

ACC101 – CHAPTER 11

Accounting for Equity



Key Terms and Concepts to Know

Authorized Shares – number of shares a corporation is legally entitled to issue

Issued Shares – number of shares sold to stockholders

Outstanding Shares – shares issued minus any shares reacquired by the corporation; i.e., the number of shares still owned by shareholders

Common Stock – basic class of stock ownership with right to vote

Preferred Stock – stock with a preferential right to dividends (preferred shareholders receive their stated dividend before common shareholders may receive a dividend)

Cumulative Preferred Stock – stockholders have the right to receive dividends in arrears (their regular dividends passed or not paid in previous years) before common shareholders may receive a dividend

Dividends

Cash Dividends – Most cash dividends are declared on a per share basis; therefore it is important to keep track of the number of outstanding shares of stock. The number of shares outstanding changes with each stock issuance and each purchase or sale of treasury stock.

- **Cash Dividends** – a temporary account closed to Retained Earnings at the end of the period

Stock Dividends – Stock dividends distribute common stock rather than cash to the shareholders. Small stock dividends, up to 25% of the outstanding shares, are recorded by capitalizing an amount equal to the number of shares times the current market price. Large stock dividends are recorded by capitalizing an amount equal to the number of shares times the par value.

Stock dividends do not affect total assets, total liabilities or total stockholders' equity. All of the accounts used to record stock dividends are equity accounts. Stock dividends capitalize a portion of retained earnings transferring it to paid-in capital. Therefore retained earnings decreases by the same amount as the total increase in common stock and paid-in capital in excess of par.

- **Stock Dividends** – a temporary account closed to Retained Earnings at the end of the period
- **Stock Dividend Distributable** – a temporary owner's equity account used until the shares are issued

There are three important dates for both types of dividends:

- Date of Declaration – Journalize the entry to record cash dividends payable or shares distributable
- Date of Record – All stockholders on this date will receive the dividend (no entry)
- Date of Payment – Journalize the entry to pay cash dividends to shareholders or distribute the shares of stock

Journal entries for cash dividends:

Cash to be distributed: outstanding shares X dividend \$ per share

Date of Declaration:

Cash Dividends	XXX	
Cash Dividends Payable		XXX

Date of Payment:

Cash Dividends Payable	XXX	
Cash		XXX

Journal entries for stock dividends:

Shares to be distributed: outstanding shares * dividend %

Date of Declaration:

Stock Dividends (Shares * Market Price)	XXX	
Stock Dividend Distributable (Shares * Par Value)		XXX
PIC-excess of par-CS (excess of market price over par)		XXX

Date of Payment:

Stock Dividend Distributable	XXX	
Common Stock		XXX

Example #2 – Accounting for Dividends

Olsen Company has completed the following transactions. Journalize the entries to record the transactions.

- March 4 Purchased 5,000 shares of its own common stock at \$32, recording the stock at cost. (Prior to the purchase, there were 50,000 shares of \$20 par common stock outstanding.)
- June 3 Declared a semiannual dividend of \$1 on the 8,000 shares of preferred stock and a \$.40 dividend on the common stock to stockholders of record on June 30, payable July 15.
- July 15 Paid the cash dividends.
- Oct. 14 Sold 2,000 shares of treasury stock at \$35, receiving cash.
- Nov. 5 Declared semiannual dividends of \$1 on the preferred stock and \$.40 on the common stock (before the stock dividend). In addition, a 5% common stock dividend was declared on the common stock outstanding, to be capitalized at the fair market value of the common stock, which is estimated at \$30.
- Dec. 10 Paid the cash dividends and issued the certificates for the common stock dividend.

