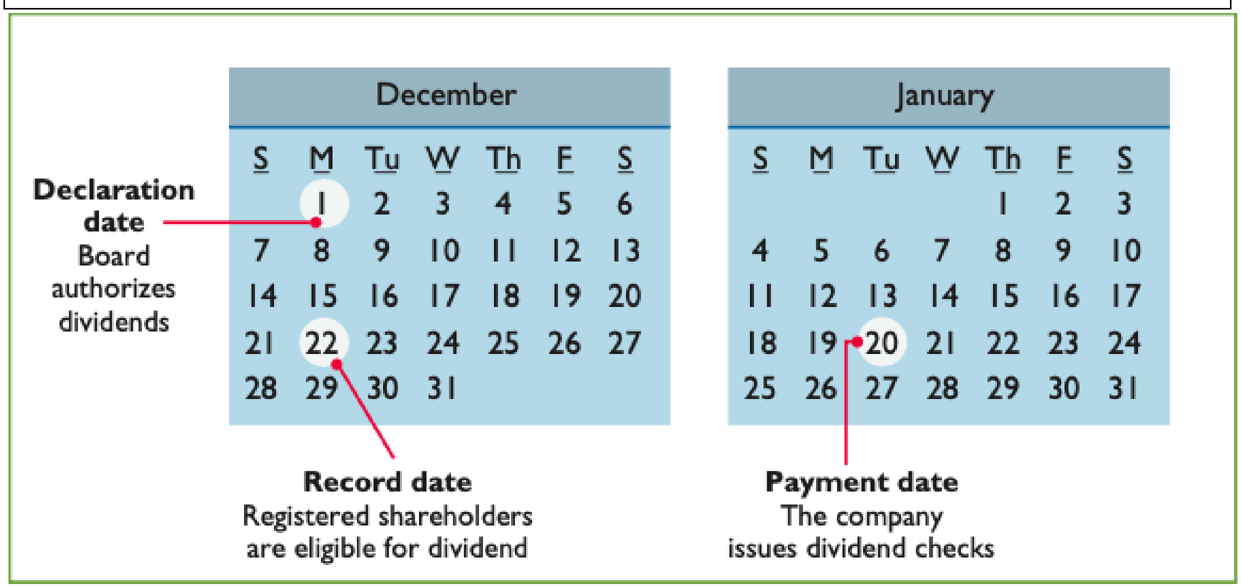
On the **payment date**, the company makes cash dividend payments to the stockholders of record (as of December 22) and records the payment of the dividend. If January 20 is the payment date for Media General, the entry on that date is:

Payment Date

Jan. 20	Dividends Payable	50,000	
	Cash		50,000
(To record payment of cash dividend)			

Note that payment of the dividend reduces both current assets and current liabilities. It has no effect on stockholders' equity. The **cumulative effect** of the **declaration and payment** of a cash dividend is to **decrease both stockholders' equity and total assets**. Illustration 2-1 summarizes the three important dates associated with dividends for Media General.

Illustration 2-1



Example 2-6

Assume that on October 1 Hiber Corporation declares the cash dividends shown below with a date of record of November 10 and a date of payment of December 2.

	Dividend per Share	Total Dividends
Preferred stock, $100 par, 5,000 shares outstanding	$2.50	$12,500
Common stock, $10 par, 100,000 shares outstanding	$0.30	30,000
Total		$42,500

On October 1, the declaration date, Hiber Corporation records the following entry:

Oct. 1	Cash Dividends	42,500	
	Cash Dividends Payable		42,500
	(Declared cash dividends).		

On November 10, the date of record, no entry is necessary. This date merely determines which stockholders will receive the dividends.

On December 2, the date of payment, Hiber Corporation records the payment of the dividends as follows:

Dec. 2	Cash Dividends Payable	42,500	
	Cash		42,500
	(Paid cash dividends).		

At the end of the accounting period, the balance in Cash Dividends will be transferred to Retained Earnings as part of the closing process. This closing entry debits Retained Earnings and credits Cash Dividends for the balance of the cash dividends account. If the cash dividends have not been paid by the end of the period, Cash Dividends Payable will be reported on the balance sheet as a current liability.

Example 2-7

The important dates in connection with a cash dividend of $75,000 on a corporation's common stock are February 26, March 30, and April 2. Journalize the entries required on each date.

Feb. 26	Cash Dividends	75,000	
	Cash Dividends Payable		75,000
Mar. 30	No entry required.		
Apr. 2	Cash Dividends Payable	75,000	
	Cash		75,000

Allocating cash dividends between preferred and common stock

As explained earlier, preferred stock has priority over common stock in regard to dividends. Holders of cumulative preferred stock must be paid any unpaid prior-year dividends and its current year's dividend before common stockholders receive dividends.

To illustrate, assume that at December 31, 2012, IBR Inc. has 1,000 shares of 8%, $100 par value cumulative preferred stock. It also has 50,000 shares of $10 par value common stock outstanding. The dividend per share for preferred stock is $8 ($100 par value X 8%). The required annual dividend for preferred stock is therefore $8,000 (1,000 X $8). At December 31, 2012, the directors declare a $6,000 cash dividend. In this case, the entire dividend amount goes to preferred stockholders because of their dividend preference. The entry to record the declaration of the dividend is:

Dec. 31	Cash Dividends	6,000	
	Dividends Payable		6,000
(To record $6 per share cash dividend to preferred stockholders)			

Because of the cumulative feature, dividends of $2 ($8 - $6) per share are in arrears on preferred stock for 2012. IBR must pay these dividends to preferred stockholders before it can pay any future dividends to common stockholders. IBR should disclose dividends in arrears in the financial statements.

At December 31, 2013, IBR declares a $50,000 cash dividend. The allocation of the dividend to the two classes of stock is as follows.

Total dividend		$50,000
Allocated to preferred stock		
Dividends in arrears, 2012 (1,000 × $2)	$2,000	
2013 dividend (1,000 × $8)	8,000	10,000
Remainder allocated to common stock		$40,000

The entry to record the declaration of the dividend is:

Dec. 31	Cash Dividends	50,000	
	Dividends Payable		50,000
(To record declaration of cash dividends of $10,000 to preferred stock and $40,000 to common stock)			

If IBR's preferred stock is not cumulative, preferred stockholders receive only $8,000 in dividends in 2013. Common stockholders receive $42,000.

<u>Example 2-8</u> MasterMind Corporation has 2,000 shares of 6%, $100 par value preferred stock outstanding at December 31, 2012. At December 31, 2012, the company declared a $60,000 cash dividend. Determine the dividend paid to preferred stockholders and common stockholders under each of the following scenarios.

1. The preferred stock is noncumulative, and the company has not missed any dividends
in previous years.
2. The preferred stock is noncumulative, and the company did not pay a dividend in
each of the two previous years.
3. The preferred stock is cumulative, and the company did not pay a dividend in each
of the two previous years.

<u>Solution</u>

1. The company has not missed past dividends and the preferred stock is noncumulative; thus, the preferred stockholders are paid only this year's dividend. The dividend paid to preferred stockholders would be $12,000 (2,000 X .06 X $100). The dividend paid to common stockholders would be $48,000 ($60,000 - $12,000).
2. The preferred stock is noncumulative; thus, past unpaid dividends do not have to be paid. The dividend paid to preferred stockholders would be $12,000 (2,000 X .06 X $100). The dividend paid to common stockholders would be $48,000 ($60,000 - $12,000).
3. The preferred stock is cumulative; thus, dividends that have been missed (dividends in arrears) must be paid. The dividend paid to preferred stockholders would be $36,000 (3 X 2,000 X .06 X $100). The dividend paid to common stockholders would be $24,000 ($60,000 - $36,000).

Stock Dividends

A **stock dividend** is a pro rata distribution to stockholders of the corporation's own stock. Whereas a company pays cash in a cash dividend, a company issues shares of stock in a stock dividend. Stock dividends are normally declared only on common stock and issued to common stockholders. **A stock dividend results in a decrease in retained earnings and an increase in paid-in capital.** Unlike a cash dividend, a stock dividend does not decrease total stockholders' equity or total assets.

To illustrate, assume that you have a 2% ownership interest in Cetus Inc.; you own
20 of its 1,000 shares of common stock. If Cetus declares a 10% stock dividend, it would issue 100 shares (1,000 X 10%) of stock. You would receive two shares (2% X 100). Would your ownership interest change? No, it would remain at 2% (22 / 1,100). **You now own more shares of stock, but your ownership interest has not changed.**

Cetus has disbursed no cash and has assumed no liabilities. What, then, are the purposes and benefits of a stock dividend? Corporations issue stock dividends generally for one or more of the following reasons.

1. To satisfy stockholders' dividend expectations without spending cash.

2. To increase the marketability of the corporation's stock. When the number of shares outstanding increases, the market price per share decreases. Decreasing the market price of the stock makes it easier for smaller investors to purchase the shares.

3. To emphasize that a portion of stockholders' equity has been permanently reinvested in the business (and is unavailable for cash dividends).

When the dividend is declared, the board of directors determines the size of the stock dividend and the value assigned to each dividend.

Generally, if the company issues a **small stock dividend** (less than 20–25% of the corporation's issued stock), the value assigned to the dividend is the fair value per share. This treatment is based on the assumption that a small stock dividend will have little effect on the market price of the shares previously outstanding. Thus, many stockholders consider small stock dividends to be distributions of earnings equal to the fair market value of the shares distributed. If a company issues a **large stock dividend** (greater than 20–25%), the value assigned to the dividend is the par or stated value. Small stock dividends predominate in practice. Thus, we will illustrate only entries for small stock dividends.

<u>Entries for stock dividends</u>

To illustrate the accounting for small stock dividends, assume that Medland Corporation has a balance of $300,000 in retained earnings. It declares a 10% stock dividend on its 50,000 shares of $10 par value common stock. The current fair market value of its stock is $15 per share. The number of shares to be issued is 5,000 (10% X 50,000). Therefore, the total amount to be debited to Stock Dividends is $75,000 (5,000 X $15). The entry to record the declaration of the stock dividend is as follows.

Stock Dividends	75,000	
Common Stock Dividends Distributable		50,000
Paid-in Capital in Excess of Par—Common Stock		25,000
(To record declaration of 10% stock dividend)		

Medland debits Stock Dividends for the fair market value of the stock issued ($15 X 5,000). (Similar to Cash Dividends, Stock Dividends decrease retained earnings.) Medland also credits Common Stock Dividends Distributable for the par value of the dividend shares ($10 X 5,000), and credits Paid-in Capital in Excess of Par— Common Stock for the excess over par ($5 X 5,000).

Common Stock Dividends Distributable is a **stockholders' equity account**. It is not a liability because assets will not be used to pay the dividend. If the company prepares a balance sheet before it issues the dividend shares, it reports the distributable account under Paid-in capital as follows:

Paid-in capital		
Common stock	$500,000	
Common stock dividends distributable	**50,000**	$550,000

When Medland issues the dividend shares, it debits Common Stock Dividends Distributable and credits Common Stock, as follows.

Common Stock Dividends Distributable	50,000	
Common Stock		50,000
(To record issuance of 5,000 shares in a stock dividend)		

Effects of stock dividends

How do stock dividends affect stockholders' equity? They **change the composition of stockholders' equity**, because they transfer to paid-in capital a portion of retained earnings. However, **total stockholders' equity remains the same**. Stock dividends also have no effect on the par or stated value per share. But the number of shares outstanding increases. The following illustration shows these effects for Medland Corporation.

	Before Dividend	**After Dividend**
Stockholders' equity		
Paid-in capital		
Common stock, $10 par	$500,000	$550,000
Paid-in capital in excess of par—common stock	—	25,000
Total paid-in capital	500,000	575,000
Retained earnings	300,000	225,000
Total stockholders' equity	**$800,000**	**$800,000**
Outstanding shares	**50,000**	**55,000**
Par value per share	**$10.00**	**$10.00**

In this example, total paid-in capital increases by $75,000 (50,000 shares X 10% X $15) and retained earnings decreases by the same amount. Note also that total stockholders' equity remains unchanged at $800,000. The number of shares increases by 5,000 (50,000 X 10%).

Example 2-9

Assume that the stockholders' equity accounts of Hendrix Corporation as of December 15 are as follows:

Common Stock, $20 par (2,000,000 shares issued)	$40,000,000
Paid-In Capital in Excess of Par—Common Stock	9,000,000
Retained Earnings	26,600,000

On December 15, Hendrix Corporation declares a stock dividend of 5% or 100,000 shares (2,000,000 shares × 5%) to be issued on January 10 to stockholders of record on December 31. The market price of the stock on December 15 (the date of declaration) is $31 per share.

The entry to record the stock dividend is as follows:

Dec. 15		
Stock Dividends	3,100,000	
Stock Dividends Distributable		2,000,000
Paid-In Capital in Excess of Par—Common Stock		1,100,000

(Declared 5% (100,000 shares) stock dividend on $20 par common stock with a market price of $31 per share).

After the preceding entry is recorded, Stock Dividends will have a debit balance of $3,100,000. Like cash dividends, the stock dividends account is closed to Retained Earnings at the end of the accounting period. This closing entry debits Retained Earnings and credits Stock Dividends.

