CHAPTER 11

Stockholders' Equity

OVERVIEW OF EXERCISES, PROBLEMS, AND CASES

Learning Objectives	Exercises	Estimated Time in Minutes	Level
Module 1			
1. Understand the concept of stockholders' equity and identify the components of the Stockholders' Equity category.	1	10	Easy
	2	10	Mod
	3	10	Mod
	4	10	Mod
2. Show that you understand the characteristics of common and preferred stock and the differences between the classes of stock.			
3. Determine the financial statement impact when stock is issued for cash or for other consideration.	5	10	Mod
	6	20	Mod
4. Describe the financial statement impact of stock treated as treasury stock.	7	15	Mod
	8	15	Mod
Module 2			
5. Compute the amount of cash dividends when a firm has issued both preferred and common stock.	9	10	Mod
	10	15	Mod
6. Show that you understand the difference between cash and stock dividends and the effect of stock dividends.	11	15	Mod
7. Determine the difference between stock dividends and stock splits.	12	15	Diff
	13	15	Diff
Module 3			
8. Show that you understand the statement of stockholders' equity and comprehensive income.	14	10	Easy
	15	15	Diff
9. Understand how investors use ratios to evaluate stockholders' equity.	16	5	Mod
10. Explain the effects that transactions involving stockholders' equity have on the statement of cash flows.	17	5	Mod
	18	5	Mod
	19	5	Mod
	20	5	Easy
Module 4			
11. Describe the important differences between the sole proprietorship and partnership forms of organization versus the corporate form (Appendix).	21	15	Mod
	22	10	Mod

*Exercise, problem, or case covers two or more learning objectives
Level = Difficulty levels: Easy; Moderate (Mod); Difficult (Diff)

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Learning Objectives	Problems and Alternates	Estimated Time in Minutes	Level
Module 1			
1. Understand the concept of stockholders' equity and identify the components of the Stockholders' Equity category.	1	20	Mod
	12*	15	Mod
	14*	15	Diff
2. Show that you understand the characteristics of common and preferred stock and the differences between the classes of stock.	2	15	Mod
3. Determine the financial statement impact when stock is issued for cash or for other consideration.	13*	20	Mod
4. Describe the financial statement impact of stock treated as treasury stock.	12*	15	Mod
	13*	20	Mod
	14*	15	Mod
Module 2			
5. Compute the amount of cash dividends when a firm has issued both preferred and common stock.	3	20	Mod
6. Show that you understand the difference between cash and stock dividends and the effect of stock dividends.	4	15	Diff
7. Determine the difference between stock dividends and stock splits.	5	20	Mod
	13*	20	Mod
Module 3			
8. Show that you understand the statement of stockholders' equity and comprehensive income.	6	20	Mod
	7	10	Mod
9. Understand how investors use ratios to evaluate stockholders' equity.			
10. Explain the effects that transactions involving stockholders' equity have on the statement of cash flows.	8	15	Diff
Module 4			
11. Describe the important differences between the sole proprietorship and partnership forms of organization versus the corporate form (Appendix).	9	15	Mod
	10	20	Mod
	11	10	Mod

*Exercise, problem, or case covers two or more learning objectives
Level = Difficulty levels: Easy; Moderate (Mod); Difficult (Diff)

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Learning Objectives	Cases	Estimated Time in Minutes	Level
Module 1			
1. Understand the concept of stockholders' equity and identify the components of the Stockholders' Equity category.	1* 3*	15 10	Mod Mod
2. Show that you understand the characteristics of common and preferred stock and the differences between the classes of stock.	3* 4	10 10	Mod Mod
3. Determine the financial statement impact when stock is issued for cash or for other consideration.			
4. Describe the financial statement impact of stock treated as treasury stock.			
Module 2			
5. Compute the amount of cash dividends when a firm has issued both preferred and common stock.	6	15	Mod
6. Show that you understand the difference between cash and stock dividends and the effect of stock dividends.			
7. Determine the difference between stock dividends and stock splits.			
Module 3			
8. Show that you understand the statement of stockholders' equity and comprehensive income.	1*	15	Mod
9. Understand how investors use ratios to evaluate stockholders' equity.	5	15	Mod
10. Explain the effects that transactions involving stockholders' equity have on the statement of cash flows.	2	15	Mod
Module 4			
11. Describe the important differences between the sole proprietorship and partnership forms of organization versus the corporate form (Appendix).			

*Exercise, problem, or case covers two or more learning objectives
Level = Difficulty levels: Easy; Moderate (Mod); Difficult (Diff)

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EXERCISES

LO 1

EXERCISE 11-1 STOCKHOLDERS' EQUITY ACCOUNTS

1. Yes, Preferred Stock, Increase
2. Yes, Additional Paid-In Capital, Increase
3. Not recorded until declared
4. Cash Dividend Payable is recorded as a liability, Decrease Retained Earnings
5. Yes, Stock Dividend Distributable, No change in total stockholders' equity
6. Yes, Treasury Stock, Decrease
7. Yes, Additional Paid-In Capital—Treasury Stock, Increase
8. Yes, Retained Earnings, Increase

LO 1

EXERCISE 11-2 SOLVE FOR UNKNOWNS

1. Common Stock Total Par Value = $10 × 10,000 = $100,000
   Additional Paid-In Capital = $350,000 – $100,000 = $250,000
   Total Stockholders' Equity = $350,000 + $100,000 (Retained Earnings) –
   $10,000 (Treasury Stock) = $440,000

2. Number of Shares of Treasury Stock = Number of Shares Issued – Number Outstanding = 10,000 – 9,200 = 800 shares

   Cost per Share = $10,000/800 shares = $12.50

LO 1

EXERCISE 11-3 SOLVING FOR STOCKHOLDERS' EQUITY AMOUNTS

1. To solve for the amount of net income for the year, the following equation can be used:

   Beg. bal. of Ret. Earn. $420,000 + x – cash dividends declared $100,000 – stock dividend $50,000
   = End. bal. of Ret. Earn. $500,000

   x = the amount of net income
   If the equation is solved for x, x = $230,000

2. To solve for the amount of cash dividends paid during the year, the following equation can be used:

   Beg. bal. of Dividends Payable $90,000 + dividends declared $100,000 – x = End. bal. of Dividends Payable $80,000

   x = the amount of dividends paid in cash to stockholders
   If the equation is solved for x, x = $110,000

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LO 1

EXERCISE 11-4 SOLVING FOR STOCKHOLDERS' EQUITY AMOUNTS

1. To solve for the amount of cash dividends declared for the year, the following equation can be used:

   Beg. bal. of Ret. Earn. $210,000 + net income $115,000 – x – stock dividend $25,000 = End. bal. of Ret. Earn. $250,000

   x = the amount of cash dividends declared
   If the equation is solved for x, x = $50,000

2. To solve for the amount of cash dividends paid during the year, the following equation can be used:

   Beg. bal. of Dividends Payable $75,000 + dividends declared $50,000 – x = End. bal. of Dividends Payable $80,000

   x = the amount of dividends paid in cash to stockholders
   If the equation is solved for x, x = $45,000

LO 3

EXERCISE 11-5 STOCK ISSUANCE

1. a.

Journal Entry Analysis

Cash	....	75,000*	
Common Stock	....		25,000**
Additional Paid-In Capital—Common	....		50,000***
To record issuance of common stock.			

*$15 × 5,000 = $75,000
**$5 × 5,000 = $25,000
***$10 × 5,000 = $50,000

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash 75,000				Common Stock 25,000 Additional Paid-In Capital—Common 50,000					

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EXERCISE 11-5 (Concluded)

b.