Solution

March 4	Treasury Stock	160,000	
	Cash		160,000
	<i>(Outstanding Shares: 50,000 – 5,000 = 45,000)</i>		
June 3	Cash Dividends	26,000	
	Cash Dividends Pay.		26,000
	<i>(PS: 8,000 * 1 = \$8,000; CS: 45,000 * .40 = \$18,000)</i>		
July 15	Cash Dividends Payable	26,000	
	Cash		26,000

Oct. 14	Cash	70,000	
	Treasury Stock		64,000
	PIC-Sale of T.S.		6,000
	<i>(Outstanding Shares: 45,000 + 2,000 = 47,000)</i>		
Nov. 5	Cash Dividends	26,800	
	Cash Dividends Payable		26,800
	<i>(PF: 8,000 * 1 = \$8,000; CS: 47,000 * .40 = 18,800)</i>		
	Stock Dividends	70,500	<i>(2,350 shares * 30 market price)</i>
	Stock Dividends Distr.	47,000	<i>(2,350 shares * 20 par)</i>
	PIC-excess of par-CS	23,500	<i>(70,500 – 47,000)</i>
	<i>**Stock Dividend: Shares issued = 47,000 * 5% = 2,350 **</i>		
Dec. 10	Cash Dividends Payable	26,800	
	Cash		26,800
	Stock Dividends Distr.	47,000	
	Common Stock		47,000

There are four basic steps to distribute dividends and calculate dividends per share:

1. If there is outstanding cumulative preferred stock, distribute dividends in arrears followed by the current year's dividend to preferred shareholders.
2. If there is outstanding non-cumulative preferred stock, distribute the current year's dividend to preferred shareholders.
3. Distribute the remaining dividends, if any, to common stockholders.
4. Divide by the respective number of shares to obtain dividends per share

Example #1 – Dividend Distribution

Myers Inc. has stock outstanding as follows: 20,000 shares of \$4.00 cumulative, nonparticipating preferred stock of \$100 par, and 60,000 shares of \$20 par common stock. During its first five years of operations, the following amounts were distributed as dividends: first year, none; second year, \$30,000; third year, \$160,000; fourth year, \$250,000; fifth year, \$140,000. Calculate the annual dividends per share on each class of stock.

Preferred shareholders are entitled to receive \$80,000 (20,000 shares * 4.00/share) per year in dividends.

Year 1

No dividends were declared therefore dividends per share are 0 for both preferred and common stock. Preferred Stock has \$80,000 dividends in arrears.

Year 2	Preferred	Common	Total
Dividends Distributed			30,000
Dividends Paid	30,000	0	30,000
Dividends per Share	\$1.50		

Dividends in Arrears:

From year 1	50,000	(80,000 owed – 30,000 paid)
From year 2	<u>80,000</u>	
Total	130,000	

Year 3	Preferred	Common	Total
Dividends Distributed			160,000
Dividends Paid	160,000	0	160,000
Dividends per Share	\$8.00		

Dividends in Arrears:

From year 1	0	(50,000 in arrears – 50,000 paid)
From year 2	0	(80,000 in arrears – 80,000 paid)
From year 3	<u>50,000</u>	(80,000 owed – 30,000 paid)
Total	50,000	

Year 4	Preferred	Common	Total
Dividends Distributed			250,000
Dividends Paid	130,000	120,000	250,000
Dividends per Share	\$6.50	\$2.00	

Dividends in Arrears:

From year 3	0	(50,000 in arrears – 50,000 paid)
From year 4	<u>0</u>	(80,000 owed – 80,000 paid)
Total	0	

Year 5	Preferred	Common	Total
Dividends Distributed			140,000
Dividends Paid	80,000	60,000	140,000
Dividends per Share	\$4.00	\$1.00	

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Practice Problem #1

Canton, Inc. has stock outstanding as follows: 25,000 shares of \$2.00 cumulative, nonparticipating preferred stock of \$50 par, and 100,000 shares of \$25 par common. During its first five years of operations, the following amounts were distributed as dividends: first year, none; second year, \$20,000; third year, \$90,000; fourth year, \$180,000; fifth year, \$250,000.

- 1) Calculate the dividends per share on each class of stock for each of the five years.
- 2) Redo #1, assuming the preferred stock is noncumulative

Transactions to Issue Stock

Issuance of Stock at Par

Issued 5,000 shares of \$100 par common stock at par for cash.

Cash	500,000	
Common Stock		500,000

Issuance of Stock at a Premium

Issued 2,000 shares of \$100 par preferred stock for \$110 per share.

Cash	220,000	
Preferred Stock		200,000
PIC-excess of par-PF		20,000

Issuance of No-par Stock

Issued 4,000 shares of no-par common stock in exchange for equipment with a fair market value of \$80,000.