At the end of the period, the *stock dividends distributable* and *paid-in capital in excess of par—common stock* accounts are reported in the Paid-In Capital section of the balance sheet. Thus, the effect of the preceding stock dividend is to transfer $3,100,000 of retained earnings to paid-in capital.

On January 10, the stock dividend is distributed to stockholders by issuing 100,000
shares of common stock. The issuance of the stock is recorded by the following entry:

Jan. 10	Stock Dividends Distributable	2,000,000	
	Common Stock		2,000,000
	(Issued stock as stock dividend).		

A stock dividend does not change the assets, liabilities, or total stockholders' equity of a corporation. Likewise, a stock dividend does not change an individual stockholder's proportionate interest (equity) in the corporation.

To illustrate, assume a stockholder owns 1,000 of a corporation's 10,000 shares outstanding. If the corporation declares a 6% stock dividend, the stockholder's proportionate interest will not change, as shown below.

	Before Stock Dividend	**After Stock Dividend**
Total shares issued	10,000	10,600 [10,000 + (10,000 × 6%)]
Number of shares owned	1,000	1,060 [1,000 + (1,000 × 6%)]
Proportionate ownership	10% (1,000/10,000)	10% (1,060/10,600)

Example 2-10

Vienna Highlights Corporation has 150,000 shares of $100 par common stock outstanding. On June 14, Vienna Highlights declared a 4% stock dividend to be issued August 15 to stockholders of record on July 1. The market price of the stock was $110 per share on June 14. Journalize the entries required on June 14, July 1, and August 15.

June 14			
Stock Dividends (150,000 × 4% × $110)		660,000	
	Stock Dividends Distributable (6,000 × $100)		600,000
	Paid-In Capital in Excess of Par—Common Stock ($660,000 – $600,000)		60,000
July 1	No entry required.		
Aug. 15	Stock Dividends Distributable	600,000	
	Common Stock		600,000

Stock Splits

A **stock split**, like a stock dividend, involves issuance of additional shares to stockholders according to their percentage ownership. **However, a stock split results in a reduction in the par or stated value per share.** The purpose of a stock split is to increase the marketability of the stock by lowering its market value per share. This, in turn, makes it easier for the corporation to issue additional stock and attracts more investors and broadens the types and numbers of stockholders.

The effect of a split on market value is generally *inversely proportional* to the size of the split. For example, after a recent 2-for-1 stock split, the market value of Nike’s stock fell from $111 to approximately $55. The lower market value stimulated market activity, and within one year the stock was trading above $100 again.

In a stock split, the number of shares increases in the same proportion that par or stated value per share decreases. For example, in a 2-for-1 split, one share of $10 par value stock is exchanged for two shares of $5 par value stock. **A stock split does not have any effect on total paid-in capital, retained earnings, or total stockholders' equity.** But the number of shares outstanding increases, and par value per share decreases. The following illustration shows these effects for Medland Corporation, assuming that it splits its 50,000 shares of common stock on a 2-for-1 basis.

	Before Stock Split	**After Stock Split**
Stockholders' equity		
Paid-in capital		
Common stock	$500,000	$500,000
Paid-in capital in excess of par value	—0—	—0—
Total paid-in capital	500,000	500,000
Retained earnings	300,000	300,000
Total stockholders' equity	**$800,000**	**$800,000**
Outstanding shares	**50,000**	**100,000**
Par value per share	**$10.00**	**$5.00**

A stock split does not affect the balances in any stockholders' equity accounts. Therefore, **it is not necessary to journalize a stock split**.

The following illustration summarizes the differences between stock splits and stock dividends.

Item	**Stock Split**	**Stock Dividend**
Total paid-in capital	No change	Increase
Total retained earnings	No change	Decrease
Total par value (common stock)	No change	Increase
Par value per share	Decrease	No change
Total stockholders' equity	No change	No change

Example 2-11

Assume that Rojek Corporation has 10,000 shares of $100 par common stock outstanding with a current market price of $150 per share. The board of directors declares the following stock split:

1. Each common shareholder will receive 5 shares for each share held. This is called a 5-for-l stock split. As a result, 50,000 shares (10,000 shares × 5) will be outstanding.
2. The par of each share of common stock will be reduced to $20 ($100/5).

The par value of the common stock outstanding is $1,000,000 both before and
after the stock split as shown below.

	Before Split	After Split
Number of shares	10,000	50,000
Par value per share	× $100	× $20
Total	$1,000,000	$1,000,000

In addition, each Rojek Corporation shareholder owns the same total par amount of stock before and after the stock split. For example, a stockholder who owned 4 shares of $100 par stock before the split (total par of $400) would own 20 shares of $20 par stock after the split (total par of $400). Only the number of shares and the par value per share have changed.

Since there are more shares outstanding after the stock split, the market price of the stock should decrease. For example, in the preceding example, there would be 5 times as many shares outstanding after the split. Thus, the market price of the stock would be expected to fall from $150 to about $30 ($150 ÷ 5).

Stock splits do not require a journal entry, since only the par (or stated) value and number of shares outstanding have changed. However, the details of stock splits are normally disclosed in the notes to the financial statements.

Example 2-12

Sing CD Company has had five years of record earnings. Due to this success, the market price of its 500,000 shares of $2 par value common stock has tripled from $15 per share to $45. During this period, paid-in capital remained the same at $2,000,000. Retained earnings increased from $1,500,000 to $10,000,000. President Joan Elbert is considering either a 10% stock dividend or a 2-for-1 stock split. She asks you to show the before-and-after effects of each option on retained earnings and total stockholders' equity.

Solution

The stock dividend amount is $2,250,000 [(500,000 X 10%) X $45]. The new balance in retained earnings is $7,750,000 ($10,000,000 - $2,250,000). The retained earnings balance after the stock split is the same as it was before the split: $10,000,000. Total stockholders' equity does not change. The effects on the stockholders' equity accounts are as follows.

	Original Balances	**After Dividend**	**After Split**
Paid-in capital	$ 2,000,000	$ 4,250,000	$ 2,000,000
Retained earnings	10,000,000	7,750,000	10,000,000
Total stockholders' equity	$12,000,000	$12,000,000	$12,000,000
Shares outstanding	500,000	550,000	1,000,000

Chapter Three: Stockholders' Equity and Financial Statement Analyses

Chapter Three: Stockholders' Equity and Financial Statement Analyses

Reporting Stockholders' Equity

As with other sections of the balance sheet, alternative terms and formats may be used in reporting stockholders' equity. Also, changes in retained earnings and paid-in capital may be reported in separate statements or notes to the financial statements.

Stockholders' Equity on the Balance Sheet

Illustration 3-1 shows two methods for reporting stockholders' equity for the December 31, 2014, balance sheet for Telex Inc.

Method 1. Each class of stock is reported, followed by its related paid-in capital accounts. Retained earnings is then reported followed by a deduction for treasury stock.

Method 2. The stock accounts are reported, followed by the paid-in capital reported as a single item, Additional paid-in capital. Retained earnings is then reported followed by a deduction for treasury stock.

Significant changes in stockholders' equity during a period may also be presented in a statement of stockholders' equity or in the notes to the financial statements. The statement of stockholders' equity is illustrated later in this section. Relevant rights and privileges of the various classes of stock outstanding should also be reported. Examples include dividend and liquidation preferences, conversion rights, and redemption rights. Such information may be disclosed on the face of the balance sheet or in the notes to the financial statements.

Illustration 3-1

Telex Inc.
Balance Sheet
December 31, 2014

Stockholders' Equity

Paid-in capital:			
Preferred 10% stock, $50 par (2,000 shares authorized and issued)	$100,000		
Excess of issue price over par	10,000	$ 110,000	
Common stock, $20 par (50,000 shares authorized, 45,000 shares issued)	$900,000		
Excess of issue price over par	190,000	1,090,000	
From sale of treasury stock		2,000	
Total paid-in capital			$1,202,000
Retained earnings			350,000
Total			$1,552,000
Deduct treasury stock (600 shares at cost)			27,000
Total stockholders' equity			$1,525,000

Method 1

Telex Inc.
Balance Sheet
December 31, 2014

Stockholders' Equity

Contributed capital:		
Preferred 10% stock, $50 par (2,000 shares authorized and issued)	$100,000	
Common stock, $20 par (50,000 shares authorized, 45,000 shares issued)	900,000	
Additional paid-in capital	202,000	
Total contributed capital		$1,202,000
Retained earnings		350,000
Total		$1,552,000
Deduct treasury stock (600 shares at cost)		27,000
Total stockholders' equity		$1,525,000

Method 2

Example 3-1

Using the following accounts and balances, prepare the Stockholders' Equity section of the balance sheet. Forty thousand shares of common stock are authorized, and 5,000 shares have been reacquired.

Common Stock, $50 par	$1,500,000
Paid-In Capital from Sale of Treasury Stock	44,000
Paid-In Capital in Excess of Par	160,000
Retained Earnings	4,395,000
Treasury Stock	120,000

Stockholders' Equity	
Paid-in capital:	
Common stock, $50 par (40,000 shares authorized; 30,000 shares issued)	$1,500,000
Excess of issue price over par	160,000
	$1,660,000
From sale of treasury stock	44,000
Total paid-in capital	$1,704,000
Retained earnings	4,395,000
Total	$6,099,000
Deduct treasury stock (5,000 shares at cost)	120,000
Total stockholders' equity	$5,979,000

Example 3-2

Jennifer Corporation has issued 300,000 shares of $3 par value common stock. It
authorized 600,000 shares. The paid-in capital in excess of par on the common stock is $380,000. The corporation has reacquired 15,000 shares at a cost of $50,000 and is currently holding those shares. Treasury stock was reissued in prior years for $72,000 more than its cost. The corporation also has 4,000 shares issued

and outstanding of 8%, $100 par value preferred stock. It authorized 10,000 shares. The paid-in capital in excess of par on the preferred stock is $25,000. Retained earnings is $610,000. Prepare the stockholders' equity section of the balance sheet.

Solution

JENNIFER CORPORATION
Balance Sheet (partial)

Stockholders' equity		
Paid-in capital		
Capital stock		
8% preferred stock, $100 par value, 10,000 shares authorized, 4,000 shares issued and outstanding		$ 400,000
Common stock, $3 par value, 600,000 shares authorized, 300,000 shares issued, and 285,000 shares outstanding		900,000
Total capital stock		1,300,000
Additional paid-in capital		
In excess of par—preferred stock	$ 25,000	
In excess of par—common stock	380,000	
From treasury stock	72,000	
Total additional paid-in capital		477,000
Total paid-in capital		1,777,000
Retained earnings		610,000
Total paid-in capital and retained earnings		2,387,000
Less: Treasury stock (15,000 common shares) (at cost)		(50,000)
Total stockholders' equity		$2,337,000

Reporting Retained Earnings

Changes in retained earnings may be reported using one of the following:

1. Separate retained earnings statement
2. Combined income and retained earnings statement
3. Statement of stockholders' equity

Changes in retained earnings may be reported in a separate retained earnings statement. When a separate retained earnings statement is prepared, the beginning balance of retained earnings is reported. The net income is then added (or net loss is subtracted) and any dividends are subtracted to arrive at the ending retained earnings for the period.

The following shows (in account form) transactions that affect retained earnings.

Retained Earnings	
1. Net loss	1. Net income
2. Prior period adjustments for overstatement of net income	2. Prior period adjustments for understatement of net income
3. Cash dividends and stock dividends	
4. Some disposals of treasury stock	

To illustrate, a retained earnings statement for Telex Inc. is shown in illustration 3-2.

Illustration 3-2

Telex Inc.
Retained Earnings Statement
For the Year Ended December 31, 2014

Retained earnings, January 1, 2014			$245,000
Net income		$180,000	
Less dividends:			
Preferred stock	$10,000		
Common stock	65,000	75,000	
Increase in retained earnings			105,000
Retained earnings, December 31, 2014			$350,000

Changes in retained earnings may also be reported in combination with the income statement. This format emphasizes net income as the connecting link between the income statement and ending retained earnings. Since this format is not often used, we do not illustrate it. Changes in retained earnings may also be reported in a statement of stockholders' equity. An example of reporting changes in retained earnings in a statement of stockholders' equity for Telex Inc. is shown later in illustration 3-4.

Example 3-3

Dry Creek Cameras Inc. reported the following results for the year ending March 31, 2014:

Retained earnings, April 1, 2013	$3,338,500
Net income	461,500
Cash dividends declared	80,000
Stock dividends declared	120,000

Prepare a retained earnings statement for the fiscal year ended March 31, 2014.

Dry Creek Cameras Inc.
Retained Earnings Statement
For the Year Ended March 31, 2014

Retained earnings, April 1, 2013		$3,338,500
Net income	$461,500	
Less dividends declared	(200,000)	
Increase in retained earnings		261,500
Retained earnings, March 31, 2014		$3,600,000

Restrictions

The balance in retained earnings is generally available for dividend declarations. Some companies state this fact. For example, Lockheed Martin Corporation states the following in the notes to its financial statements.