Journal Entry Analysis			
	Building	175,000	
	Common Stock		35,000*
	Additional Paid-In Capital—Common		140,000
	To record issuance of common stock.		
	*$5 × 7,000 = $35,000		

Balance Sheet						Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	←	REVENUES	–	EXPENSES	=	NET INCOME
Building 175,000				Common Stock 35,000 Additional Paid-In Capital—Common 140,000						

c.

Journal Entry Analysis			
	Patent	50,000*	
	Common Stock		10,000**
	Additional Paid-In Capital—Common		40,000***
	To record issuance of common stock.		
	*$25 × 2,000 shares = $50,000 **$5 × 2,000 shares = $10,000 ***($25 – $5) × 2,000 shares = $40,000		

Balance Sheet						Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	←	REVENUES	–	EXPENSES	=	NET INCOME
Patent 50,000				Common Stock 10,000 Additional Paid-In Capital—Common 40,000						

2.

Common stock, $5 par value, 14,000 shares issued and outstanding	$ 70,000
Additional paid-in capital ($50,000 + $140,000 + $40,000)	230,000
Total contributed capital	$300,000

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LO 3

EXERCISE 11-6 STOCK ISSUANCE

1. a. There is no entry.

b.

Journal Entry Analysis

2016			
Mar. 10	Cash	175,000*	
	Common Stock		50,000**
	Additional Paid-In Capital—Common		125,000***
	To record issuance of common stock.		

*$35 × 5,000 = $175,000
**$10 × 5,000 = $50,000
***($35 – $10) × 5,000 = $125,000

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash 175,000				Common Stock 50,000 Additional Paid-In Capital—Common 125,000					

c.

Journal Entry Analysis

Mar. 18	Cash	12,000*	
	Preferred Stock		10,000**
	Additional Paid-In Capital—Preferred		2,000***
	To record issuance of preferred stock.		

*$120 × 100 shares = $12,000
**$100 × 100 shares = $10,000
***($120 – $100) × 100 shares = $2,000

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash 12,000				Preferred Stock 10,000 Additional Paid-In Capital—Preferred 2,000					

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EXERCISE 11-6 (Concluded)

d.

Journal Entry Analysis				
	Apr. 12	Cash	450,000*	
		Common Stock		100,000**
		Additional Paid-In Capital—Common		350,000***
		To record issuance of common stock.		
		*$45 × 10,000 = $450,000 **$10 × 10,000 = $100,000 ***($45 – $10) × 10,000 shares = $350,000		

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash 450,000				Common Stock 100,000 Additional Paid-In Capital—Preferred 350,000					

2. 8% Preferred stock, $100 par value, 5,000 shares authorized,

8% Preferred stock, $100 par value, 5,000 shares authorized, 100 shares issued and outstanding	$ 10,000
Common stock, $10 par value, 2,000,000 shares authorized, 15,000 shares issued and outstanding	150,000
Additional paid-in capital—Preferred stock	2,000
Additional paid-in capital—Common stock	475,000
Total contributed capital	$637,000

3. The balance sheet does not indicate the market value of the stock. Market value is a function of the demand for the stock at various economic indicators such as interest rates and inflation.

LO 4

EXERCISE 11-7 TREASURY STOCK

1. a.

Journal Entry Analysis				
	July 1	Treasury Stock	40,000*	
		Cash		40,000
		To record purchase of treasury stock.		
		*$20 × 2,000 = $40,000		

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash (40,000)				Treasury Stock (40,000)					

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EXERCISE 11-7 (Concluded)

b.

Journal Entry Analysis				
Aug. 1	Treasury Stock	7,200*	
	Cash		7,200
	To record purchase of treasury stock.		
	*$18 × 400 = $7,200		

Balance Sheet						Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	←	REVENUES	–	EXPENSES	=	NET INCOME
Cash (7,200)				Treasury Stock (7,200)						

2. Resale price of treasury stock (2,400 × $28) $67,200
Cost of treasury stock ($40,000 + $7,200) 47,200
Excess of selling price over cost $20,000

This "excess," or "gain," is shown on the balance sheet as an increase in the Additional Paid-In Capital—Treasury Stock account.

LO 4

EXERCISE 11-8 TREASURY STOCK TRANSACTIONS

1. a.

Journal Entry Analysis			
2016			
Feb. 1	Treasury Stock	100,000*	
	Cash		100,000
	To record purchase of treasury stock.		
	*$20 × 5,000 = $100,000		

Balance Sheet						Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	←	REVENUES	–	EXPENSES	=	NET INCOME
Cash (100,000)				Treasury Stock (100,000)						

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EXERCISE 11-8 (Concluded)

b.

Journal Entry Analysis				
Mar. 1	Treasury Stock		15,600*	
	Cash			15,600
	To record purchase of treasury stock.			
	*$13 × 1,200 = $15,600			

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash (15,600)				Treasury Stock (15,600)					

2. The company sold treasury stock at amounts less than those it had paid to reacquire the stock. In a sense, the company had a loss of $8 per share on the stock purchased February 1 and $1 per share on the stock purchased March 1, but the "loss" is not shown on the income statement. Instead, the "loss" reduces stockholders' equity.

3.

Beginning balance	$ 390,000
Reacquisition of treasury stock—February 1	(100,000)
	$ 290,000
Reacquisition of treasury stock—March 1	(15,600)
	$ 274,400
Reissue of all treasury stock	115,600
	(41,200)*
Ending balance	$ 348,800

*Overall, the total stockholders' equity decreased by $41,200:
$8**(5,000) + $1***(1,200) = $41,200.
**($20 – $12) = $8
***($13 – $12) = $1

LO 5

EXERCISE 11-9 CASH DIVIDENDS

1. Preferred Dividends per Year = 1,000 × $100 × 9% = $9,000

Year	Preferred Dividends	Common Dividends
2013	$ 0	$ 0
2014	10,000*	0
2015	17,000**	3,000
2016	9,000	16,000

*$9,000 (from 2013) + $1,000 (for 2014) = $10,000.
**$8,000 (from 2014) + $9,000 (for 2015) = $17,000.

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EXERCISE 11-9 (Concluded)

2.

Year	Preferred Dividends	Common Dividends
2013	$ 0	$ 0
2014	9,000	1,000
2015	9,000	11,000
2016	9,000	16,000

LO 5

EXERCISE 11-10 CASH DIVIDENDS

1. Preferred: $200,000 × 8% = $16,000* for preferred
Common: $100,000 – $16,000* = $84,000 for common stockholders

2.

Journal Entry Analysis				
July	1	Retained Earnings.................................	100,000	
		Dividends Payable		100,000
		To record dividend declared.		

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
		Dividends Payable 100,000		Retained Earnings (100,000)					

Journal Entry Analysis				
Aug.	1	Dividends Payable	100,000	
		Cash		100,000
		To record payment of dividend.		

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash (100,000)		Dividends Payable (100,000)							

3. Preferred: $16,000 × 3 years = $48,000* for cumulative preferred
Common: $100,000 – $48,000* = $52,000

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LO 6

EXERCISE 11-11 STOCK DIVIDENDS

1. a.

Journal Entry Analysis

Jan. 15	Retained Earnings	120,000**	
	Common Stock Dividend Distributable		40,000*
	Additional Paid-In Capital—Common		80,000
	To record stock dividend declared.		

*40,000 × 10% × $10 = $40,000
**40,000 × 10% × $30 = $120,000

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
				Common Stock Dividend Distributable 40,000 Additional Paid-In Capital—Common 80,000 Retained Earnings (120,000)					

b.

Journal Entry Analysis

Jan. 30	Common Stock Dividend Distributable	40,000	
	Common Stock		40,000
	To record issuance of stock dividend.		

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
				Common Stock 40,000 Common Stock Dividend Distributable (40,000)					

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EXERCISE 11-11 (Concluded)

2.