Equipment	80,000	
Common Stock		80,000

Issued 1,000 shares of no-par preferred stock with a state value of \$50 per share for \$55 per share.

Cash	55,000	
Preferred Stock		50,000
PIC-excess of stated value-PF		5,000

Treasury Stock Transactions

Entries for the purchase of Treasury Stock

Purchased 2,000 shares of treasury common stock for \$80,000.

Treasury Stock	80,000	
Cash		80,000

Entries for the sale of treasury stock at a price greater than we paid

Sold 500 shares of the treasury stock purchased above for \$43 per share.

Cash	21,500	
Treasury Stock		20,000
PIC-from Sale of TS		1,500

Entries for the sale of treasury stock at a price less than we paid

Sold 1,000 shares of the treasury stock purchased above for \$38 per share.

Cash	38,000	
PIC-from Sale of TS	2,000	
Treasury Stock		40,000

Stockholders' Equity

Paid-In Capital		
Preferred Stock	\$200,000	
PIC-excess of par-PF	<u>100,000</u>	300,000
Common Stock	500,000	
PIC-excess of par-CS	<u>300,000</u>	800,000
PIC from sale of treasury stock		25,000
Donated Capital		<u>50,000</u>
Total Paid-in Capital		\$1,175,000
Retained Earnings		<u>550,000</u>
Total		1,725,000
Deduct Treasury Stock		<u>(120,000)</u>
Total Stockholders' Equity		\$1,605,000

Practice Problem #2

The following selected accounts appear in the ledger of Cyma Environmental Corporation on January 1, 2003.

Preferred 4% Stock, \$100 par (10,000 shares authorized, 8,000 shares issued)	\$800,000
PIC-excess of par-PF	80,000
Common Stock, \$20 par (60,000 shares authorized, 30,000 shares issued)	600,000
PIC-excess of par-CS.....	900,000
Retained Earnings.....	1,277,000

Journalize the entries to record the following transactions.

- a. Issued 20,000 shares of common stock at \$32 receiving cash.
- b. Sold 1,000 shares of preferred 4% stock at \$120.
- c. Purchased 5,000 shares of treasury common for \$220,000
- d. Sold 2,000 shares of treasury common for \$84,000
- e. Sold 1,500 shares of treasury common for \$68,500
- f. Issued 10,000 shares of common stock in exchange for Land costing \$385,000

Practice Problem #3

Selected transactions completed by Zebra Company appear below. Journalize the transactions.

- Jan. 5 Split the common stock 4 for 1 and reduced the par from \$100 to \$25 per share. After the split, there were 100,000 common shares outstanding.
- Feb. 20 Purchased 10,000 shares of treasury stock for \$300,000.
- Mar. 12 Declared the semiannual dividends of \$4 on 20,000 shares of preferred stock and \$.50 on the outstanding common stock.
- April 12 Paid the cash dividends.
- June 5 Sold 5,000 shares of treasury stock at \$33, receiving cash.
- Sept. 2 Declared semiannual dividends of \$4 on preferred stock, and \$.50 on common stock (before the stock dividend). In addition, a 4% common stock dividend was declared on the common stock outstanding, to be capitalized at fair market value of the common stock, which is estimated at \$40.
- Oct. 5 Paid the cash dividends and issued the certificates for the common stock dividend.

SAMPLE MULTIPLE CHOICE QUESTIONS

1. Investors who are most interested in the dividend yield are those who invest for
 - a. Current income flow
 - b. Market price appreciation
 - c. Both market price appreciation and current income flow
 - d. Neither market price appreciation or current income flow
2. Organization Costs is included on the balance sheet as a(n):
 - a. Plant asset
 - b. Investment
 - c. Current asset
 - d. Intangible asset
3. Retained earnings:
 - a. is the same as contributed capital
 - b. changes are summarized in the Retained Earnings Statement
 - c. cannot have a debit balance
 - d. over time will have a direct relationship with the amount of cash on hand if the corporation is profitable.
4. The charter of a corporation provides for the issuance of 100,000 shares of common stock. Assume that 20,000 shares were originally issued and 2,500 were subsequently reacquired. What is the number of shares outstanding?
 - a. 22,500
 - b. 17,500
 - c. 20,000
 - d. 82,500
5. A Company acquired land in exchange for 5,000 shares of its \$10 par common stock. The fair market value of the land is \$63,000, it is appraised at \$60,000 and the stock is widely traded and was selling for \$12.50 per share when exchanged for the land. At what amount should the land be recorded by A Company?
 - a. \$50,000
 - b. \$62,500
 - c. \$63,000
 - d. \$60,000
6. The excess of sales price of treasury stock over its cost should be credited to:
 - a. Treasury Stock Receivable
 - b. Premium on Capital Stock
 - c. Income fro Sale of Treasury Stock
 - d. Paid-In Capital from Sale of Treasury Stock