Lockheed Martin Corporation
Notes to the Financial Statements

At December 31, retained earnings were unrestricted and available for dividend payments.

In some cases, there may be **retained earnings restrictions**. These make a portion of the retained earnings balance currently unavailable for dividends. Restrictions result from one or more of the following causes.

1. Legal restrictions. Many states require a corporation to restrict retained earnings for the cost of treasury stock purchased. The restriction keeps intact the corporation's legal capital that is being temporarily held as treasury stock. When the company sells the treasury stock, the restriction is lifted.

2. Contractual restrictions. Long-term debt contracts may restrict retained earnings as a condition for the loan. The restriction limits the use of corporate assets for payment of dividends. Thus, it increases the likelihood that the corporation will be able to meet required loan payments.

3. Voluntary restrictions. The board of directors may voluntarily create retained earnings restrictions for specific purposes. For example, the board may authorize a restriction for future plant expansion. By reducing the amount of retained earnings available for dividends, the company makes more cash available for the planned expansion.

Companies generally disclose **retained earnings restrictions** in the notes to the financial statements. For example, Tektronix Inc., a manufacturer of electronic measurement devices, had total retained earnings of $774 million, but the unrestricted portion was only $223.8 million.

Tektronix Inc.
Notes to the Financial Statements

Certain of the Company's debt agreements require compliance with debt covenants. Management believes that the Company is in compliance with such requirements. The Company had unrestricted retained earnings of $223.8 million after meeting those requirements.

Prior Period Adjustments

Suppose that a corporation has closed its books and issued financial statements. The corporation then discovers that it made a material error in reporting net income of a prior year. How should the company record this situation in the accounts and report it in the financial statements?

The correction of an error in previously issued financial statements is known as a **prior period adjustment**. The company makes the correction directly to Retained Earnings, because the effect of the error is now in this account. The net income for the prior period has been recorded in retained earnings through the journalizing and posting of closing entries.

To illustrate, assume that General Microwave discovers in 2012 that it understated depreciation expense on equipment in 2011 by $300,000 due to computational errors. These errors overstated both net income for 2011 and the current balance in retained earnings. The entry for the prior period adjustment, ignoring all tax effects, is as follows.

Retained Earnings	300,000	
Accumulated Depreciation—Equipment		300,000
(To adjust for understatement of depreciation in a prior period)		

A debit to an income statement account in 2012 is incorrect because the error pertains to a prior year.

Companies report prior period adjustments in the retained earnings statement. They add (or deduct, as the case may be) these adjustments from the beginning retained earnings balance. This results in an adjusted beginning balance. For example, assuming a beginning balance of $800,000 in retained earnings, General Microwave reports the prior period adjustment as follows.

General Microwave Retained Earnings Statement (partial)	
Balance, January 1, as reported	$ 800,000
Correction for overstatement of net income in prior period (depreciation error)	(300,000)
Balance, January 1, as adjusted	$ 500,000

Example 3-4

Vega Corporation has retained earnings of $5,130,000 on January 1, 2012. During the year, Vega earned $2,000,000 of net income. It declared and paid a $250,000 cash dividend. In 2012, Vega recorded an adjustment of $180,000 due to the understatement (from a mathematical error) of 2011 depreciation expense. Prepare a retained earnings statement for 2012.

Solution

VEGA CORPORATION Retained Earnings Statement For the Year Ended December 31, 2012	
Balance, January 1, as reported	$5,130,000
Correction for overstatement of net income in prior period (depreciation error)	(180,000)
Balance, January 1, as adjusted	4,950,000
Add: Net income	2,000,000
	6,950,000
Less: Cash dividends	(250,000)
Balance, December 31	$6,700,000

Statement of Stockholders' Equity

Illustration 3-3 presents the stockholders' equity section of Graber Inc.'s balance sheet. Note the following: (1) "Common stock dividends distributable" is shown under "Capital stock," in "Paid-in capital." (2) A note (Note R) discloses a retained earnings restriction.

Illustration 3-3

Graber Inc.
Balance Sheet (partial)

Stockholders' equity		
Paid-in capital		
Capital stock		
9% Preferred stock, $100 par value, cumulative, callable at $120, 10,000 shares authorized, 6,000 shares issued and outstanding		$ 600,000
Common stock, no par, $5 stated value, 500,000 shares authorized, 400,000 shares issued and 390,000 outstanding	$2,000,000	
Common stock dividends distributable	**50,000**	2,050,000
Total capital stock		2,650,000
Additional paid-in capital		
In excess of par—preferred stock	30,000	
In excess of stated value—common stock	1,050,000	
Total additional paid-in capital		1,080,000
Total paid-in capital		3,730,000
Retained earnings **(see Note R)**		1,160,000
Total paid-in capital and retained earnings		4,890,000
Less: Treasury stock (10,000 common shares)		80,000
Total stockholders' equity		$4,810,000

Note R: Retained earnings is restricted for the cost of treasury stock, $80,000.

Instead of presenting a detailed stockholders' equity section in the balance sheet and a retained earnings statement, many companies prepare a **stockholders' equity statement**. This statement shows the changes (1) in each stockholders' equity account and (2) in total that occurred during the year.

When the only change in stockholders' equity is due to net income or net loss and
dividends, a retained earnings statement is sufficient. However, when a corporation also has changes in stock and paid-in capital accounts, a statement of stockholders' equity is normally prepared. A statement of stockholders' equity is normally prepared in a columnar format. Each column is a major stockholders' equity classification. Changes in each classification are then described in the left-hand column. Illustration 3-4 illustrates a statement of stockholders' equity for Telex Inc.

Illustration 3-4

Telex Inc.
Statement of Stockholders' Equity
For the Year Ended December 31, 2014

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total
Balance, January 1, 2014	$100,000	$850,000	$177,000	$245,000	$(17,000)	$1,355,000
Net income				180,000		180,000
Dividends on preferred stock...........				(10,000)		(10,000)
Dividends on common stock				(65,000)		(65,000)
Issuance of additional common stock....		50,000	25,000			75,000
Purchase of treasury stock					(10,000)	(10,000)
Balance, December 31, 2014	$100,000	$900,000	$202,000	$350,000	$(27,000)	$1,525,000

<u>Example 3-5</u>

The Rolman Corporation is authorized to issue 1,000,000 shares of $5 par value common stock. In its first year, the company has the following stock transactions.

<u>Jan. 10</u> Issued 400,000 shares of stock at $8 per share.

<u>July 1</u> Issued 100,000 shares of stock for land. The land had an asking price of $900,000. The stock is currently selling on a national exchange at $8.25 per share.

<u>Sept. 1</u> Purchased 10,000 shares of common stock for the treasury at $9 per share.

<u>Dec. 1</u> Sold 4,000 shares of the treasury stock at $10 per share.

<u>Instructions</u>

(a) Journalize the transactions.

(b) Prepare the stockholders' equity section assuming the company had retained earnings of $200,000 at December 31.

<u>Solution</u>

(a) Jan. 10	Cash	3,200,000	
	Common Stock		2,000,000
	Paid-in Capital in Excess of Par— Common Stock		1,200,000
	(To record issuance of 400,000 shares of $5 par value stock)		
July 1	Land	825,000	
	Common Stock		500,000
	Paid-in Capital in Excess of Par— Common Stock		325,000
	(To record issuance of 100,000 shares of $5 par value stock for land)		
Sept. 1	Treasury Stock	90,000	
	Cash		90,000
	(To record purchase of 10,000 shares of treasury stock at cost)		
Dec. 1	Cash	40,000	
	Treasury Stock		36,000
	Paid-in Capital from Treasury Stock		4,000
	(To record sale of 4,000 shares of treasury stock above cost)		

(b)

ROLMAN CORPORATION
Balance Sheet (partial)

Stockholders' equity		
Paid-in capital		
Capital stock		
Common stock, $5 par value, 1,000,000 shares authorized, 500,000 shares issued, 494,000 shares outstanding		$2,500,000
Additional paid-in capital		
In excess of par—common stock	$1,525,000	
From treasury stock	4,000	
Total additional paid-in capital		1,529,000
Total paid-in capital		4,029,000
Retained earnings		200,000
Total paid-in capital and retained earnings		4,229,000
Less: Treasury stock (6,000 shares)		(54,000)
Total stockholders' equity		$4,175,000

Financial Analysis and Interpretation:

Income statement analyses:

Earnings per Share

Net income is often used by investors and creditors in evaluating a company's profitability. However, net income by itself is difficult to use in comparing companies of different sizes. Also, trends in net income may be difficult to evaluate if there have been significant changes in a company's stockholders' equity. Thus, the profitability of companies is often expressed as earnings per share. Earnings per common share (EPS), sometimes called *basic earnings per share,* is the net income per share of common stock outstanding during a period. Corporations whose stock is traded in a public market must report earnings per common share on their income statements. Earnings per share is computed as follows:

$$\text{Earnings per Share} = \frac{\text{Net Income – Preferred Dividends}}{\text{Average Number of Common Shares Outstanding}}$$

If a company has preferred stock outstanding, any preferred dividends are subtracted from net income. This is because the numerator represents only those earnings available to the common shareholders. To illustrate, the following data (in thousands) were taken from recent financial statements of Google:

	Year 2	Year 1
Net income	$8,505,000	$6,520,000
Average number of common shares outstanding	318,702 shares	316,221 shares
Earnings per share . . . . . …... . . .	$26.69	$20.62
	($8,505,000/318,702 shares)	($6,520,000/316,221 shares)

Google had no preferred stock outstanding; thus, no preferred dividends were subtracted in computing earnings per share. As shown above, Google's earnings per share increased from $20.62 in Year 1 to $26.69 in Year 2. An increase in earnings per share is generally considered a favorable trend.

Earnings per share can be used to compare two companies with different net incomes. For example, the following data (in millions) were taken from a recent year's financial statements for Goldman Sachs Group, Inc., and Wells Fargo & Company.

	Goldman Sachs	**Wells Fargo**
Net income	$8,354	$12,362
Preferred dividends	$641	$730
Average number of common shares outstanding . ..	545.0 shares	5,226.8 shares

Goldman Sachs:

$$\text{Earnings per Share} = \frac{\text{Net Income – Preferred Dividends}}{\text{Average Number of Common Shares Outstanding}}$$

$$= \frac{\$8{,}354 - \$641}{545.0 \text{ shares}} = \frac{\$7{,}713}{545.0 \text{ shares}} = \$14.15$$

Wells Fargo:

$$\text{Earnings per Share} = \frac{\text{Net Income – Preferred Dividends}}{\text{Average Number of Common Shares Outstanding}}$$

$$= \frac{\$12{,}362 - \$730}{5{,}226.8 \text{ shares}} = \frac{\$11{,}632}{5{,}226.8 \text{ shares}} = \$2.23$$

Based on earnings per share, Goldman Sachs is more profitable than Wells Fargo.

Example 3-6

Financial statement data for years ending December 31 for Finnegan Company are shown below.

	2014	2013
Net income	$350,000	$195,000
Preferred dividends	$20,000	$15,000
Average number of common shares outstanding	75,000 shares	50,000 shares

a. Determine earnings per share for 2014 and 2013.
b. Does the change in the earnings per share from 2013 to 2014 indicate a favorable or an unfavorable trend?

a. 2014:

$$\text{Earnings per Share} = \frac{\text{Net Income – Preferred Dividends}}{\text{Average Number of Common Shares Outstanding}}$$

$$= \frac{\$350{,}000 - \$20{,}000}{75{,}000 \text{ shares}} = \frac{\$330{,}000}{75{,}000 \text{ shares}} = \$4.40$$

2013:

$$\text{Earnings per Share} = \frac{\text{Net Income – Preferred Dividends}}{\text{Average Number of Common Shares Outstanding}}$$

$$= \frac{\$195{,}000 - \$15{,}000}{50{,}000 \text{ shares}} = \frac{\$180{,}000}{50{,}000 \text{ shares}} = \$3.60$$

b. The increase in the earnings per share from $3.60 to $4.40 indicates a favorable trend in the company’s profitability.

Stockholders' Equity Analysis

Return on equity

Investors and analysts can measure profitability from the viewpoint of the common stockholder by the **return on common stockholders' equity**. This ratio shows how many dollars of net income the company earned for each dollar invested by the common stockholders. It is computed by dividing **net income available to common stockholders** (which is net income minus preferred stock dividends) by average common stockholders' equity. To illustrate, Walt Disney Company's beginning-of-the-year and end-of-the year common stockholders' equity were $31,820 and $30,753 million respectively. Its net income was $4,687 million, and no preferred stock was outstanding. The return on common stockholders' equity ratio is computed as follows.

Net Income Available to Common Stockholders	÷	Average Common Stockholders' Equity	=	Return on Common Stockholders' Equity
($4,687 − $0)	÷	$\frac{(\$31,820 + \$30,753)}{2}$	=	15.0%

As shown above, if a company has preferred stock, we would deduct the amount of **preferred dividends** from the company's net income to compute income available to common stockholders. Also, the par value of preferred stock is deducted from total average stockholders' equity to arrive at the amount of common stockholders' equity.