WORTHY COMPANY
PARTIAL BALANCE SHEET
JANUARY 31, 2016

Stockholders' Equity

Common stock, $10 par, 44,000 shares issued and outstanding	$440,000*
Additional paid-in capital—Common stock.......................................	180,000**
Retained earnings..	280,000***
Total stockholders' equity	$900,000

*40,000 shares × 110% × $10 par = $440,000
**$100,000 + $80,000 = $180,000
***$400,000 – $120,000 = $280,000

Overall, these transactions did not change total stockholders' equity. They reclassified some equity from the Retained Earnings category to contributed capital.

LO 7

EXERCISE 11-12 STOCK DIVIDENDS VERSUS STOCK SPLITS

1. Assets	**=**	**Liabilities**	**+**	**Stockholders' Equity**
Stock Dividend:				(Retained Earnings) – 500,000 (Common Stock Dividend Distributable) (50,000 × 100% × $10) + 500,000

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
				Common Stock Dividend Distributable 500,000 Retained Earnings (500,000)					

Stock Split: No Entry

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EXERCISE 11-12 (Concluded)

2. Stockholders' Equity Category:

a. Stock Dividend

Common stock, $10 par, 100,000 shares issued and outstanding	$1,000,000*
Additional paid-in capital—Common stock	750,000
Retained earnings	380,000**
Total stockholders' equity	$2,130,000

*50,000 shares × 200% × $10 = $1,000,000
**$880,000 – $500,000 = $380,000

b. Stock Split

Common stock, $5 par, 100,000 shares issued and outstanding	$ 500,000*
Additional paid-in capital—Common stock	750,000
Retained earnings	880,000
Total stockholders' equity	$2,130,000

*Par = $10/2 = $5; Shares = 50,000 × 2 = 100,000

LO 7

EXERCISE 11-13 STOCK DIVIDENDS AND STOCK SPLITS

1.

Jan. 1	Balance	60,000	shares
May 1	60,000 × 15%	9,000	
		69,000	
Nov. 1		× 2	
Total shares outstanding		138,000	shares

2. $10/2 = $5 per share

3. Stockholders' Equity:

Common stock, $5 par value, 138,000 shares issued and outstanding	$ 690,000
Additional paid-in capital	570,000*
Retained earnings [$1,240,000 – (9,000 × $20)]	1,060,000
Total stockholders' equity	$2,320,000

*9,000 shares × ($20 – $10) = $90,000 from May 1
$90,000 + $480,000 = $570,000

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LO 8

EXERCISE 11-14 REPORTING CHANGES IN STOCKHOLDERS' EQUITY ITEMS

RYDE INC.
STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE YEAR ENDED APRIL 30, 2016

	Common Stock	Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
Balance, May 1, 2015	$345,000	$1,298,000	$3,013,000	$4,656,000
Net income			556,000	556,000
Dividends			(78,000)	(78,000)
Balance, April 30, 2016	$345,000	$1,298,000	$3,491,000	$5,134,000

LO 8

EXERCISE 11-15 COMPREHENSIVE INCOME

The Unrealized Gain/Loss—Available-for-Sale Securities account occurred when the company adjusted its investments for the changes in the market value of the securities. When a company buys stock in another company and the value of the stock changes, it is necessary to write up or down the stock. In the case of available-for-sale securities, the adjustment is not considered a gain or loss on the income statement. Instead, the adjustment is recorded directly to the Stockholders' Equity category.

The account titled Loss on Foreign Currency Translation Adjustments occurred when assets held in currencies other than U.S. dollars were converted to dollars. During that conversion, a gain or loss occurs. This gain or loss is not the result of selling the assets and is often referred to as a "*paper*" gain or loss.

There are arguments pro and con on the concept of comprehensive income. Some firms believe that some items should not be presented on the income statement because of their size or volatility. Presentation on the income statement may make it difficult for statement users to predict future income. Other firms believe that all income items should be reflected on the income statement. They believe that income is more useful if the statement user can view the effects of all items.

LO 9

EXERCISE 11-16 PAYOUT RATIO AND BOOK VALUE PER SHARE

1. Dividend payout ratio: $45,000/$80,000 = 56.25%

Note: The solution assumes that the common stockholders have a right to the total net income of $80,000. The preferred stock is not cumulative, and it does not indicate that a cash dividend was declared to the preferred stockholders. Further, it appears that the preferred stockholders received a stock dividend during the year, rather than a cash dividend. Therefore, the $45,000 of income should be attributable to the common stockholders.

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EXERCISE 11-16 (Concluded)

2. Book value per share:

Total stockholders' equity	
Preferred stock	$110,000
Paid-in capital—Preferred	55,000
Common stock	500,000
Paid-in capital—Common	50,000
Retained earnings	220,000
	$935,000
Liquidation value of preferred stock (1,100 shares × $120)	(132,000)
Net assets applicable to common stock	$803,000

Number of shares of common stock:
$500,000/$5 per share = 100,000 shares
Book value per share = $803,000/100,000 = $8.03

LO 10

EXERCISE 11-17 IMPACT OF TRANSACTIONS INVOLVING ISSUANCE OF STOCK ON STATEMENT OF CASH FLOWS

F—Issuance of common stock for cash
F—Issuance of preferred stock for cash
N—Issuance of common stock for equipment*
N—Issuance of preferred stock for land and building*
N—Conversion of preferred stock into common stock*

*****Note:* Even though they are financing transactions, no cash changed hands in the transactions marked "N." As a result, they would not be listed under the Financing category of the statement of cash flows. However, they would be reported in a supplementary schedule relating to the statement of cash flows.

LO 10

EXERCISE 11-18 IMPACT OF TRANSACTIONS INVOLVING TREASURY STOCK ON STATEMENT OF CASH FLOWS

F—Repurchase of common stock as treasury stock
F—Reissuance of common stock (held as treasury stock)
N—Retirement of treasury stock*

*****Note:* Even though it is a financing transaction, no cash changed hands in the retirement of treasury stock transaction. As a result, it would not be listed under the Financing category of the statement of cash flows. However, this transaction would be reported in a supplementary schedule relating to the statement of cash flows.

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LO 10

EXERCISE 11-19 IMPACT OF TRANSACTIONS INVOLVING DIVIDENDS ON STATEMENT OF CASH FLOWS

F—Payment of cash dividend on common stock
F—Payment of cash dividend on preferred stock
N—Distribution of stock dividend*
N—Declaration of stock split*

*****_Note:_ Even though they are financing transactions, no cash changed hands in the transactions marked "N." As a result, they would not be listed under the Financing category of the statement of cash flows. However, they would be reported in a supplementary schedule relating to the statement of cash flows.

LO 10

EXERCISE 11-20 DETERMINING DIVIDENDS PAID ON STATEMENT OF CASH FLOWS

1.

Dividends payable, December 31, 2015	$ 80,000
Dividends declared during 2016	400,000
Cash payments during 2016	(X)
Dividends payable, December 31, 2016	$100,000

$80,000 + $400,000 – X = $100,000
X = $380,000

2. Clifford would report the cash dividend payments of $380,000 as a cash outflow in the Financing Activities category of its 2016 statement of cash flows.