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7. A corporation purchases 10,000 shares of its own \$10 par common stock for \$17.50 per share, recording it at cost. What will be the effect on total stockholders' equity?
 - a. Decrease, \$175,000
 - b. Decrease, \$100,000
 - c. Increase, \$175,000
 - d. Increase, \$100,000
8. A corporation has 25,000 shares of \$100 par value stock outstanding. If the corporation issues a 2-for-1 split or a 100% stock dividend, the number of shares outstanding after the split or dividend will be:
 - a. 25,000 shares
 - b. 50,000 shares
 - c. 75,000 shares
 - d. 100,000 shares
9. The charter of a corporation provides for the issuance of 100,000 shares of common stock. Assume that 60,000 shares were originally issued and 10,000 were subsequently reacquired. What is the amount of cash dividends to be paid if a \$1 per share dividend is declared?
 - a. \$50,000
 - b. \$100,000
 - c. \$70,000
 - d. \$60,000
10. A company with 100,000 authorized shares of \$5 par common stock issued 80,000 shares at \$7. Subsequently, the company declared a 2% stock dividend on a date when the market price was \$10 a share. The effect of the declaration and issuance of the stock dividend is to:
 - a. Decrease retained earnings, increase common stock, and decrease paid-in capital
 - b. Increase retained earnings, decrease common stock, and decrease paid-in capital
 - c. Increase retained earnings, decrease common stock, and increase paid-in capital
 - d. Decrease retained earnings, increase common stock, and increase paid-in capital
11. Easy transfer of ownership is a characteristic of which form of business organization?
 - a. Sole proprietorship
 - b. Partnership
 - c. Corporation
 - d. All of the above
12. In which forms of business organization are the owners personally liable for all the debts of the business?
 - a. Sole proprietorship and corporation
 - b. Sole proprietorship and partnerships
 - c. Partnership and corporation
 - d. All of them

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13. Issuing stock to investors for cash at a price above par would result in
 - a. a debit to Common Stock and a credit to Cash
 - b. a debit to Cash and a credit to Common Stock
 - c. a debit to Cash and PIC-excess of par-CS and a credit to Common Stock
 - d. a debit to Cash and a credit to Common Stock and PIC-excess of par-CS
14. The par value of the shares issued represents a corporation's legal capital.
 - a. True
 - b. False
15. When treasury stock is purchased, the number of outstanding shares decreases.
 - a. True
 - b. False
16. Dividends in arrears are reported as a current liability on the balance sheet.
 - a. True
 - b. False
17. No journal entry is required on the date of record.
 - a. True
 - b. False
18. Which of the following is not a characteristic of a corporation?
 - a. Separate legal existence
 - b. Unlimited liability for stockholders
 - c. Easy transferability of ownership interests
 - d. Ability to acquire capital easily
19. Which of the following is not a disadvantage of the corporate business form?
 - a. Organization Costs
 - b. Government regulation
 - c. Continuous life
 - d. Additional taxes
20. Which of the following is not a stockholder right?
 - a. The preemptive right
 - b. The right to share in dividends
 - c. The right to vote on the board of directors
 - d. The right to participate in management decisions
21. Which of the following represents the maximum number of shares that a corporation can issue?
 - a. Outstanding shares
 - b. Issued shares
 - c. Authorized shares
 - d. Treasury shares