Example 3-7

On January 1, 2012, Siena Corporation purchased 2,000 shares of treasury stock.

Other information regarding Siena Corporation is provided below.

	2011	2012
Net income	$110,000	$110,000
Dividends on preferred stock	$10,000	$10,000
Dividends on common stock	$2,000	$1,600
Weighted-average number of shares outstanding	10,000	8,000*
Common stockholders' equity, beginning of year	$500,000	$400,000*
Common stockholders' equity, end of year	$500,000	$400,000

*Adjusted for purchase of treasury stock.

Compute (a) return on common stockholders' equity for each year and (b) earnings per share for each year, and (c) discuss the changes in each.

Solution

(a)

	2011	2012
Return on common stockholders' equity	$\frac{(\$110,000 - \$10,000)}{(\$500,000 + \$500,000)/2} = 20\%$	$\frac{(\$110,000 - \$10,000)}{(\$400,000 + \$400,000)/2} = 25\%$

(b)

	2011	2012
Earnings per share	$\frac{(\$110,000 - \$10,000)}{10,000} = \$10$	$\frac{(\$110,000 - \$10,000)}{8,000} = \$12.50$

(c) Between 2011 and 2012, return on common stockholders' equity improved from 20% to 25%. Earnings per share increased from $10 to $12.50. While this would appear to be good news for the company's common stockholders, these increases should be carefully evaluated. It is important to note that net income did not change during this period. The increase in both ratios was due to the purchase of treasury shares, which reduced the denominator of each ratio. As the company repurchases its own shares, it becomes more reliant on debt and thus increases its risk.

Book value per share and price-to-book ratio

Investors also refer to ordinary shareholders' equity as stated in the accounts as 'book value'. By contrast, 'market value' represents the interests of the same ordinary shareholders measured at current market value. Book value is often expressed on a per-share basis:

$$\textbf{Book value per share} = \frac{\text{Share capital and reserves attributable to ordinary shareholders (end-period)}}{\text{End-period ordinary shares outstanding}}$$

Investors compare a company's per-share book value (taken from the most recent accounts) with the current market price of its shares, by means of the **price-to-book ratio**:

$$\textbf{Price-to-book ratio} = \frac{\text{Current market price per share}}{\text{Book value per share (end of most recent quarter or year)}}$$

Profitable and growing companies have a price-to-book ratio of greater than one. This is evident when we analyze the price-to-book (P/B) ratio: the ratio is the product of return on equity and the price–earnings ratio.

$$\textbf{Price-to-book ratio} = \frac{\text{Earnings per share}}{\text{Book value per share (end period)}} \times \frac{\text{Current market price per share}}{\text{Earnings per share}}$$

Investors use the P/E ratio as an indicator of a company's growth prospects. The P/B ratio serves the same role – but it's a richer measure because it includes the firm's current profitability as well. And it's a more reliable measure in the case of companies whose earnings are cyclical or that suffer short-term earnings declines. PSA Peugeot Citroën's recent history illustrates this well. The French vehicle manufacturer made losses in 1997. It returned to profit in 1998 and improved its profitability in each of the following three years. The company's P/B ratio for the five years to 2001 is analyzed below:

	1997	1998	1999	2000	2001
PSA Peugeot Citroën					
P/B ratio	0.72	0.78	1.23	1.20	1.20
Return on equity (end-year)	(0.05)	0.057	0.084	0.15	0.162
P/E ratio	–	13.6	14.7	8.0	7.4

The company's P/B ratio was less than unity in 1997 and 1998: the company's return on equity was less than its cost in both years. The P/B ratio rose above unity in 1999 as the company increased its ROE. Despite the company's rising profitability in subsequent years, the market judged its growth prospects to be limited: The P/B ratio remained around 1.2 in 2000 and 2001. (Note that French share prices were declining in these years and PSA's share price was affected by the change in market sentiment.) By contrast, the P/E ratio tells a less clear story. It was relatively high in 1998 and 1999 – because earnings were low but recovering – but fell back in 2000 and 2001 as earnings stabilized. (It can't be computed for 1997 because PSA made losses that year.)

Investors combine information about current book value with forecasts of future earnings in their valuations of companies.

‘Equity’ in leverage ratios

When calculating financial leverage, investors opt for a broader definition of equity. In addition to ordinary shareholder's equity, they include other sources of non-repayable capital such as (non-redeemable) preference shares. In the case of a group, ‘equity’ embraces minority interests as well as those of parent company shareholders. Thus, the consolidated debt–equity ratio is usually calculated as follows:

Debt–equity ratio =

$$\frac{\text{Net debt at end-period}}{\begin{array}{c}\text{Shareholders' equity} \\ \text{(of ordinary and non-redeemable} \\ \text{preference shareholders), end-period}\end{array} + \text{Minority interests, end-period}}$$

There is disagreement about how to classify equity with debt characteristics. For example, is preferred stock redeemable at the option of the holder debt or equity? Companies following IAS account for it as debt. Companies following US GAAP, however, must show such redeemable preferred stock and other types of 'quasi-equity' (also known as 'temporary equity') in a separate section – between long-term debt and shareholders' equity – on the balance sheet. How might an investor deal with debt-like equity securities in leverage calculations? A useful approach is to check the terms of the contract between issuing company and security holder (the company usually provides summary details in the notes to the accounts) and decide on the classification of each type of security on a case-by-case basis.

Example 3-8

On January 1, 2012, Hayslett Corporation had the following stockholders' equity accounts.

Common Stock ($10 par value, 260,000 shares issued and outstanding)	$2,600,000
Paid-in Capital in Excess of Par—Common Stock	1,500,000
Retained Earnings	3,200,000

During the year, the following transactions occurred.

<u>April 1</u> Declared a $1.50 cash dividend per share to stockholders of record on April 15, payable May 1.

<u>May 1</u> Paid the dividend declared in April.

<u>June 1</u> Announced a 2-for-1 stock split. Prior to the split, the market price per share was $24.

<u>Aug. 1</u> Declared a 10% stock dividend to stockholders of record on August 15, distributable August 31. On August 1, the market price of the stock was $10 per share.

<u>Aug. 31</u> Issued the shares for the stock dividend.

<u>Dec. 1</u> Declared a $1.50 per share dividend to stockholders of record on December 15, payable January 5, 2011.

<u>Dec. 31</u> Determined that net income for the year was $600,000.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Prepare a stockholders' equity section at December 31.

Solution

(a)

Date		Account	Debit	Credit
Apr.	1	Cash Dividends (260,000 × $1.50)	390,000	
		Dividends Payable		390,000
May	1	Dividends Payable	390,000	
		Cash		390,000
June	1	Memo—two-for-one stock split increases number of shares to 520,000 (260,000 × 2) and reduces par value to $5 per share.		
Aug.	1	Stock Dividends (52,000* × $10)	520,000	
		Common Stock Dividends Distributable (52,000 × $5)		260,000
		Paid-in Capital in Excess of Par—Common Stock (52,000 × $5)		260,000
		*520,000 × .10		
	31	Common Stock Dividends Distributable	260,000	
		Common Stock		260,000
Dec.	1	Cash Dividends (572,000** × $1.50)	858,000	
		Dividends Payable		858,000
		**(260,000 × 2) + 52,000		
	31	Income Summary	600,000	
		Retained Earnings		600,000

(b) **HAYSLETT CORPORATION**

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, $5 par value, 572,000 shares issued and outstanding	$2,860,000
Paid-in capital in excess of par—common stock	1,760,000
Total paid-in capital	4,620,000
Retained earnings	2,032,000*
Total stockholders' equity	$6,652,000

*$3,200,000 + $600,000 − $390,000 − $520,000 − $858,000

Exercises & Problems

Exercises & Problems

1. Which of the following is *not* a major advantage of a corporation?
a. Separate legal existence.
b. Continuous life.
c. Government regulations.
d. Transferable ownership rights.

2. A major disadvantage of a corporation is:
a. limited liability of stockholders.
b. additional taxes.
c. transferable ownership rights.
d. None of the above.

3. Costs incurred in the formation of a corporation:
a. do not include legal fees.
b. are expensed as incurred.
c. are recorded as an asset.
d. provide future benefits whose amounts and timing are easily determined.

4. Which of the following statements is *false*?
a. Ownership of common stock gives the owner a voting right.
b. The stockholders' equity section begins with paid-in capital.
c. The authorization of capital stock does not result in a formal accounting entry.
d. Legal capital per share applies to par value stock but not to no-par value stock.

5. Total stockholders' equity (in the absence of treasury stock) equals:
a. Total paid-in capital + Retained earnings.
b. Paid-in capital + Capital stock + Retained earnings.
c. Capital stock + Additional paid-in capital - Retained earnings.
d. Common stock + Retained earnings.

6. The account Retained Earnings is:
a. a subdivision of paid-in capital.
b. net income retained in the corporation.
c. reported as an expense in the income statement.
d. closed to capital stock.

7. A-Team Corporation issued 1,000 shares of $5 par value stock for land. The stock is actively traded at $9 per share. The land was advertised for sale at $10,500. The land should be recorded at:
a. $4,000.
b. $5,000.
c. $9,000.
d. $10,500.

8. ABC Corporation issues 1,000 shares of $10 par value common stock at $12 per share. In recording the transaction, credits are made to:
a. Common Stock $10,000 and Paid-in Capital in Excess of Stated Value $2,000.
b. Common Stock $12,000.
c. Common Stock $10,000 and Paid-in Capital in Excess of Par $2,000.
d. Common Stock $10,000 and Retained Earnings $2,000.

9. Treasury stock may be repurchased:
a. to reissue the shares to officers and employees under bonus and stock compensation plans.
b. to signal to the stock market that management believes the stock is underpriced.
c. to have additional shares available for use in the acquisition of other companies.
d. More than one of the above.

10. XYZ, Inc. sells 100 shares of $5 par value treasury stock at $13 per share. If the cost of acquiring the shares was $10 per share, the entry for the sale should include credits to:
a. Treasury Stock $1,000 and Paid-in Capital from Treasury Stock $300.
b. Treasury Stock $500 and Paid-in Capital from Treasury Stock $800.
c. Treasury Stock $1,000 and Retained Earnings $300.
d. Treasury Stock $500 and Paid-in Capital in Excess of Par $800.

11. In the stockholders' equity section, the cost of treasury stock is deducted from:
a. total paid-in capital and retained earnings.
b. retained earnings.
c. total stockholders' equity.
d. common stock in paid-in capital.

12. Preferred stock may have priority over common stock *except* in:
a. dividends.
b. assets in the event of liquidation.
c. cumulative dividend features.
d. voting.

13. Which of the following is *not* reported under additional paid-in capital?
a. Paid-in capital in excess of par.
b. Common stock.
c. Paid-in capital in excess of stated value.
d. Paid-in capital from treasury stock.

14. M-Bot Corporation has 10,000 shares of 8%, $100 par value, cumulative preferred stock outstanding at December 31, 2012. No dividends were declared in 2010 or 2011. If
M-Bot wants to pay $375,000 of dividends in 2012, common stockholders will receive:

a. $0.
b. $295,000.
c. $215,000.
d. $135,000.

15. In the stockholders' equity section of the balance sheet, common stock:

a. is listed before preferred stock.
b. is added to total capital stock.
c. is part of paid-in capital.
d. is part of additional paid-in capital.

16. Trudy Borke is studying for her accounting midterm examination. Identify for Trudy the advantages and disadvantages of the corporate form of business organization.

17. At December 31, Jimbo Corporation reports net income of $450,000. Prepare the entry to close net income.

18. On May 10, Jack Corporation issues 2,000 shares of $10 par value common stock for cash at $18 per share. Journalize the issuance of the stock.

19. On June 1, Donkey Inc. issues 3,000 shares of no-par common stock at a cash price
of $6 per share. Journalize the issuance of the shares assuming the stock has a stated value of $1 per share.

20. Jer Inc.'s $10 par value common stock is actively traded at a market value of $15 per
share. Jer issues 5,000 shares to purchase land advertised for sale at $85,000. Journalize the issuance of the stock in acquiring the land.

21. On July 1, Laura Corporation purchases 500 shares of its $5 par value common stock
for the treasury at a cash price of $8 per share. On September 1, it sells 300 shares of the treasury stock for cash at $11 per share. Journalize the two treasury stock transactions.

22. Cora Inc. issues 5,000 shares of $100 par value preferred stock for cash at $130 per
share. Journalize the issuance of the preferred stock.

23. Vivi Corporation has the following accounts at December 31: Common Stock, $10 par, 5,000 shares issued, $50,000; Paid-in Capital in Excess of Par—Common Stock $20,000; Retained Earnings $45,000; and Treasury Stock, 500 shares, $11,000. Prepare the stockholders' equity section of the balance sheet.

24. Indicate whether each of the following statements is true or false.

a. The corporation is an entity separate and distinct from its owners.

b. The liability of stockholders is normally limited to their investment in the corporation.

c. The relative lack of government regulation is an advantage of the corporate form of business.

d. There is no journal entry to record the authorization of capital stock.

e. No-par value stock is quite rare today.