LO 11

EXERCISE 11-21 SOLE PROPRIETORSHIPS (APPENDIX)

The Owner's Equity section of Par Golf's balance sheet consists of the owner's capital account as follows:

Woods, Capital ($50,000 investment – $10,000 net loss – $20,000 withdrawal) = $20,000

LO 11

EXERCISE 11-22 PARTNERSHIPS (APPENDIX)

	Lewis	Jamal	Lapin
Beginning balance	$20,000	$ 50,000	$30,000
Allocation of net income	16,667*	16,667*	16,666*
	$36,667	$ 66,667	$46,666
Withdrawals	(5,000)	(12,000)	(9,000)
Ending balance	$31,667	$ 54,667	$37,666

*$50,000/3 = $16,667 rounded

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PROBLEMS

LO 1

PROBLEM 11-1 STOCKHOLDERS' EQUITY CATEGORY

PEELER COMPANY
PARTIAL BALANCE SHEET
DECEMBER 31, 2016

Stockholders' Equity

Preferred stock, $100 par, 7%, 1,000 shares authorized, 500 shares issued and outstanding	$ 50,000[a]
Common stock, $5 par, 10,000 shares authorized, 5,000 shares issued, 4,600 shares outstanding	25,000[c]
Additional paid-in capital—Preferred stock	10,000[b]
Additional paid-in capital—Common stock	365,000[d]
Additional paid-in capital—Treasury stock	500[e]
Total contributed capital	$450,500
Retained earnings	13,500[g]
Treasury stock, 400 shares, common	(24,000)[f]
Total stockholders' equity	$440,000

1/10 Preferred stock: 500 × $100 par = $50,000 credit[a]
Additional paid-in capital: 500 × ($120 – $100) = $10,000 credit[b]

1/10 Common stock: 4,000 × $5 par = $20,000 credit[c]
Additional paid-in capital: 4,000 × ($80 – $5) = $300,000 credit[d]

1/20 Common stock: 1,000 × $5 par = $5,000 credit[c]
Additional paid-in capital: 1,000 × ($70 – $5) = $65,000 credit[d]

Acquisition of treasury stock:
Treasury stock: 500 × $60 = $30,000 debit[f]

Resale of treasury stock:
Treasury stock: 100 × $60 = $6,000 credit[f]
Additional paid-in capital: 100 × ($65 – $60) = $500 credit[e]

12/31 Net income: Retained earnings, $40,000 credit[g]

12/31 Preferred dividend:
(500 × $100 par × 7%) = $3,500 debit to Retained Earnings[g]

Common stock dividend:
4,600 outstanding × $5 per share = $23,000 debit to Retained Earnings[g]

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LO 2

PROBLEM 11-2 EVALUATING ALTERNATIVE INVESTMENTS

1. Common stock has ownership privileges. The residual of the company belongs to the common shareholders.

Preferred stock has preference over common stockholders in dividend payouts.

Bonds earn interest that is a legal obligation of the company.

2. The return on the preferred stock depends upon its issue price. If it is assumed that the stock is issued at par value, then the return is 8%. Since all three instruments yield the same rate of return, 8%, Ellen should choose to invest in the bonds because they carry the lowest risk. As risk increases, the expected rate of return on an investment should increase.

LO 5

PROBLEM 11-3 DIVIDENDS FOR PREFERRED AND COMMON STOCK

	Preferred Stock	**Common Stock**
1.	\$100,000 × 8% = \$8,000	\$59,000 – \$8,000 = \$51,000
	Per share: \$8,000/1,000 shares = \$8.00	\$51,000/20,000 shares = \$2.55

	Preferred Stock	**Common Stock**
2.	\$8,000 × 3 years = \$24,000	\$59,000 – \$24,000 = \$35,000 in 2016
	Per share: \$24,000/1,000 = \$24.00	\$35,000/20,000 = \$1.75

LO 6

PROBLEM 11-4 EFFECT OF STOCK DIVIDEND

1. The memo to the board of directors should include the following points:

a. A stock dividend does not change the total stockholders' equity amount.

b. A stock dividend does reduce the balance of Retained Earnings and transfers the amount of the stock dividend to the contributed capital component of stockholders' equity.

c. A stock dividend results in additional shares of stock outstanding. Therefore, it affects the financial ratios of the firm. For example, book value per share and earnings per share decline as a result of the stock dividend.

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PROBLEM 11-4 (Concluded)

2. The statement to the stockholders should stress the following points:

a. Each stockholder has the same proportionate ownership of the company after the dividend as before the dividend.

b. A stock dividend is likely to cause the market price per share of the stock to decline. The additional shares received by the stockholder should offset the decline in the per-share price and leave the stockholder at least as well off as before the dividend.

c. What happens to the stock price after the stock dividend is dependent on the company's profitability and a wide variety of industry and economic factors.

LO 7

PROBLEM 11-5 DIVIDENDS AND STOCK SPLITS

1.

Mar.	1	Retained Earnings and total stockholders' equity decrease.
Apr.	1	Total stockholders' equity remains unchanged.
June	1	Common Stock Distributable increases by $7,500 (15,000 × 5% × $10). Additional Paid-In Capital—Common Stock increases by $6,000 [(15,000 × 5%) × ($18 – $10)]. Retained Earnings decreases by $13,500. Total stockholders' equity does not change.
July	1	Common Stock Distributable decreases and Common Stock increases by $7,500.
Sept.	1	Retained Earnings and total stockholders' equity decrease by $7,875 [(15,000 + 750) × $0.50].
Oct.	1	Total stockholders' equity does not change.
Dec.	1	The par value of common stock changes from $10 to $5 as the number of shares issued and outstanding doubles from 15,750 to 31,500, but the total par value does not change. The total stockholders' equity also does not change.

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PROBLEM 11-5 (Concluded)

2. The Stockholders' Equity category as of December 31, 2016, would appear as follows:

FREDERIKSEN INC.
PARTIAL BALANCE SHEET
DECEMBER 31, 2016

Stockholders' Equity

Preferred stock, $80 par, 7%, 3,000 shares issued and outstanding	$ 240,000
Common stock, $5 par, 31,500 shares[a] issued and outstanding	157,500
Additional paid-in capital—Preferred stock	60,000
Additional paid-in capital—Common stock	231,000[b]
Total contributed capital	$ 688,500
Retained earnings	2,711,825[c]
Total stockholders' equity	$3,400,325

[a](15,000 + 750 stock dividend) × 2 stock split = 31,500
[b]$225,000 + $6,000 stock dividend = $231,000
[c]$2,100,000 – $16,800 cash dividend – $13,500 stock dividend – $7,875 cash dividend + $650,000 net income = $2,711,825

3. A stock dividend results in the capitalization of part of the Retained Earnings account. The value of the shares issued in the stock dividend is deducted from the Retained Earnings account and added to the Capital Stock account (and the Additional Paid-In Capital account for small stock dividends). The number of outstanding shares is increased, and the par value of the shares is unchanged. In a stock split, there is no change to any of the capital accounts. There is an increase in the number of outstanding shares, which is offset by a corresponding decrease in the par value of those shares.

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LO 8

PROBLEM 11-6 STATEMENT OF STOCKHOLDERS' EQUITY

	Preferred Stock	Common Stock	Paid-In Capital	Treasury Stock	Retained Earnings
Balance, January 1	$ 0	$ 0	$ 0	$ 0	$ 0
Sale of preferred stock	50,000		10,000		
Sale of common stock		20,000	300,000		
Issuance of common stock for building site		5,000	65,000		
Purchase of treasury stock				(30,000)	
Sale of treasury stock			500	6,000	
Net income					40,000
Cash dividends—Preferred					(3,500)
Cash dividends—Common					(23,000)
Balance, December 31	$50,000	$25,000	$375,500	$(24,000)	$ 13,500

Explanations:

1/10 Preferred stock: 500 × $100 par = $50,000 increase
Additional paid-in capital: 500 × ($120 – $100) = $10,000 increase

1/10 Common stock: 4,000 × $5 = $20,000 increase
Additional paid-in capital: 4,000 × ($80 – $5) = $300,000 increase

1/20 Common stock: 1,000 × $5 par = $5,000 increase
Additional paid-in capital: 1,000 × ($70 – $5) = $65,000 increase

Acquisition of treasury stock:
Treasury stock: 500 × $60 = $30,000 decrease

Resale of treasury stock:
Treasury stock: 100 × $60 = $6,000 increase
Additional paid-in capital: 100 × ($65 – $60) = $500 increase

12/31 Net income:
Retained earnings: $40,000 increase

12/31 Cash dividends:
Preferred stock:
(500 × $100 × 7%) = $3,500 decrease in Retained Earnings
Common stock:
4,600 outstanding × $5 per share = $23,000 decrease in Retained Earnings

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LO 8

PROBLEM 11-7 SOUTHWEST AIRLINES' COMPREHENSIVE INCOME

1. Southwest Airlines has several items that were not included in the net income amount but are included on the statement of comprehensive income. The effect of including these items on the income statement would have been to decrease net income. The largest item is an unrealized loss on fuel derivative instruments. One of the airline's largest costs is the cost of fuel, and it uses these instruments to protect itself when prices fluctuate.