22. Which of the following decreases when a corporation purchases treasury stock?
- a. Authorized shares
 - b. Issued shares
 - c. Treasury shares
 - d. Outstanding shares
23. Sting, Inc. issued 1,000 shares of common stock at \$10 per share. If the stock has a par value of \$4 a share, the journal entry to record the issuance would include a
- a. Credit to Common Stock for \$4,000.
 - b. Debit to Cash for \$4,000.
 - c. Credit to Paid-in-Capital in Excess of Par for \$10,000
 - d. Debit to Retained Earnings for \$6,000
24. Sting, Inc. issued 1,000 shares of common stock at \$10 per share. If the stock was no-par stock, the journal entry to record the issuance would include a
- a. debit to Cash for \$6,000
 - b. credit to Paid-in-Capital in Excess of Par for 6,000
 - c. credit to Common Stock for \$10,000
 - d. debit to Paid-in-Capital in Excess of Par for \$10,000
25. If 1,000 shares of \$5 par common stock are reacquired by a corporation for \$12 a share, total stockholders' equity will be reduced by
- a. \$5,000
 - b. \$12,000
 - c. \$0
 - d. \$7,000
26. Which of the following will increase the Paid-in-Capital section of the balance sheet?
- a. Stock split
 - b. Stock dividend
 - c. Cash dividend
 - d. Property dividend
27. Buzz, Inc. has 8,000 shares of 5%, \$50 par, cumulative preferred stock and 50,000 shares of \$3 par common stock outstanding. No dividends were declared last year, however, a dividend of \$50,000 was declared and paid this year. What amount of the total dividend was paid to common stockholders?
- a. \$10,000
 - b. \$30,000
 - c. \$15,000
 - d. \$50,000

28. Scratch, Inc. has 2,000 shares of 5%, \$100 par, cumulative preferred stock and 80,000 shares of \$4 par common stock outstanding. Last year the board of directors declared and paid an \$8,000 dividend. This year the dividend declared and paid was \$15,000. What amount of this year's total dividend was paid to preferred stockholders?
- a. \$15,000
 - b. \$10,000
 - c. \$0
 - d. \$12,000
29. Visor, Inc. had 300,000 shares of \$20 par common stock outstanding when a 3% stock dividend was declared and paid. How many shares were outstanding after the stock dividend?
- a. 390,000
 - b. 330,000
 - c. 300,000
 - d. 309,000
30. Visor, Inc. had 300,000 shares of \$20 par common stock outstanding when a 3% stock dividend was declared. The market price of the stock at the time of the declaration was \$22 per share. The journal entry to record the dividend declaration would include a credit to
- a. Common Stock for \$180,000
 - b. PIC-excess of par-CS for \$198,000
 - c. Stock Dividends for \$198,000
 - d. Stock Dividends Distributable for \$180,000

SOLUTIONS TO PRACTICE PROBLEMS

Practice Problem #1 – Part 1

Year 1

No dividends were declared therefore Dividends per Share is 0 for both preferred and common stock. Preferred Stock has \$50,000 dividends in arrears.

<u>Year 2</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Dividends Distributed			20,000
Dividends Paid	20,000		20,000
Dividends per share	\$.80		

Dividends in Arrears:

From year 1	30,000	(50,000 owed – 20,000 paid)
From year 2	<u>50,000</u>	
Total	80,000	

<u>Year 3</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Dividends Distributed			90,000
Dividends Paid	90,000		90,000
Dividends per share	\$ 3.60		

Dividends in Arrears:

From year 1	0	(30,000 owed – 30,000 paid)
From year 2	0	(50,000 owed – 50,000 paid)
From year 3	<u>40,000</u>	(50,000 owed – 10,000 paid)
Total	40,000	

<u>Year 4</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Dividends Distributed			180,000
Dividends Paid	90,000	90,000	180,000
Dividends per share	\$ 3.60	\$.90	

Dividends in Arrears:

From year 3	<u>0</u>	(40,000 owed – 40,000 paid)
Total	0	

<u>Year 5</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Dividends Distributed			250,000
Dividends Paid	50,000	200,000	250,000
Dividends per share	\$ 1.00	\$ 2.00	

Practice Problem #1 – Part 2

Year 1

No dividends were declared therefore Dividends per Share is 0 for both preferred and common stock.