25. At the end of its first year of operation, Jane Corporation has $1,000,000 of common
stock and net income of $216,000. Prepare (a) the closing entry for net income and (b) the stockholders' equity section at year-end.

26. Balboa Island Corporation began operations on April 1 by issuing 60,000 shares of $5 par value common stock for cash at $13 per share. On April 19, it issued 2,000 shares of common stock to attorneys in settlement of their bill of $27,500 for organization costs. Journalize both issuances, assuming the stock is not publicly traded.

27. Caleb Corporation purchased 2,000 shares of its $10 par value common stock for $120,000 on August 1. It will hold these shares in the treasury until resold. On December 1, the corporation sold 1,200 shares of treasury stock for cash at $72 per share. Journalize the treasury stock transactions.

28. Doreen Corporation has issued 100,000 shares of $5 par value common stock. It authorized 500,000 shares. The paid-in capital in excess of par on the common stock is $240,000. The corporation has reacquired 7,000 shares at a cost of $46,000 and is currently holding those shares. Treasury stock was reissued in prior years for $47,000 more than its cost. The corporation also has 2,000 shares issued and outstanding of 7%, $100 par-value preferred stock. It authorized 10,000 shares. The paid-in capital in excess of par on the preferred stock is $23,000. Retained earnings is $372,000. Prepare the stockholders' equity section of the balance sheet.

29. Angela has prepared the following list of statements about corporations.

a. A corporation is an entity separate and distinct from its owners.

b. As a legal entity, a corporation has most of the rights and privileges of a person.

c. Most of the largest U.S. corporations are privately held corporations.

d. Corporations may buy, own, and sell property; borrow money; enter into legally binding contracts; and sue and be sued.

e. The net income of a corporation is not taxed as a separate entity.

f. Creditors have a legal claim on the personal assets of the owners of a corporation if the corporation does not pay its debts.

g. The transfer of stock from one owner to another requires the approval of either the corporation or other stockholders.

h. The board of directors of a corporation legally owns the corporation.

i. The chief accounting officer of a corporation is the controller.

j. Corporations are subject to less state and federal regulations than partnerships or proprietorships.

Instructions

Identify each statement as true or false. If false, indicate how to correct the statement.

30. Angela (see 29) has studied the information you gave her in that exercise and has come to you with more statements about corporations.

a. Corporation management is both an advantage and a disadvantage of a corporation compared to a proprietorship or a partnership.

b. Limited liability of stockholders, government regulations, and additional taxes are the major disadvantages of a corporation.

c. When a corporation is formed, organization costs are recorded as an asset.

d. Each share of common stock gives the stockholder the ownership rights to vote at stockholder meetings, share in corporate earnings, keep the same percentage ownership when new shares of stock are issued, and share in assets upon liquidation.

e. The number of issued shares is always greater than or equal to the number of authorized shares.

f. A journal entry is required for the authorization of capital stock.

g. Publicly held corporations usually issue stock directly to investors.

h. The trading of capital stock on a securities exchange involves the transfer of already issued shares from an existing stockholder to another investor.

i. The market value of common stock is usually the same as its par value.

j. Retained earnings is the total amount of cash and other assets paid in to the corporation by stockholders in exchange for capital stock.

Instructions

Identify each statement as true or false. If false, indicate how to correct the statement.

31. During its first year of operations, Benji Corporation had the following transactions pertaining to its common stock.
Jan. 10 Issued 70,000 shares for cash at $5 per share.
July 1 Issued 40,000 shares for cash at $7 per share.
Instructions
(a) Journalize the transactions, assuming that the common stock has a par value of $5 per share.
(b) Journalize the transactions, assuming that the common stock is no-par with a stated value of $1 per share.

32. Jake Corporation issued 1,000 shares of stock.
Instructions
Prepare the entry for the issuance under the following assumptions.
(a) The stock had a par value of $5 per share and was issued for a total of $52,000.
(b) The stock had a stated value of $5 per share and was issued for a total of $52,000.
(c) The stock had no par or stated value and was issued for a total of $52,000.
(d) The stock had a par value of $5 per share and was issued to attorneys for services during incorporation valued at $52,000.
(e) The stock had a par value of $5 per share and was issued for land worth $52,000.

33. Laci Co. had the following transactions during the current period.

Mar. 2 Issued 5,000 shares of $5 par value common stock to attorneys in payment of a bill for $30,000 for services provided in helping the company to incorporate.

June 12 Issued 60,000 shares of $5 par value common stock for cash of $375,000.

July 11 Issued 1,000 shares of $100 par value preferred stock for cash at $110 per share.

Nov. 28 Purchased 2,000 shares of treasury stock for $80,000.

Instructions

Journalize the transactions.

34. As an auditor for the CPA firm of Valente and Ardvino, you encounter the following situations in auditing different clients.

1. PM Corporation is a closely held corporation whose stock is not publicly traded. On December 5, the corporation acquired land by issuing 5,000 shares of its $20 par value common stock. The owners' asking price for the land was $120,000, and the fair value of the land was $115,000.

2. Paul Corporation is a publicly held corporation whose common stock is traded on the securities markets. On June 1, it acquired land by issuing 20,000 shares of its $10 par value stock. At the time of the exchange, the land was advertised for sale at $250,000. The stock was selling at $12 per share.

Instructions

Prepare the journal entries for each of the situations above.

35. On January 1, 2012, the stockholders' equity section of Joshua Corporation shows: Common stock ($5 par value) $1,500,000; paid-in capital in excess of par $1,000,000; and retained earnings $1,200,000. During the year, the following treasury stock transactions occurred.

Mar. 1 Purchased 50,000 shares for cash at $15 per share.

July 1 Sold 10,000 treasury shares for cash at $17 per share.

Sept. 1 Sold 8,000 treasury shares for cash at $14 per share.

Instructions

(a) Journalize the treasury stock transactions.

(b) Restate the entry for September 1, assuming the treasury shares were sold at $12 per share.

36. Michaela Corporation purchased from its stockholders 5,000 shares of its own previously issued stock for $250,000. It later resold 2,000 shares for $54 per share, then 2,000 more shares for $49 per share, and fi nally 1,000 shares for $40 per share.

Instructions

Prepare journal entries for the purchase of the treasury stock and the three sales of treasury stock.

37. Paul Corporation is authorized to issue both preferred and common stock. The par value of the preferred is $50. During the fi rst year of operations, the company had the following events and transactions pertaining to its preferred stock.

Feb. 1 Issued 20,000 shares for cash at $53 per share.

July 1 Issued 12,000 shares for cash at $57 per share.

Instructions

(a) Journalize the transactions.

(b) Post to the stockholders' equity accounts.

(c) Indicate the financial statement presentation of the related accounts.

38. David Corporation issued 100,000 shares of $20 par value, cumulative, 8% preferred
stock on January 1, 2011, for $2,100,000. In December 2013, David declared its first dividend of $500,000.

Instructions

(a) Prepare David's journal entry to record the issuance of the preferred stock.

(b) If the preferred stock is *not* cumulative, how much of the $500,000 would be paid to **common** stockholders?

(c) If the preferred stock is cumulative, how much of the $500,000 would be paid to **common** stockholders?

39. Carolyn Corporation recently hired a new accountant with extensive experience in accounting for partnerships. Because of the pressure of the new job, the accountant was unable to review his textbooks on the topic of corporation accounting. During the first month, the accountant made the following entries for the corporation's capital stock.

May 2 Cash 130,000

Capital Stock 130,000

(Issued 10,000 shares of $10 par value common stock at $13 per share)

10 Cash 600,000

Capital Stock 600,000

(Issued 10,000 shares of $50 par value preferred stock at $60 per share)

15 Capital Stock 15,000

Cash 15,000

(Purchased 1,000 shares of common stock for the treasury at $15 per share)

31 Cash 8,000

Capital Stock 5,000

Gain on Sale of Stock 3,000

(Sold 500 shares of treasury stock at $16 per share)

Instructions

On the basis of the explanation for each entry, prepare the entry that should have been made for the capital stock transactions.

40. The following stockholders' equity accounts, arranged alphabetically, are in the ledger of Borkowski Corporation at December 31, 2012.

Common Stock ($5 stated value)	$1,700,000
Paid-in Capital in Excess of Par—Preferred Stock	280,000
Paid-in Capital in Excess of Stated Value—Common Stock	900,000
Preferred Stock (8%, $100 par, noncumulative)	500,000
Retained Earnings	1,134,000
Treasury Stock (10,000 common shares)	120,000

Instructions

Prepare the stockholders' equity section of the balance sheet at December 31, 2012.

41. The stockholders' equity section of Erik Corporation at December 31 is as follows.

ERIK CORPORATION

Balance Sheet (partial)

Paid-in capital	
Preferred stock, cumulative, 10,000 shares authorized, 6,000 shares issued and outstanding	$ 300,000
Common stock, no par, 750,000 shares authorized, 600,000 shares issued	1,200,000
Total paid-in capital	1,500,000
Retained earnings	1,858,000
Total paid-in capital and retained earnings	3,358,000
Less: Treasury stock (10,000 common shares)	(64,000)
Total stockholders' equity	$3,294,000

Instructions

From a review of the stockholders' equity section, as chief accountant, write a memo to the president of the company answering the following questions.

(a) How many shares of common stock are outstanding?

(b) Assuming there is a stated value, what is the stated value of the common stock?

(c) What is the par value of the preferred stock?
(d) If the annual dividend on preferred stock is $30,000, what is the dividend rate on preferred stock?
(e) If dividends of $60,000 were in arrears on preferred stock, what would be the balance in Retained Earnings?

42. In a recent year, the stockholders' equity section of Aluminum Company of America
(Alcoa) showed the following (in alphabetical order): additional paid-in capital $6,101, common stock $925, preferred stock $55, retained earnings $7,428, and treasury stock 2,828. All dollar data are in millions.

The preferred stock has 557,740 shares authorized, with a par value of $100 and an annual $3.75 per share cumulative dividend preference. At December 31, 557,649 shares of preferred are issued and 546,024 shares are outstanding. There are 1.8 billion shares of $1 par value common stock authorized, of which 924.6 million are issued and 844.8 million are outstanding at December 31.

Instructions
Prepare the stockholders' equity section, including disclosure of all relevant data.

43. The ledger of Hickory Hills Corporation contains the following accounts: Common Stock, Preferred Stock, Treasury Stock, Paid-in Capital in Excess of Par—Preferred Stock, Paid-in Capital in Excess of Stated Value—Common Stock, Paid-in Capital from Treasury Stock, and Retained Earnings.

Instructions
Classify each account using the following table headings.

		Paid-in Capital	
Account	**Capital Stock**	**Additional**	**Retained Earnings**	**Other**

44. Alexia Corporation was organized on January 1, 2012. It is authorized to issue 10,000
shares of 8%, $100 par value preferred stock, and 500,000 shares of no-par common stock with a stated value of $2 per share. The following stock transactions were completed during the first year.

Jan. 10 Issued 80,000 shares of common stock for cash at $4 per share.

Mar. 1 Issued 5,000 shares of preferred stock for cash at $105 per share.

Apr. 1 Issued 24,000 shares of common stock for land. The asking price of the land was
$90,000. The fair value of the land was $85,000.

May 1 Issued 80,000 shares of common stock for cash at $4.50 per share.

Aug. 1 Issued 10,000 shares of common stock to attorneys in payment of their bill of $30,000 for services provided in helping the company organize.

Sept. 1 Issued 10,000 shares of common stock for cash at $5 per share.

Nov. 1 Issued 1,000 shares of preferred stock for cash at $109 per share.

Instructions

(a) Journalize the transactions.

(b) Post to the stockholders' equity accounts. (Use J5 as the posting reference.)

(c) Prepare the paid-in capital section of stockholders' equity at December 31, 2012.

45. Brandon Corporation had the following stockholders' equity accounts on January 1, 2012: Common Stock ($5 par) $500,000, Paid-in Capital in Excess of Par—Common Stock $200,000, and Retained Earnings $100,000. In 2012, the company had the following treasury stock transactions.

Mar. 1 Purchased 5,000 shares at $9 per share.

June 1 Sold 1,000 shares at $12 per share.

Sept. 1 Sold 2,000 shares at $10 per share.

Dec. 1 Sold 1,000 shares at $6 per share.

Brandon Corporation uses the cost method of accounting for treasury stock. In 2012, the company reported net income of $30,000.

Instructions

(a) Journalize the treasury stock transactions, and prepare the closing entry at December 31, 2012, for net income.

(b) Open accounts for (1) Paid-in Capital from Treasury Stock, (2) Treasury Stock, and (3) Retained Earnings. Post to these accounts using J10 as the posting reference.

(c) Prepare the stockholders' equity section for Jacobsen Corporation at December 31, 2012.

46. The stockholders' equity accounts of Ashley Corporation on January 1, 2012, were as follows.

Preferred Stock (8%, $50 par, cumulative, 10,000 shares authorized)	$ 400,000
Common Stock ($1 stated value, 2,000,000 shares authorized)	1,000,000
Paid-in Capital in Excess of Par—Preferred Stock	100,000
Paid-in Capital in Excess of Stated Value—Common Stock	1,450,000
Retained Earnings	1,816,000
Treasury Stock (10,000 common shares)	50,000

During 2012, the corporation had the following transactions and events pertaining to its stockholders' equity.