2. While comprehensive income would show all sources of income for the period, these numbers could lead readers to believe this is an ordinary result of operations. Some items are considered to be "*paper*" gains or losses; these adjustments are not presented on the income statement because they are unrealized. These adjustments are often volatile and may be quite sizable. Further, no cash inflows or outflows directly result from these adjustments. Accordingly, some of Southwest Airlines' stockholders may prefer that these items be reported on the statement of comprehensive income. Including these items on the income statement might make it difficult for investors to predict future income. On the other hand, this information gives important insight into the activities of the company and investors should consider it when making an investment decision.

LO 10

PROBLEM 11-8 EFFECTS OF STOCKHOLDERS' EQUITY TRANSACTIONS ON STATEMENT OF CASH FLOWS

Cash flows from financing activities:	
Issuance of preferred stock (500 × $120)	$ 60,000
Issuance of common stock (4,000 × $80)	320,000
Purchase of treasury stock (500 × $60)	(30,000)
Reissuance of treasury stock (100 × $65)	6,500
Net cash flow from financing activities	$356,500

The following transactions would not appear in the Financing Activities section of the statement of cash flows:

Peeler obtained the building site by issuing 1,000 shares of common stock; no cash changed hands. As a result, this transaction would be reported as a noncash investing and financing transaction on the statement of cash flows.

Assuming that the indirect method is used, the company's 2016 net income would appear as the first item under the Cash Flows from Operating Activities section of the statement of cash flows.

The dividend declared on December 31, 2016, will not be paid until 2017. As a result, the payment of this dividend will appear as a cash outflow in the Financing section of the 2017 statement of cash flows.

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LO 11

PROBLEM 11-9 INCOME DISTRIBUTION OF A PARTNERSHIP (APPENDIX)

1. If income is $15,000, it should be distributed as follows:

	Abbott	Costello
Salary to Abbott	$ 20,000	
Interest to Costello: 10% × $300,000		$ 30,000
Remainder in 2:1 ratio:		
($15,000 – $50,000) × 2/3	(23,333)	
($15,000 – $50,000) × 1/3		(11,667)
Total distributed	$ (3,333)	$ 18,333

Note: Generally, salary and interest are allocated first to the partners' accounts and then, if there is a deficit, the deficit is allocated in the agreed ratio. In this case, the result is a negative amount distributed to Ms. Abbott.

2. If income is $50,000, it should be distributed as follows:

	Abbott	Costello
Salary to Abbott	$20,000	
Interest to Costello: 10% × $300,000		$30,000
Total distributed	$20,000	$30,000

3. If income is $80,000, it should be distributed as follows:

	Abbott	Costello
Salary to Abbott	$20,000	
Interest to Costello: 10% × $300,000		$30,000
Remainder in 2:1 ratio:		
($80,000 – $50,000) × 2/3	20,000	
($80,000 – $50,000) × 1/3		10,000
Total distributed	$40,000	$40,000

LO 11

PROBLEM 11-10 SOLE PROPRIETORSHIPS (APPENDIX)

1. The balance of the owner's capital account can be calculated as follows:

Beginning balance	$ 0
Investments by owner	120,000
	$120,000
Net income	24,000
Withdrawals	(12,000)
Ending balance	$132,000

2. The capital account indicates the amount of the owner's investment that has not been withdrawn. It is based on accrual accounting and does not indicate the amount of cash in the business.

Note: The purchase of copy machines for $42,000 by the printing business has no effect on Chong Yu's capital account.

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LO 11 **PROBLEM 11-11 PARTNERSHIPS (APPENDIX)**

Allocation:	Nerise	O'Brien	Total
Amount to be allocated			$21,200*
Salary	$ 7,200		
Interest ($100,000 × 6%)		$ 6,000	13,200
Remainder to allocate			$ 8,000
Balance of equity	4,000	4,000	8,000
	$11,200	$10,000	$ 0

*$90,000 – $68,800.

	Nerise	O'Brien
Beginning balance	$ 0	$ 0
Investments	25,000	100,000
Allocation	11,200	10,000
	$36,200	$110,000
Withdrawals	(13,200)*	(4,000)
Ending balance	$23,000	$106,000

*Salary allocation of $600 × 12 = $7,200 + $6,000 (withdrawals $500 a month) = $13,200

MULTI-CONCEPT PROBLEMS

LO 1,4 **PROBLEM 11-12 ANALYSIS OF STOCKHOLDERS' EQUITY**

1. Preferred Stock Issued = $120,000/$30 par = 4,000 shares issued
2. Preferred Stock Outstanding = 4,000 – 100 (Treasury Stock) = 3,900* shares
3. ($120,000 + $6,000)/4,000 = $31.50
4. $70,000/7,000 shares issued = $10 per share
5. ($70,000 + $560,000)/7,000 shares issued= $90 per share
6. $3,200/100 shares = $32 per share
7. $757,000 + $40,000 – $3,200 = $793,800
8. [$793,800 – (3,900* preferred shares × $30 par)]/7,000 = $96.69

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LO 3,4,7

PROBLEM 11-13 EFFECTS OF STOCKHOLDERS' EQUITY TRANSACTIONS ON THE BALANCE SHEET

1.

	Assets	=	Liabilities	+	Stockholders' Equity
a.	+500,000				+100,000 +400,000
b.	+20,000 +80,000				+10,000 +90,000
c.	–16,000				–16,000
d.			+10,900		–10,900*
e.	No accounting entry				
f.	+180,000**				+180,000

*(100,000 + 10,000 – 1,000)($0.10).

***Note:* The net income in transaction (f) results in an increase of $180,000 in stockholders' equity. The corresponding $180,000 may have been an increase in assets (as shown), a decrease in liabilities, or some combination of the two.

2.

HORTON INC.
PARTIAL BALANCE SHEET
DECEMBER 31, XXXX

Stockholders' Equity

Common stock, 2,000,000 authorized, 220,000 issued, 218,000 outstanding, $0.50 par value	$110,000
Additional paid-in capital ($400,000 + $90,000)	490,000
Retained earnings (–$10,900 + $180,000)	169,100
Treasury stock	(16,000)
Total stockholders' equity	$753,100

3. *Note:* The company is authorized to issue 2,000,000 shares of common stock, $0.50 par value. At the end of the year, 220,000 shares are issued; however, only 218,000 are outstanding because the company has purchased 2,000 shares of common stock for further distribution. The figures presented reflect the retroactive treatment of a 2-for-1 stock split during the year.

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LO 1,4 **PROBLEM 11-14 STOCKHOLDERS' EQUITY SECTION OF THE BALANCE SHEET**

1.

IVES INC.
BALANCE SHEET
AS OF XXXX

Assets	
Cash	$ 3,500
Account receivable	5,000
Plant, property, and equipment	108,000
Total assets	$116,500
Liabilities	
Accounts payable	$ 5,500
Dividends payable	1,500
Stockholders' Equity	
Common stock, $1 par, 100,000 shares issued	100,000
Additional paid-in capital	11,000
Retained earnings	(1,000)
Treasury stock	(500)
Total liabilities and stockholders' equity	$116,500

Treasury stock is not an asset; it is a *contra* owners' equity account. Retained earnings is not an asset; it is the accumulated, undistributed profit of the company.