Year 2	Preferred	Common	Total
Dividends Distributed			20,000
Dividends Paid	20,000		20,000
Dividends per share	\$.80		

Year 3	Preferred	Common	Total
Dividends Distributed			90,000
Dividends Paid	50,000	40,000	90,000
Dividends per share	\$ 1.00	\$.40	

Year 4	Preferred	Common	Total
Dividends Distributed			180,000
Dividends Paid	50,000	130,000	180,000
Dividends per share	\$ 1.00	\$1.30	

Year 5	Preferred	Common	Total
Dividends Distributed			250,000
Dividends Paid	50,000	200,000	250,000
Dividends per share	\$ 1.00	\$2.00	

Practice Problem #2

A. Cash	640,000	
Common Stock		400,000
PIC-excess of par-CS		240,000
B. Cash	120,000	
Preferred stock		100,000
PIC-excess of par-PF		20,000
C. Treasury Stock	220,000	
Cash		220,000
D. Cash	84,000	
PIC-Sale of Treasury Stock	4,000	
Treasury Stock		88,000
<i>(2,000 * 44 cost per share)</i>		

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E. Cash	68,500	
Treasury Stock	66,000	
<i>(1,500 * 44 cost per share)</i>		
PIC-Treasury Stock		2,500

F. Land	385,000	
Common Stock		200,000
PIC-excess of par-CS		185,000

Practice Problem #3

Jan. 5 No entry required *\$25 par – 100,000 share outstanding*

Feb. 20	Treasury Stock	300,000	
	Cash		300,000
	<i>(90,000 shares outstanding)</i>		

Mar. 12	Cash Dividends	125,000	
	Cash Dividends Payable		125,000
	<i>(20,000 * \$4 = 80,000 PF + 90,000 * \$.50 = 45,000 CS)</i>		

Apr. 12	Cash Dividends Payable	125,000	
	Cash		125,000

June 5	Cash	165,000	
	Treasury Stock		150,000
	PIC-from sale of treasury stock		15,000

Sept. 2	Cash Dividends	127,500	
	Cash Dividends Payable		127,500
	<i>(20,000 * \$4 = 80,000 PF + 5,000 * \$.50 = 47,500)</i>		

	Stock Dividends	152,000	
	Stock Div. Distr.		95,000
	PIC-excess of par-CS		57,000
	<i>Stock Dividend: 4% * 95,000 shares = 3,800</i>		

Oct. 5	Cash Dividends Payable	127,500	
	Cash		127,500
	Stock Dividends Distr.	95,000	
	Common Stock		95,000

SOLUTIONS TO MULTIPLE CHOICE QUESTIONS

1. A
2. D
3. B
4. B
5. C
6. D
7. A: $10,000 \text{ shares} \times 17.50/\text{share} = 175,000$
8. B: $25,000 \times 2 = 50,000 \text{ shares}$
9. A: $60,000 \text{ issued shares} - 10,000 \text{ reacquired} = 50,000 \times 1 = \$50,000$
10. D: Stock Dividends 16,000 *(decreases retained earnings)*
 Stock Div. Distr. 8,000 *(will increase common stock when issued)*
 PIC-excess of par-CS 8,000 *(increases paid-in capital)*
11. C
12. B
13. D: Cash
 Common Stock
 PIC-excess of par-CS
14. A
15. A
16. B
17. A
18. B
19. C
20. D
21. C
22. D
23. A: Cash 10,000
 Common Stock 4,000
 PIC-excess of par-CS 6,000
24. C
25. B: $1,000 \times 12 = 12,000$
26. B
27. A: 5% of \$50 par = \$2.50 dividend
 $8,000 \times 2.50 = 20,000/\text{year} \times 2 \text{ years} = 40,000$ to Preferred
 then 10,000 to Common
28. D: PF Dividend = 5% of 100 = \$5/share $\times 2,000 \text{ shares} = 10,000/\text{year}$
 Year 1: 8,000 to preferred, 2,000 in arrears
 Year 2: 2,000 in arrears + 10,000 regular = \$12,000 to preferred
29. D: $300,000 \times 3\% = 9,000$; $300,000 + 9,000 = 309,000$
30. D: Stock Dividends 198,000 *(9,000 * 22)*
 Stock Dividend Distr. 180,000 *(9,000 * 20)*
 PIC-excess of par-CS 18,000