Feb. 1 Issued 25,000 shares of common stock for $120,000.

Apr. 14 Sold 6,000 shares of treasury stock—common for $33,000.

Sept. 3 Issued 5,000 shares of common stock for a patent valued at $35,000.

Nov. 10 Purchased 1,000 shares of common stock for the treasury at a cost of $6,000.

Dec. 31 Determined that net income for the year was $452,000.

No dividends were declared during the year.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts and post the journal entries to the stockholders' equity accounts.

(c) Prepare a stockholders' equity section at December 31, 2012, including the disclosure of the preferred dividends in arrears.

47. Mary Corporation is authorized to issue 20,000 shares of $50 par value, 10% preferred stock and 125,000 shares of $3 par value common stock. On January 1, 2012, the ledger contained the following stockholders' equity balances.

Preferred Stock (10,000 shares)	$500,000
Paid-in Capital in Excess of Par—Preferred Stock	75,000
Common Stock (70,000 shares)	210,000
Paid-in Capital in Excess of Par—Common Stock	700,000
Retained Earnings	300,000

During 2012, the following transactions occurred.

Feb. 1 Issued 2,000 shares of preferred stock for land having a fair value of $125,000.

Mar. 1 Issued 1,000 shares of preferred stock for cash at $65 per share.

July 1 Issued 16,000 shares of common stock for cash at $7 per share.

Sept. 1 Issued 400 shares of preferred stock for a patent. The asking price of the patent was $30,000. Market values were preferred stock $70 and patent indeterminable.

Dec. 1 Issued 8,000 shares of common stock for cash at $7.50 per share.

Dec. 31 Net income for the year was $260,000. No dividends were declared.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts and post the journal entries to the stockholders' equity accounts. (Use J2 for the posting reference.)

(c) Prepare a stockholders' equity section at December 31, 2012.

48. The following stockholders' equity accounts arranged alphabetically are in the ledger
of Desiree Corporation at December 31, 2012.

Common Stock ($5 stated value)	$2,000,000
Paid-in Capital from Treasury Stock	10,000
Paid-in Capital in Excess of Stated Value—Common Stock	1,600,000
Paid-in Capital in Excess of Par—Preferred Stock	679,000
Preferred Stock (8%, $50 par, noncumulative)	800,000
Retained Earnings	1,748,000
Treasury Stock (10,000 common shares)	130,000

Instructions

Prepare a stockholders' equity section at December 31, 2012.

49. Leigh Corporation has been authorized to issue 20,000 shares of $100 par value, 10%, noncumulative preferred stock and 1,000,000 shares of no-par common stock. The corporation assigned a $2.50 stated value to the common stock. At December 31, 2012, the ledger contained the following balances pertaining to stockholders' equity.

Preferred Stock	$ 120,000
Paid-in Capital in Excess of Par—Preferred Stock	20,000
Common Stock	1,000,000
Paid-in Capital in Excess of Stated Value—Common Stock	1,800,000
Treasury Stock (1,000 common shares)	13,000
Paid-in Capital from Treasury Stock	500
Retained Earnings	82,000

The preferred stock was issued for land having a fair value of $140,000. All common stock issued was for cash. In November, 1,500 shares of common stock were purchased for the treasury at a per share cost of $13. In December, 500 shares of treasury stock were sold for $14 per share. No dividends were declared in 2012.

Instructions

(a) Prepare the journal entries for the:

(1) Issuance of preferred stock for land.

(2) Issuance of common stock for cash.

(3) Purchase of common treasury stock for cash.

(4) Sale of treasury stock for cash.

(b) Prepare the stockholders' equity section at December 31, 2012.

50. Joanjim Corporation was organized on January 1, 2012. It is authorized to issue 20,000 shares of 6%, $40 par value preferred stock, and 500,000 shares of no-par common stock with a stated value of $2 per share. The following stock transactions were completed during the first year.

Jan. 10 Issued 100,000 shares of common stock for cash at $3 per share.

Mar. 1 Issued 10,000 shares of preferred stock for cash at $55 per share.

Apr. 1 Issued 25,000 shares of common stock for land. The asking price of the land was
$90,000. The company's estimate of fair value of the land was $75,000.

May 1 Issued 75,000 shares of common stock for cash at $4 per share.

Aug. 1 Issued 10,000 shares of common stock to attorneys in payment of their bill for $50,000 for services provided in helping the company organize.

Sept. 1 Issued 5,000 shares of common stock for cash at $6 per share.

Nov. 1 Issued 2,000 shares of preferred stock for cash at $60 per share.

Instructions

(a) Journalize the transactions.

(b) Post to the stockholders' equity accounts. (Use J1 as the posting reference.)

(c) Prepare the paid-in capital section of stockholders' equity at December 31, 2012.

51. Dougherty Corporation had the following stockholders' equity accounts on January 1, 2012: Common Stock ($1 par) $400,000, Paid-in Capital in Excess of Par—Common Stock $500,000, and Retained Earnings $100,000. In 2012, the company had the following treasury stock transactions.

Mar. 1 Purchased 5,000 shares at $7 per share.

June 1 Sold 1,000 shares at $10 per share.

Sept. 1 Sold 2,000 shares at $9 per share.

Dec. 1 Sold 1,000 shares at $5 per share.

Dougherty Corporation uses the cost method of accounting for treasury stock. In 2012, the company reported net income of $80,000.

Instructions

(a) Journalize the treasury stock transactions, and prepare the closing entry at December 31, 2012, for net income.

(b) Open accounts for (1) Paid-in Capital from Treasury Stock, (2) Treasury Stock, and (3) Retained Earnings. Post to these accounts using J12 as the posting reference.

(c) Prepare the stockholders' equity section for Dougherty Corporation at December 31, 2012.

52. The stockholders' equity accounts of Joey Corporation on January 1, 2012, were as follows.

Preferred Stock (10%, $100 par, noncumulative, 5,000 shares authorized)	$ 300,000
Common Stock ($5 stated value, 300,000 shares authorized)	1,000,000
Paid-in Capital in Excess of Par—Preferred Stock	20,000
Paid-in Capital in Excess of Stated Value—Common Stock	425,000
Retained Earnings	488,000
Treasury Stock (5,000 common shares)	40,000

During 2012, the corporation had the following transactions and events pertaining to its stockholders' equity.

Feb. 1 Issued 3,000 shares of common stock for $25,500.

Mar. 20 Purchased 1,500 additional shares of common treasury stock at $8 per share.

June 14 Sold 4,000 shares of treasury stock—common for $36,000.

Sept. 3 Issued 2,000 shares of common stock for a patent valued at $19,000.

Dec. 31 Determined that net income for the year was $350,000.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts and post the journal entries to the stockholders' equity accounts.

(c) Prepare a stockholders' equity section at December 31, 2012.

53. Dominick Corporation is authorized to issue 10,000 shares of $40 par value, 10% preferred stock and 200,000 shares of $5 par value common stock. On January 1, 2012, the ledger contained the following stockholders' equity balances.

Preferred Stock (5,000 shares)	$200,000
Paid-in Capital in Excess of Par—Preferred Stock	60,000
Common Stock (70,000 shares)	350,000
Paid-in Capital in Excess of Par—Common Stock	700,000
Retained Earnings	300,000

During 2012, the following transactions occurred.

Feb. 1 Issued 1,000 shares of preferred stock for land having a fair value of $65,000.

Mar. 1 Issued 2,000 shares of preferred stock for cash at $60 per share.

July 1 Issued 20,000 shares of common stock for cash at $5.80 per share.

Sept. 1 Issued 800 shares of preferred stock for a patent. The asking price of the patent was $60,000. Market values were preferred stock $65 and patent, indeterminable.

Dec. 1 Issued 10,000 shares of common stock for cash at $6 per share.

Dec. 31 Net income for the year was $210,000. No dividends were declared.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts and post the journal entries to the stockholders' equity accounts.

(c) Prepare a stockholders' equity section at December 31, 2012.

54. The following stockholders' equity accounts arranged alphabetically are in the ledger of Dillon Corporation at December 31, 2012.

Common Stock ($10 stated value)	$1,200,000
Paid-in Capital from Treasury Stock	6,000
Paid-in Capital in Excess of Stated Value—Common Stock	690,000
Paid-in Capital in Excess of Par—Preferred Stock	288,400
Preferred Stock (8%, $100 par, noncumulative)	300,000
Retained Earnings	826,000
Treasury Stock (8,000 common shares)	88,000

Instructions

Prepare a stockholders' equity section at December 31, 2012.

55. Geoffery Corporation has been authorized to issue 40,000 shares of $100 par value,

8%, noncumulative preferred stock and 2,000,000 shares of no-par common stock. The corporation assigned a $5 stated value to the common stock. At December 31, 2012, the ledger contained the following balances pertaining to stockholders' equity.

Preferred Stock	$ 240,000
Paid-in Capital in Excess of Par—Preferred Stock	56,000
Common Stock	2,000,000
Paid-in Capital in Excess of Stated Value—Common Stock	4,400,000
Treasury Stock (1,000 common shares)	22,000
Paid-in Capital from Treasury Stock	3,000
Retained Earnings	560,000

The preferred stock was issued for land having a fair value of $296,000. All common stock issued was for cash. In November, 1,500 shares of common stock were purchased for the treasury at a per share cost of $22. In December, 500 shares of treasury stock were sold for $28 per share. No dividends were declared in 2012.

Instructions
(a) Prepare the journal entries for the:
(1) Issuance of preferred stock for land.
(2) Issuance of common stock for cash.
(3) Purchase of common treasury stock for cash.
(4) Sale of treasury stock for cash.
(b) Prepare the stockholders' equity section at December 31, 2012.

56. Entries for cash dividends are required on the:
a. declaration date and the payment date.
b. record date and the payment date.
c. declaration date, record date, and payment date.
d. declaration date and the record date.

57. Which of the following statements about small stock dividends is *true*?
a. A debit to Retained Earnings for the par value of the shares issued should be made.
b. A small stock dividend decreases total stockholders' equity.
c. Market value per share should be assigned to the dividend shares.
d. A small stock dividend ordinarily will have an effect on par value per share of stock.

58. Which of the following statements about a 3-for-1 stock split is *true*?
a. It will triple the market value of the stock.
b. It will triple the amount of total stockholders' equity.
c. It will have no effect on total stockholders' equity.
d. It requires the company to distribute cash.

59. Encore Inc. declared an $80,000 cash dividend. It currently has 3,000 shares of 7%, $100 par value cumulative preferred stock outstanding. It is one year in arrears on its preferred stock. How much cash will Encore distribute to the common stockholders?

a. $38,000.
b. $42,000.
c. $59,000.
d. None.

60. Raptor Inc. has retained earnings of $500,000 and total stockholders' equity of $2,000,000. It has 100,000 shares of $8 par value common stock outstanding, which is currently selling for $30 per share. If Raptor declares a 10% stock dividend on its common stock:

a. net income will decrease by $80,000.
b. retained earnings will decrease by $80,000 and total stockholders' equity will increase by $80,000.
c. retained earnings will decrease by $300,000 and total stockholders' equity will increase by $300,000.
d. retained earnings will decrease by $300,000 and total paid-in capital will increase by $300,000.

61. Which of the following can cause a restriction in retained earnings?

a. State laws regarding treasury stock.
b. Long-term debt contract terms.
c. Authorizations by the board of directors in light of planned expansion of corporate facilities.
d. All of the above.

62. All *but one* of the following is reported in a retained earnings statement. The exception is:

a. cash and stock dividends.
b. net income and net loss.
c. sales revenue.
d. prior period adjustments.

63. A prior period adjustment is:
a. reported in the income statement as a nontypical item.
b. a correction of an error that is recorded directly to retained earnings.
c. reported directly in the stockholders' equity section.
d. reported in the retained earnings statement as an adjustment of the ending balance of retained earnings.

64. In the stockholders' equity section, Common Stock Dividends Distributable is reported as a(n):
a. deduction from total paid-in capital and retained earnings.
b. addition to additional paid-in capital.
c. deduction from retained earnings.
d. addition to capital stock.

65. Katie Inc. reported net income of $186,000 during 2012 and paid dividends of $26,000 on common stock. It also has 10,000 shares of 6%, $100 par value, noncumulative preferred stock outstanding. Common stockholders' equity was $1,200,000 on January 1, 2012, and $1,600,000 on December 31, 2012. The company's return on common stockholders' equity for 2012 is:
a. 10.0%. **c.** 7.1%.
b. 9.0%. **d.** 13.3%.

66. Corporation income statements may be the same as the income statements for unincorporated companies *except* for:
a. gross profit. **c.** operating income.
b. income tax expense. **d.** net sales.