2. The Retained Earnings account has a debit balance because the accumulated earnings of the company represent a net loss and/or dividends paid out have exceeded the cumulative earnings.

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ALTERNATE PROBLEMS

LO 1

PROBLEM 11-1A STOCKHOLDERS' EQUITY CATEGORY

KEBLER COMPANY
PARTIAL BALANCE SHEET
DECEMBER 31, 2016

Stockholders' Equity

Preferred stock, $100 par, 7%, 2,000 shares authorized, 1,000 shares issued	$100,000[a]
Common stock, $5 par, 20,000 shares authorized, 10,000 shares issued, 9,100 shares outstanding	50,000[b]
Additional paid-in capital—Preferred stock	20,000[c]
Additional paid-in capital—Common stock	730,000[d]
Additional paid-in capital—Treasury stock	500[f]
Total contributed capital	$900,500
Retained earnings	27,500[g]
Treasury stock, 900 shares, common	(54,000)[e]
Total stockholders' equity	$874,000

1/10 Preferred stock: 1,000 × $100 par = $100,000[a] credit
Additional paid-in capital: 1,000 × ($120 – $100) = $20,000[c] credit
1/10 Common stock: 8,000 × $5 = $40,000 credit[b]
Additional paid-in capital: 8,000 × ($80 – $5) = $600,000[d] credit
1/20 Common stock: 2,000 × $5 par = $10,000 credit[b]
Additional paid-in capital: 2,000 × ($70 – $5) = $130,000[d] credit

Treasury stock acquired:
Treasury stock: 1,000 × $60 = $60,000[e] debit

Treasury stock resold:
Treasury stock: 100 × $60 = $6,000[e] credit
Additional paid-in capital: 100 × ($65 – $60) = $500[f] credit

12/31 Net income:
Retained earnings: $80,000[g] credit
12/31 Dividend:
Preferred: 1,000 × $100 par × 7% = $7,000[g] debit to Retained Earnings
Common: 9,100 shares × $5 = $45,500[g] debit to Retained Earnings

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LO 2

PROBLEM 11-2A EVALUATING ALTERNATIVE INVESTMENTS

1. **Common stock**—dividends become an obligation of the company after they are declared. Prior to the declaration, the company is not obligated to pay dividends to common shareholders.

   Preferred stock—dividends become an obligation of the company after they are declared. Prior to the declaration, the company is not obligated to pay dividends. However, preferred stockholders have preference over common stockholders and will receive dividends before common stockholders. In addition, the cumulative feature requires that all dividends in arrears be paid to preferred stockholders before any dividends are paid to common stockholders.

   Bonds—the interest and principal payments are a legal obligation of the company.

2. Rob should invest in the common stock because the return is greatest. Rob must be aware, however, that the risk is also the greatest. If the company fails to perform as it has in the past and is expected to perform in the future, Rob not only would lose dividends but might also lose the investment in stock.

LO 5

PROBLEM 11-3A DIVIDENDS FOR PREFERRED AND COMMON STOCK

	Preferred Stock	**Common Stock**
1.	$200,000 × 8% = $16,000	$118,000 – $16,000 = $102,000
	Per share: $16,000/2,000 = $8.00	$102,000/40,000 = $2.55
2.	**Preferred Stock**	**Common Stock**
	$16,000 × 3 years = $48,000	$118,000 – $48,000 = $70,000
	Per share: $48,000/2,000 = $24.00	$70,000/40,000 = $1.75

LO 6

PROBLEM 11-4A EFFECT OF STOCK DIVIDEND

1. The statement should include the following points:
   - **a.** A stock dividend does not change the total stockholders' equity amount.
   - **b.** A stock dividend does reduce the balance of Retained Earnings and transfers the amount of the stock dividend to the contributed capital component of stockholders' equity.
   - **c.** A stock dividend results in additional shares of stock outstanding. Therefore, it affects the financial ratios of the firm. For example, book value per share and earnings per share decline as a result of the stock dividend.

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PROBLEM 11-4A (Concluded)

2. The statement to the stockholders should stress the following points:

- **a.** Each stockholder has the same proportionate ownership of the company after the dividend as before the dividend.
- **b.** A stock dividend is likely to cause the market price per share of the stock to decline. The additional shares received by the stockholder should offset the decline in the per-share price and leave the stockholder at least as well off as before the dividend.
- **c.** What happens to the stock price after the stock dividend is dependent on the company's profitability and a wide variety of industry and economic factors.

LO 7

PROBLEM 11-5A DIVIDENDS AND STOCK SPLITS

1. Mar. 1 Cash dividends increase (or Retained Earnings decreases) and total stockholders' equity decreases.

Apr. 1 Total stockholders' equity remains unchanged.

June 1 Common Stock Distributable increases by \$8,000 (10,000 × 8% × \$10). Additional Paid-In Capital—Common Stock increases by \$12,800 (10,000 × 8% × \$16). Retained Earnings decreases by \$20,800. Total stockholders' equity does not change.

July 1 Common Stock Distributable decreases, and Common Stock increases by \$8,000.

Sept. 1 Retained Earnings and total stockholders' equity decrease by \$7,560 [(10,000 + 800) × \$0.70].

Oct. 1 Total stockholders' equity does not change.

Dec. 1 The par value of common stock changes from \$10 to \$3.33 as the number of shares issued and outstanding triples from 10,800 to 32,400, but the total par value does not change. The total stockholders' equity also does not change.

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PROBLEM 11-5A (Concluded)

2.

SVENBERG INC.
PARTIAL BALANCE SHEET
DECEMBER 31, 2016

Stockholders' Equity	
Preferred stock, $80 par, 8%, 1,000 shares issued and outstanding	$ 80,000
Common stock, $3.33 par, 32,400[a] shares issued and outstanding	108,000[b]
Additional paid-in capital—Preferred	60,000
Additional paid-in capital—Common	237,800[c]
Total contributed capital	$ 485,800
Retained earnings	2,665,240[d]
Total stockholders' equity	$3,151,040

[a](10,000 + 800 stock dividend) × 3 (stock split) = 32,400
[b]Difference due to rounding of par value.
[c]$225,000 + $12,800 stock dividend = $237,800
[d]$1,980,000 – $6,400 cash dividend – $20,800 stock dividend – $7,560 cash dividend + $720,000 net income = $2,665,240

3. A stock dividend results in the capitalization of part of the Retained Earnings account. The value of the shares issued in the stock dividend is deducted from the Retained Earnings account and added to the Capital Stock account (and the Additional Paid-In Capital account for small stock dividends). The number of outstanding shares is increased, and the par value of the shares is unchanged. In a stock split, there is no change to any of the capital accounts. There is an increase in the number of outstanding shares, which is offset by a corresponding decrease in the par value of those shares.