67. During 2012, Talon Inc. had sales revenue $376,000, gross profit $176,000, operating expenses $66,000, cash dividends $30,000, other expenses and losses $20,000. Its corporate tax rate is 30%. What was Talon's income tax expense for the year?

a. $18,000.
b. $52,800.
c. $112,800.
d. $27,000.

68. The return on common stockholders' equity is defined as:

a. net income divided by total assets.
b. cash dividends divided by average common stockholders' equity.
c. income available to common stockholders divided by average common stockholders' equity.
d. None of these is correct.

69. If everything else is held constant, earnings per share is increased by:

a. the payment of a cash dividend to common shareholders.
b. the payment of a cash dividend to preferred shareholders.
c. the issuance of new shares of common stock.
d. the purchase of treasury stock.

70. The income statement for Nadeen, Inc. shows income before income taxes $700,000, income tax expense $210,000, and net income $490,000. If Nadeen has 100,000 shares of common stock outstanding throughout the year, earnings per share is:

a. $7.00.
b. $4.90.
c. $2.10.
d. No correct answer is given.

71. Charmaine Corporation has 80,000 shares of common stock outstanding. It declares
a $1 per share cash dividend on November 1 to stockholders of record on December 1. The dividend is paid on December 31. Prepare the entries on the appropriate dates to record the declaration and payment of the cash dividend.

72. Willand Corporation has 50,000 shares of $10 par value common stock outstanding.
It declares a 10% stock dividend on December 1 when the market value per share is $16. The dividend shares are issued on December 31. Prepare the entries for the declaration and payment of the stock dividend.

73. The stockholders' equity section of Melanie Corporation consists of common stock ($10 par) $2,000,000 and retained earnings $500,000. A 10% stock dividend (20,000 shares) is declared when the market value per share is $14. Show the before and after effects of the dividend on the following.

(a) The components of stockholders' equity.
(b) Shares outstanding.
(c) Par value per share.

74. For the year ending December 31, 2012, Vail Inc. reports net income $140,000 and dividends $85,000. Prepare the retained earnings statement for the year assuming the balance in retained earnings on January 1, 2012, was $220,000.

75. The balance in retained earnings on January 1, 2012, for Thomas Inc, was $800,000.
During the year, the corporation paid cash dividends of $90,000 and distributed a stock dividend of $8,000. In addition, the company determined that it had understated its depreciation expense in prior years by $50,000. Net income for 2012 was $120,000. Prepare the retained earnings statement for 2012.

76. SUPERVALU, one of the largest grocery retailers in the United States, is headquartered in Minneapolis. The following financial information (in millions) was taken from the company's 2009 annual report. Net sales $40,597; net income $393; beginning stockholders' equity $2,581; ending stockholders' equity $2,887. Compute the return on common stockholders' equity ratio.

77. Stanley Corporation reported net income of $152,000, declared dividends on common stock of $50,000, and had an ending balance in retained earnings of $360,000. Stockholders' equity was $700,000 at the beginning of the year and $820,000 at the end of the year. Compute the return on common stockholders' equity.

78. The following information is available for Mildred Corporation for the year ended December 31, 2012: Cost of goods sold $205,000; Sales revenue $450,000; Other revenues and gains $50,000; and Operating expenses $75,000. Assuming a corporate tax rate of 30%, prepare an income statement for the company.

79. Wegrzyn Corporation reports net income of $380,000 and a weighted average of 200,000 shares of common stock outstanding for the year. Compute the earnings per share of common stock.

80. Income and common stock data for Wegrzyn Corporation are presented in Ex. 79. Assume also that Wegrzyn has cumulative preferred stock dividends for the current year of $20,000 that were declared and paid. Compute the earnings per share of common stock.

81. Erik Corporation has 3,000 shares of 7%, $100 par value preferred stock outstanding
at December 31, 2012. At December 31, 2012, the company declared a $105,000 cash dividend. Determine the dividend paid to preferred stockholders and common stockholders under each of the following scenarios.

1. The preferred stock is noncumulative, and the company has not missed any dividends in previous years.

2. The preferred stock is noncumulative, and the company did not pay a dividend in each of the two previous years.

3. The preferred stock is cumulative, and the company did not pay a dividend in each of the two previous years.

82. Ekedahl Company has had 4 years of retained earnings. Due to this success, the market price of its 400,000 shares of $3 par value common stock has increased from $12 per share to $51. During this period, paid-in capital remained the same at $2,400,000. Retained earnings increased from $1,800,000 to $12,000,000. President E. Ofey is considering either a 15% stock dividend or a 2-for-1 stock split. He asks you to show the before-and-after effects of each option on (a) retained earnings and (b) total stockholders' equity.

83. Jason Corporation has retained earnings of $3,100,000 on January 1, 2012. During the year, Jason earned $1,200,000 of net income. It declared and paid a $150,000 cash dividend. In 2012, Jason recorded an adjustment of $110,000 due to the overstatement (from mathematical error) of 2011 depreciation expense. Prepare a retained earnings statement for 2012.

84. On January 1, 2012, Raczynski Corporation purchased 1,000 shares of treasury stock. Other information regarding Raczynski Corporation is provided below.

	2011	**2012**
Net income	$200,000	$210,000
Dividends on preferred stock	$30,000	$30,000
Dividends on common stock	$20,000	$25,000
Weighted-average number of common shares outstanding	10,000	9,000
Common stockholders' equity beginning of year	$600,000	$750,000
Common stockholders' equity end of year	$750,000	$830,000

Compute (a) return on common stockholders' equity for each year and (b) earnings per share for each year, and (c) discuss the changes in each.

85. On January 1, Chreesh Corporation had 95,000 shares of no-par common stock issued and outstanding. The stock has a stated value of $5 per share. During the year, the following occurred.

Apr. 1 Issued 25,000 additional shares of common stock for $17 per share.

June 15 Declared a cash dividend of $1 per share to stockholders of record on June 30.

July 10 Paid the $1 cash dividend.

Dec. 1 Issued 2,000 additional shares of common stock for $19 per share.

15 Declared a cash dividend on outstanding shares of $1.20 per share to stockholders of record on December 31.

Instructions

(a) Prepare the entries, if any, on each of the three dividend dates.

(b) How are dividends and dividends payable reported in the financial statements prepared at December 31?

86. Griseta Corporation was organized on January 1, 2011. During its first year, the corporation issued 2,000 shares of $50 par value preferred stock and 100,000 shares of $10 par value common stock. At December 31, the company declared the following cash dividends: 2011, $6,000; 2012, $12,000; and 2013, $28,000.

Instructions

(a) Show the allocation of dividends to each class of stock, assuming the preferred stock dividend is 7% and not cumulative.

(b) Show the allocation of dividends to each class of stock, assuming the preferred stock dividend is 8% and cumulative.

(c) Journalize the declaration of the cash dividend at December 31, 2013, under part (b).

87. On January 1, 2012, Brittany Corporation had $1,000,000 of common stock outstanding that was issued at par. It also had retained earnings of $750,000. The company issued 40,000 shares of common stock at par on July 1 and earned net income of $400,000 for the year.

Instructions

Journalize the declaration of a 15% stock dividend on December 10, 2012, for the following independent assumptions.

1. Par value is $10, and market value is $18.

2. Par value is $5, and market value is $20.

88. On October 31, the stockholders' equity section of Ennis Company consists of common stock $300,000 and retained earnings $900,000. Ennis is considering the following two courses of action: (1) declaring a 5% stock dividend on the 30,000, $10 par value shares outstanding, or (2) effecting a 2-for-1 stock split that will reduce par value to $5 per share. The current market price is $14 per share.

Instructions

Prepare a tabular summary of the effects of the alternative actions on the components of stockholders' equity, outstanding shares, and par value per share. Use the following column headings: Before Action, After Stock Dividend, and After Stock Split.

89. On October 1, Little Tommy Corporation's stockholders' equity is as follows.

Common stock, $5 par value	$400,000
Paid-in capital in excess of par—common stock	25,000
Retained earnings	155,000
Total stockholders' equity	$580,000

On October 1, Little Tommy declares and distributes a 10% stock dividend when the market value of the stock is $15 per share.

Instructions

(a) Compute the par value per share (1) before the stock dividend and (2) after the stock
dividend.

(b) Indicate the balances in the three stockholders' equity accounts after the stock dividend shares have been distributed.

90. During 2012, Margan Corporation had the following transactions and events.

1. Declared a cash dividend.

2. Issued par value common stock for cash at par value.

3. Completed a 2-for-1 stock split in which $10 par value stock was changed to $5 par value stock.

4. Declared a small stock dividend when the market value was higher than par value.

5. Made a prior period adjustment for overstatement of net income.

6. Issued the shares of common stock required by the stock dividend declaration in item no. 4 above.

7. Paid the cash dividend in item no. 1 above.

8. Issued par value common stock for cash above par value.

Instructions

Indicate the effect(s) of each of the foregoing items on the subdivisions of stockholders' equity. Present your answer in tabular form with the following columns. Use (I) for increase, (D) for decrease, and (NE) for no effect. Item no. 1 is given as an example.

Paid-in Capital	**Item**	**Capital Stock**	**Additional**	**Retained Earnings**
	1	NE	NE	D

91. Before preparing financial statements for the current year, the chief accountant for Paul Company discovered the following errors in the accounts.

1. The declaration and payment of $50,000 cash dividend was recorded as a debit to Interest Expense $50,000 and a credit to Cash $50,000.

2. A 10% stock dividend (1,000 shares) was declared on the $10 par value stock when the market value per share was $18. The only entry made was: Stock Dividends (Dr.) $10,000 and Dividend Payable (Cr.) $10,000. The shares have not been issued.

3. A 4-for-1 stock split involving the issue of 400,000 shares of $5 par value common stock for 100,000 shares of $20 par value common stock was recorded as a debit to Retained Earnings $2,000,000 and a credit to Common Stock $2,000,000.

Instructions

Prepare the correcting entries at December 31.

92. On January 1, 2012, Barb Corporation had retained earnings of $550,000. During the
year, Barb had the following selected transactions.

1. Declared cash dividends $120,000.

2. Corrected overstatement of 2011 net income because of depreciation error $40,000.

3. Earned net income $350,000.

4. Declared stock dividends $60,000.

Instructions

Prepare a retained earnings statement for the year.

93. Jayleah Company reported retained earnings at December 31, 2011, of $310,000. Jayleah had 200,000 shares of common stock outstanding throughout 2012. The following transactions occurred during 2012.

1. An error was discovered: in 2010, depreciation expense was recorded at $70,000, but the correct amount was $50,000.

2. A cash dividend of $0.50 per share was declared and paid.

3. A 5% stock dividend was declared and distributed when the market price per share was $15 per share.

4. Net income was $285,000.

Instructions

Prepare a retained earnings statement for 2012.

94. Beck Company reported the following balances at December 31, 2011: common stock
$400,000; paid-in capital in excess of par value—common stock $100,000; and retained earnings $250,000. During 2012, the following transactions affected stockholder's equity.

1. Issued preferred stock with a par value of $125,000 for $200,000.

2. Purchased treasury stock (common) for $40,000.

3. Earned net income of $140,000.

4. Declared and paid cash dividends of $56,000.

Instructions

Prepare the stockholders' equity section of Beck Company's December 31, 2012, balance sheet.

95. The following accounts appear in the ledger of Kallie Inc. after the books are closed at December 31.

Common Stock, no par, $1 stated value, 400,000 shares authorized; 300,000 shares issued	$ 300,000
Common Stock Dividends Distributable	30,000
Paid-in Capital in Excess of Stated Value—Common Stock	1,200,000
Preferred Stock, $5 par value, 8%, 40,000 shares authorized; 30,000 shares issued	150,000
Retained Earnings	800,000
Treasury Stock (10,000 common shares)	74,000
Paid-in Capital in Excess of Par—Preferred Stock	344,000

Instructions

Prepare the stockholders' equity section at December 31, assuming retained earnings is restricted for plant expansion in the amount of $100,000.

96. The following information is available for Kelsey Corporation for the year ended December 31, 2012: Sales $800,000; Other revenues and gains $92,000; Operating expenses $110,000; Cost of goods sold $465,000; Other expenses and losses $32,000; Preferred stock dividends $30,000. The company's tax rate was 20%, and it had 50,000 shares outstanding during the entire year.

Instructions

(a) Prepare a corporate income statement.

(b) Calculate earnings per share.

97. In 2012, Stone Pony Corporation had net sales of $600,000 and cost of goods sold of $360,000. Operating expenses were $153,000, and interest expense was $7,500. The corporation's tax rate is 30%. The corporation declared preferred dividends of $15,000 in 2012, and its average common stockholders' equity during the year was $200,000.

Instructions

(a) Prepare an income statement for Stone Pony Corporation.

(b) Compute Stone Pony Corporation's return on common stockholders' equity for 2012.

98. Nikennis Corporation has outstanding at December 31, 2012, 50,000 shares of $20 par value, cumulative, 8% preferred stock and 200,000 shares of $5 par value common stock. All shares were outstanding the entire year. During 2012, Nikennis earned total revenues of $2,000,000 and incurred total expenses (except income taxes) of $1,200,000. Nikennis's income tax rate is 30%.

Instructions

Compute Nikennis's 2012 earnings per share.

99. The following financial information is available for Monique Corporation.

	2012	**2011**
Average common stockholders' equity	$1,200,000	$900,000
Dividends paid to common stockholders	50,000	30,000
Dividends paid to preferred stockholders	20,000	20,000
Net income	290,000	200,000
Market price of common stock	20	15

The weighted-average number of shares of common stock outstanding was 80,000 for 2011 and 100,000 for 2012.

Instructions

Calculate earnings per share and return on common stockholders' equity for 2012 and 2011.

100. This financial information is available for Hoyle Corporation.

	2012	2011
Average common stockholders' equity	$1,800,00	$1,900,000
Dividends paid to common stockholders	90,000	70,000
Dividends paid to preferred stockholders	20,000	20,000
Net income	290,000	248,000
Market price of common stock	20	25

The weighted-average number of shares of common stock outstanding was 180,000 for 2011 and 150,000 for 2012.

Instructions

Calculate earnings per share and return on common stockholders' equity for 2012 and 2011.

101. At December 31, 2012, Jennyfer Corporation has 2,000 shares of $100 par value, 8%, preferred stock outstanding and 100,000 shares of $10 par value common stock issued. Jennyfer's net income for the year is $241,000.

Instructions

Compute the earnings per share of common stock under the following independent situations. (Round to two decimals.)

(a) The dividend to preferred stockholders was declared. There has been no change in the number of shares of common stock outstanding during the year.

(b) The dividend to preferred stockholders was not declared. The preferred stock is cumulative. Jennyfer held 10,000 shares of common treasury stock throughout the year.

102. On January 1, 2012, Kristen Corporation had the following stockholders' equity accounts.

Common Stock ($20 par value, 60,000 shares issued and outstanding)	$1,200,000
Paid-in Capital in Excess of Par—Common Stock	200,000
Retained Earnings	600,000

During the year, the following transactions occurred.

Feb. 1 Declared a $1 cash dividend per share to stockholders of record on February 15, payable March 1.

Mar. 1 Paid the dividend declared in February.

Apr. 1 Announced a 2-for-1 stock split. Prior to the split, the market price per share was $36.

July 1 Declared a 10% stock dividend to stockholders of record on July 15, distributable

July 31. On July 1, the market price of the stock was $13 per share.

31 Issued the shares for the stock dividend.

Dec. 1 Declared a $0.50 per share dividend to stockholders of record on December 15, payable January 5, 2013.

31 Determined that net income for the year was $350,000.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances and post the entries to the stockholders' equity accounts. (*Note:* Open additional stockholders' equity accounts as needed.)

(c) Prepare a stockholders' equity section at December 31.

103. The stockholders' equity accounts of Falk Company at January 1, 2012, are as follows.

Preferred Stock, 6%, $50 par	$600,000
Common Stock, $5 par	800,000
Paid-in Capital in Excess of Par—Preferred Stock	200,000
Paid-in Capital in Excess of Par—Common Stock	300,000
Retained Earnings	800,000

There were no dividends in arrears on preferred stock. During 2012, the company had the following transactions and events.

July 1 Declared a $0.50 cash dividend on common stock.

Aug. 1 Discovered $25,000 understatement of 2011 depreciation on equipment. Ignore income taxes.

Sept. 1 Paid the cash dividend declared on July 1.

Dec. 1 Declared a 10% stock dividend on common stock when the market value of the stock was $18 per share.

15 Declared a 6% cash dividend on preferred stock payable January 15, 2013.

31 Determined that net income for the year was $355,000.

31 Recognized a $200,000 restriction of retained earnings for plant expansion.

Instructions

(a) Journalize the transactions, events, and closing entry.

(b) Enter the beginning balances in the accounts, and post to the stockholders' equity accounts. (*Note:* Open additional stockholders' equity accounts as needed.)

(c) Prepare a retained earnings statement for the year.

(d) Prepare a stockholders' equity section at December 31, 2012.

104. The post-closing trial balance of Violet Corporation at December 31, 2012, contains
the following stockholders' equity accounts.

Preferred Stock (15,000 shares issued)	$ 750,000
Common Stock (250,000 shares issued)	2,500,000
Paid-in Capital in Excess of Par—Preferred Stock	250,000
Paid-in Capital in Excess of Par—Common Stock	400,000
Common Stock Dividends Distributable	250,000
Retained Earnings	1,042,000

A review of the accounting records reveals the following.

1. No errors have been made in recording 2012 transactions or in preparing the closing entry for net income.

2. Preferred stock is $50 par, 6%, and cumulative; 15,000 shares have been outstanding since January 1, 2011.

3. Authorized stock is 20,000 shares of preferred, 500,000 shares of common with a $10 par value.

4. The January 1 balance in Retained Earnings was $1,170,000.

5. On July 1, 20,000 shares of common stock were issued for cash at $16 per share.

6. On September 1, the company discovered an understatement error of $90,000 in computing depreciation in 2011. The net of tax effect of $63,000 was properly debited directly to Retained Earnings.

7. A cash dividend of $250,000 was declared and properly allocated to preferred and common stock on October 1. No dividends were paid to preferred stockholders in 2011.

8. On December 31, a 10% common stock dividend was declared out of retained earnings on common stock when the market price per share was $16.

9. Net income for the year was $585,000.

10. On December 31, 2012, the directors authorized disclosure of a $200,000 restriction of retained earnings for plant expansion. (Use Note X.)

Instructions

(a) Reproduce the Retained Earnings account for 2012.

(b) Prepare a retained earnings statement for 2012.

(c) Prepare a stockholders' equity section at December 31, 2012.

(d) Compute the allocation of the cash dividend to preferred and common stock.

(e) Compute the earnings per share of common stock using 240,000 as the weighted average shares outstanding for the year.

105. On January 1, 2012, Saa Corporation had the following stockholders' equity accounts.

Common Stock (no par value, 90,000 shares issued and outstanding)	$1,400,000
Retained Earnings	500,000

During the year, the following transactions occurred.

Feb. 1 Declared a $1 cash dividend per share to stockholders of record on February 15, payable March 1.

Mar. 1 Paid the dividend declared in February.

Apr. 1 Announced a 4-for-1 stock split. Prior to the split, the market price per share was $36.

July 1 Declared a 5% stock dividend to stockholders of record on July 15, distributable July 31. On July 1, the market price of the stock was $13 per share.

31 Issued the shares for the stock dividend.

Dec. 1 Declared a $0.50 per share dividend to stockholders of record on December 15, payable January 5, 2013.

31 Determined that net income for the year was $350,000.

Instructions

Prepare the stockholders' equity section of the balance sheet at: (a) March 31, (b) June 30, (c) September 30, and (d) December 31, 2012.

106. On January 1, 2012, Hammermeister Inc. had the following stockholders' equity account balances.

Common Stock, no-par value (500,000 shares issued)	$1,500,000
Common Stock Dividends Distributable	200,000
Retained Earnings	600,000

During 2012, the following transactions and events occurred.

1. Issued 50,000 shares of common stock as a result of a 10% stock dividend declared on December 15, 2009.

2. Issued 30,000 shares of common stock for cash at $6 per share.

3. Corrected an error that had understated the net income for 2010 by $70,000.

4. Declared and paid a cash dividend of $80,000.

5. Earned net income of $300,000.

Instructions

Prepare the stockholders' equity section of the balance sheet at December 31, 2012.

107. On January 1, 2012, Syed Corporation had the following stockholders' equity accounts.

Common Stock ($5 par value, 200,000 shares issued and outstanding)	$1,000,000
Paid-in Capital in Excess of Par—Common Stock	200,000
Retained Earnings	840,000

During the year, the following transactions occurred.

Jan. 15 Declared a $1 cash dividend per share to stockholders of record on January 31, payable February 15.

Feb. 15 Paid the dividend declared in January.

Apr. 15 Declared a 10% stock dividend to stockholders of record on April 30, distributable

May 15. On April 15, the market price of the stock was $15 per share.

May 15 Issued the shares for the stock dividend.

July 1 Announced a 2-for-1 stock split. The market price per share prior to the announcement was $17. (The new par value is $2.50.)

Dec. 1 Declared a $0.50 per share cash dividend to stockholders of record on December 15, payable January 10, 2013.
31 Determined that net income for the year was $250,000.

Instructions
(a) Journalize the transactions and the closing entry for net income.
(b) Enter the beginning balances and post the entries to the stockholders' equity accounts. (*Note:* Open additional stockholders' equity accounts as needed.)
(c) Prepare a stockholders' equity section at December 31.

108. The stockholders' equity accounts of Motz Inc., at January 1, 2012, are as follows.

Preferred Stock, $100 par, 7%	$600,000
Common Stock, $10 par	900,000
Paid-in Capital in Excess of Par—Preferred Stock	100,000
Paid-in Capital in Excess of Par—Common Stock	200,000
Retained Earnings	500,000

There were no dividends in arrears on preferred stock. During 2012, the company had the following transactions and events.
July 1 Declared a $0.50 cash dividend on common stock.
Aug. 1 Discovered a $72,000 overstatement of 2011 depreciation on equipment. Ignore income taxes.
Sept. 1 Paid the cash dividend declared on July 1.
Dec. 1 Declared a 10% stock dividend on common stock when the market value of the stock was $16 per share.
15 Declared a 7% cash dividend on preferred stock payable January 31, 2013.
31 Determined that net income for the year was $350,000.
Instructions
(a) Journalize the transactions and the closing entry for net income.
(b) Enter the beginning balances in the accounts and post to the stockholders' equity accounts. (*Note:* Open additional stockholders' equity accounts as needed.)
(c) Prepare a retained earnings statement for the year.

(d) Prepare a stockholders' equity section at December 31, 2012.

109. The ledger of Conway Corporation at December 31, 2012, after the books have been
closed, contains the following stockholders' equity accounts.

Preferred Stock (10,000 shares issued)	$1,000,000
Common Stock (400,000 shares issued)	2,000,000
Paid-in Capital in Excess of Par—Preferred Stock	200,000
Paid-in Capital in Excess of Stated—Common Stock	1,180,000
Common Stock Dividends Distributable	200,000
Retained Earnings	2,560,000

A review of the accounting records reveals the following.

1. No errors have been made in recording 2012 transactions or in preparing the closing entry for net income.

2. Preferred stock is 6%, $100 par value, noncumulative, and callable at $125. Since January 1, 2011, 10,000 shares have been outstanding; 20,000 shares are authorized.

3. Common stock is no-par with a stated value of $5 per share; 600,000 shares are authorized.

4. The January 1 balance in Retained Earnings was $2,450,000.

5. On October 1, 100,000 shares of common stock were sold for cash at $8 per share.

6. A cash dividend of $500,000 was declared and properly allocated to preferred and common stock on November 1. No dividends were paid to preferred stockholders in 2011.

7. On December 31, a 10% common stock dividend was declared out of retained earnings on common stock when the market price per share was $9.

8. Net income for the year was $970,000.

9. On December 31, 2012, the directors authorized disclosure of a $100,000 restriction of retained earnings for plant expansion. (Use Note A.)

Instructions

(a) Reproduce the Retained Earnings account (T account) for 2012.

(b) Prepare a retained earnings statement for 2012.

(c) Prepare a stockholders' equity section at December 31, 2012.

(d) Compute the allocation of the cash dividend to preferred and common stock.

(e) Compute the earnings per share of common stock using 325,000 as the weighted average shares outstanding for the year.

110. On January 1, 2012, Acierno Corporation had the following stockholders' equity accounts.

Common Stock (no-par value, 100,000 shares issued and outstanding)	\$2,800,000
Retained Earnings	1,000,000

During the year, the following transactions occurred.

Feb. 1 Declared a \$1 cash dividend per share to stockholders of record on February 15, payable March 1.

Mar. 1 Paid the dividend declared in February.

Apr. 1 Announced a 4-for-1 stock split. Prior to the split, the market price per share was \$36.

July 1 Declared a 5% stock dividend to stockholders of record on July 15, distributable July 31. On July 1, the market price of the stock was \$13 per share.

31 Issued the shares for the stock dividend.

Dec. 1 Declared a \$0.50 per share dividend to stockholders of record on December 15, payable January 5, 2013.

31 Determined that net income for the year was \$700,000.

Instructions

Prepare the stockholders' equity section of the balance sheet at: (a) March 31, (b) June 30, (c) September 30, and (d) December 31, 2012.

111. On January 1, 2012, Beacham Inc. had the following shareholders' equity balances.

Common Stock, no-par value (1,000,000 shares issued)	$3,000,000
Common Stock Dividends Distributable	400,000
Retained Earnings	1,200,000

During 2012, the following transactions and events occurred.

1. Issued 100,000 shares of common stock as a result of a 10% stock dividend declared on December 15, 2011.

2. Issued 60,000 shares of common stock for cash at $5 per share.

3. Corrected an error that had understated the net income for 2010 by $140,000.

4. Declared and paid a cash dividend of $300,000.

5. Earned net income of $600,000.

Instructions

Prepare the stockholders' equity section of the balance sheet at December 31, 2012.

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End

Best Wishes