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LO 8 **PROBLEM 11-6A STATEMENT OF STOCKHOLDERS' EQUITY**

	Preferred Stock	Common Stock	Paid-In Capital	Treasury Stock	Retained Earnings
Balance, January 1	$ 0	$ 0	$ 0	$ 0	$ 0
Sale of preferred stock	100,000		20,000		
Sale of common stock		40,000	600,000		
Issuance of common stock for building site		10,000	130,000		
Purchase of treasury stock				(60,000)	
Sale of treasury stock			500	6,000	
Net income					80,000
Cash dividends—Preferred					(7,000)
Cash dividends—Common					(45,500)
Balance, December 31	$100,000	$50,000	$750,500	$(54,000)	$ 27,500

Explanations:

1/10 Preferred stock: 1,000 × $100 par = $100,000 increase
Additional paid-in capital: 1,000 × ($120 – $100) = $20,000 increase

1/10 Common stock: 8,000 × $5 = $40,000 increase
Additional paid-in capital: 8,000 × ($80 – $5) = $600,000 increase

1/20 Common stock: 2,000 × $5 par = $10,000 increase
Additional paid-in capital: 2,000 × ($70 – $5) = $130,000 increase

Acquisition of treasury stock:
Treasury stock: 1,000 × $60 = $60,000 decrease

Resale of treasury stock:
Treasury stock: 100 × $60 = $6,000 increase
Additional paid-in capital: 100 × ($65 – $60) = $500 increase

12/31 Net income:
Retained earnings: $80,000 increase

12/31 Cash dividends:
Preferred stock:
(1,000 × $100 × 7%) = $7,000 decrease in Retained Earnings

Common stock:
9,100 outstanding × $5 per share = $45,500 decrease in Retained Earnings

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PROBLEM 11-7A COSTCO'S COMPREHENSIVE INCOME

1. Other comprehensive income includes items that are not in the traditional net income amount but are included in the broader measure of comprehensive income. These items include: foreign-currency translation adjustments, adjustments in the market values of certain investments, and other items that are not specified by the company. Costco has an amount as foreign-currency translation adjustment for 2014.
2. Other transactions that affected stockholders' equity included: an increase by issuing stock by the exercise of stock options, an increase by conversion of notes into stock, a decrease by repurchase of stock, an increase by issuing treasury stock for compensation, and a decrease for cash dividends.
3. Cash dividends reduce stockholders' equity. A stock dividend changes the balance of accounts within the Stockholders' Equity category, but the total amount of stockholders' equity is not affected.

LO 10

PROBLEM 11-8A EFFECTS OF STOCKHOLDERS' EQUITY TRANSACTIONS ON THE STATEMENT OF CASH FLOWS

Cash flows from financing activities:	
Issuance of preferred stock (1,000 × $120)	$120,000
Issuance of common stock (8,000 × $80)	640,000
Purchase of treasury stock (1,000 × $60)	(60,000)
Reissuance of treasury stock (100 × $65)	6,500
Net cash flows from financing activities	$706,500

The following transactions would not appear in the Financing Activities section of the statement of cash flows:

- Kebler obtained the building site by issuing 2,000 shares of common stock; no cash changed hands. As a result, this transaction would be reported as a noncash investing and financing transaction on the statement of cash flows.
- Assuming the indirect method is used, the company's 2016 net income would appear as the first item under the Cash Flows from Operating Activities section of the statement of cash flows.
- The dividend declared on December 31, 2016, will not be paid until 2017. As a result, the payment of this dividend will appear as a cash outflow, in the Financing section of the 2017 statement of cash flows.

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LO 11 **PROBLEM 11-9A INCOME DISTRIBUTION OF A PARTNERSHIP (APPENDIX)**

1.

	Katz	Kan
Salary to Katz	$ 40,000	
Interest to Kan: 10% × $600,000		$ 60,000
Remainder in 2:1 ratio:		
($30,000 – $100,000) × 2/3	(46,667)	
($30,000 – $100,000) × 1/3		(23,333)
Total distributed	$ (6,667)	$ 36,667

Note: Generally, salary and interest are allocated first to the partners' accounts and then, if there is a deficit, the deficit is allocated in the agreed ratio. The result, in this case, is a negative amount distributed to Katz.

2. If income is $100,000, it should be distributed as follows:

	Katz	Kan
Salary to Katz	$40,000	
Interest to Kan: 10% × $600,000		$60,000
Total distributed	$40,000	$60,000

3. If income is $160,000, it should be distributed as follows:

	Katz	Kan
Salary to Katz	$40,000	
Interest to Kan: 10% × $600,000		$60,000
Remainder in 2:1 ratio:		
($160,000 – $100,000) × 2/3	40,000	
($160,000 – $100,000) × 1/3		20,000
Total distributed	$80,000	$80,000

LO 11 **PROBLEM 11-10A SOLE PROPRIETORSHIPS (APPENDIX)**

1. The balance of the owner's capital account can be calculated as follows:

Beginning balance	$ 0
Investments by owner	150,000
	$150,000
Net income	30,000
Withdrawals	(15,000)
Ending balance	$165,000

2. The capital account indicates the amount of the owner's investment that has not been withdrawn. It is based on accrual accounting and does not indicate the amount of cash in the business.

Note: The purchase of copy machines for $52,500 by the printing business has no effect on Chen Chien Lao's capital account.

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LO 11 **PROBLEM 11-11A PARTNERSHIPS (APPENDIX)**

Allocation:	Locke	Keyes	Total
Amount to be allocated			$19,600*
Salary	$10,800		
Interest ($140,000 × 6%)		$8,400	19,200
Remainder to allocate			$ 400
Balance of equity	200	200	400
	$11,000	$8,600	$ 0

*$126,000 – $106,400.

	Locke	Keyes
Beginning balance	$ 0	$ 0
Investments	35,000	140,000
Allocation of net income	11,000	8,600
	$46,000	$148,600
Withdrawals	(19,200)*	(5,600)
Ending balance	$26,800	$143,000

*Salary allocation of $700 × 12 = $8,400 + $10,800 = $19,200

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ALTERNATE MULTI-CONCEPT PROBLEMS

LO 1,4 PROBLEM 11-12A ANALYSIS OF STOCKHOLDERS' EQUITY

1. Preferred Stock Issued = $400,000/$50 par = 8,000 shares
2. Preferred Stock Outstanding = 8,000 – 200 (Treasury Stock) = 7,800 shares
3. ($400,000 + $12,000)/8,000 = $51.50
4. $280,000/14,000 = $20
5. ($280,000 + $980,000)/14,000 = $90
6. $12,800/200 = $64
7. $1,674,000 + $80,000 – $12,800 = $1,741,200
8. [$1,741,200 – (7,800 × $50)]/14,000 = $96.51

LO 3,4,7 PROBLEM 11-13A EFFECTS OF STOCKHOLDERS' EQUITY TRANSACTIONS ON BALANCE SHEET

1.	Assets	=	Liabilities	+	Stockholders' Equity
a.	+100,000				+10,000 +90,000
b.	+100,000				+10,000 +90,000
c.	–10,000				–10,000
d.			+9,500		–9,500*
e.	+340,000**				+340,000

*(10,000 + 10,000 – 1,000)($0.50)

***Note:* The net income of transaction (e) increases owners' equity by $340,000 (as shown). The corresponding amount may be an increase to assets, a decrease in liabilities, or some combination.

2. Contributed capital is the amount given in exchange for assets. In the first transaction, the company gave stock for cash, an asset. In the second transaction, the company gave stock for a patent, also an asset. Contributed capital may also be given for payment of debt. Retained earnings is the second category of owners' equity, and it represents the amount of undistributed, accumulated earnings of the company. Hilton's Retained Earnings balance is the income of $340,000 less dividends of $9,500 = $330,500.

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PROBLEM 11-13A (Concluded)

3. The book value of the common stock at the end of the year is computed as follows:

Stockholders' Equity:

Common stock	$ 20,000
Additional paid-in capital—Common stock	180,000
Retained earnings ($340,000 – $9,500)	330,500
Treasury stock	(10,000)
Total stockholders' equity	$520,500

Number of shares of stock outstanding = 10,000 + 10,000 – 1,000 = 19,000
Book value per share = $520,500/19,000 = $27.39

LO 1,4

PROBLEM 11-14A STOCKHOLDERS' EQUITY SECTION OF THE BALANCE SHEET

1.

GRAINFIELD INC.
PARTIAL BALANCE SHEET
AS OF XXXX

Stockholders' Equity

Preferred stock, 10,000 shares authorized, 5,000 shares issued and outstanding, $10 par, 5%	$ 50,000
Common stock, 1,000,0000 shares authorized, 100,000 shares issued and 97,000 shares outstanding, $1 par value	100,000
Additional paid-in capital	68,400
Retained earnings	54,900
Treasury stock, 3,000 shares of common	(15,000)
Total stockholders' equity	$258,300

2. Dividends Payable is a liability and is not in stockholders' equity.

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DECISION CASES

READING AND INTERPRETING FINANCIAL STATEMENTS

LO 1,8

DECISION CASE 11-1 COMPARING TWO COMPANIES IN THE SAME INDUSTRY: PANERA BREAD AND CHIPOTLE

1. Panera Bread had the following number of shares:
Authorized: 112,500,000
Issued: 30,703,472
Outstanding: 30,703,472 – 5,260,744 treasury stock = 25,442,728

Chipotle had the following number of shares:
Authorized: 230,000
Issued: 35,394
Outstanding: 35,394 – 4,367 treasury stock = 31,027

2. Panera Bread's Retained Earnings account increased during the period from $1,049,884,000 to $1,229,177,000. Chipotle's Retained Earnings account increased from $1,276,897,000 to $1,722,271,000.

Retained earnings is increased by the net income for the period and reduced by dividends that are declared to stockholders.

3. Panera Bread had a total stockholders' equity of $736,184,000, while Chipotle had $2,012,369,000. The dollar amount of stockholders' equity, by itself, does not indicate the overall position of the company because the two companies are not the same size. Both companies are solid companies and have a large amount of value to the stockholders as reflected by total stockholders' equity.

LO 10

DECISION CASE 11-2 READING PANERA BREAD'S STATEMENT OF CASH FLOWS

1. The largest cash inflow was from the issuance of long-term debt. The largest cash outflow was from the repurchase of common stock. Smaller amounts were reflected on the statement of cash flows for items related to stock options and employee benefit plans.

2. The statement of cash flows does not indicate any amounts were paid for dividends during the period.

3. When treasury stock is purchased, cash is reduced in the Asset category, and total stockholders' equity is reduced by the same amount. The Treasury Stock account is considered a contra account and is subtracted from the total of contributed capital in the Stockholders' Equity section.

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MAKING FINANCIAL DECISIONS

LO 1,2

DECISION CASE 11-3 DEBT VERSUS PREFERRED STOCK

1. The purpose of this problem is to allow students to see the similarities and differences between a liability and an equity. In the problem, the loan of First Company is very similar to the preferred stock of Second Company. Both securities indicate annual payments of 8% (interest or dividend). Further, the stock carries a mandatory redemption feature that indicates it must be repaid or redeemed at the end of five years.

Note: There are specific FASB and SEC guidelines on the classification of preferred stock with mandatory redemption features that you may wish to ask the students to reference.

There may, however, be differences between the securities of First and Second companies. Legally, the loan payable has a right to assets before stock. Also, the preferred stock dividend is cumulative, but that is not the same as interest on a loan. Stockholders do not have the right to dividends until they have been declared, even when the stock is cumulative.

2. Whether the preferred stock should be considered a liability or an equity is a matter of judgment. This is a good opportunity to stress form over substance. The proper classification of the security should be based on the student's belief about the substance of the transaction rather than on whether the company has chosen to call the security a loan or stock.

LO 2

DECISION CASE 11-4 PREFERRED VERSUS COMMON STOCK

Preferred Stock—Preferred stock has no voting rights. The company is not obligated to pay dividends until they are declared; however, the cumulative feature requires that the company pay preferred shareholders all dividends in arrears before common shareholders receive a dividend.

If one person purchased all 50,000 shares of common stock, the new investor would own 11% (50/450) of the company. The original owners would own 18% (80/450) of the company. If one or two of the original owners purchased the stock, the power could shift to those shareholders. Dividends are never required on common stock. They become a legal obligation of the company only after they are declared.

In order to develop a recommendation, the issues concerned must be evaluated more thoroughly. If the primary concern is the ability to monitor cash flow, then common stock is more attractive. However, common stock is not attractive if the current owners are concerned that additional shares of stock may result in loss of voting control of the company. One solution may be to issue common stock that allows the current stockholders the right to maintain their ownership percentages. Another solution may be to issue a second class of common stock that does not have equal voting rights.

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ETHICAL DECISION MAKING

LO 9

DECISION CASE 11-5 INSIDE INFORMATION

1. **Recognize an ethical dilemma:**
   The ethical issue in this case is whether or not Jim Brock acted improperly when he advised his father to buy shares of Hubbard Inc. stock. Surprisingly, in discussing this case with students, many students do not see that Brock has a professional responsibility to his employer. Further, most students are not aware of the term "insider information."

2. **Analyze the key elements in the situation:**
   1. Was anyone harmed by Brock's actions, e.g., the parties that sold the stock at a low price?
   2. Does it matter if Brock himself profited or if some other party purchased stock based on his knowledge?
   3. Do brokers and analysts receive information about the firm that is not available to the public? Doesn't everyone engage in insider information?

3. **List alternatives and evaluate the impact of each on those affected:**
   If Brock decides he has acted ethically, then he has no further responsibility in the matter. In the future, he should ask his employer for more guidance or company policy about how important information should be handled.

   If Brock decides he did act unethically, he should consider what action he should take to correct the situation. He should contact both his employer and legal counsel. He should be prepared to pay back any profit his father made on the purchase of the stock.

4. **Select the best alternative:**
   In this case, it appears that Jim has acted unethically. He has not upheld his responsibilities to his employer. Further, it is quite possible that his actions are illegal. The SEC and state authorities have very stringent rules against someone using "insider information" in order to obtain an advantage.

LO 5

DECISION CASE 11-6 DIVIDEND POLICY

Retained earnings represents accumulated, undistributed earnings of the company, but it is not an asset. The earnings may be tied up in buildings and land used in production or even in current assets like inventory and supplies. If the larger dividend creates a working capital problem, it may jeopardize the future of the company. It would not be good to vote for a large dividend if the company will not have enough cash to meet current obligations.

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SOLUTION TO INTEGRATIVE PROBLEM

Alternative A. If Griffin had issued bonds to purchase the asset, the additional transactions would have been as follows. (*Note:* This assumes that the transaction to purchase the asset and to depreciate the asset were recorded under either alternative.)

Journal Entry Analysis				
Jan.	1	Cash	8	
		Bonds Payable		8
		To record issuance of bonds to be used for equipment.		

Balance Sheet						Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY		REVENUES	–	EXPENSES	=	NET INCOME
Cash 8		Bonds Payable 8								

Journal Entry Analysis				
Dec.	31	Interest Expense	0.5	
		Bonds Payable	1.0	
		Cash		1.5
		To record payment on bonds.		

Balance Sheet						Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY		REVENUES	–	EXPENSES	=	NET INCOME
Cash (1.5)		Bonds Payable (1.0)		(0.5)				Interest Expense 0.5		(0.5)

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Griffin's balance sheet and income statement would appear as follows:

GRIFFIN INC.
BALANCE SHEET
DECEMBER 31, 2016
(IN MILLIONS)

Assets		
Cash		$ 8.25*
Other current assets		6.40
Equipment (net of accumulated depreciation)		7.00
Other long-term assets		45.00
Total assets		$66.65
Liabilities		
Current portion of bonds payable	$ 1.00	
Other current liabilities	4.00	
Bonds payable—long term	6.00	
Other long-term liabilities	12.00	
Total liabilities		$23.00
Stockholders' Equity		
Preferred stock	$ 1.00	
Additional paid-in capital on preferred stock	2.00	
Common stock	4.00	
Additional paid-in capital on common stock	16.00	
Retained earnings	20.65	
Total stockholders' equity		43.65
Total liabilities and stockholders' equity		$66.65

*Cash increase by $8.0 bond issuance – $1.5 loan payment + 0.15 tax saving (0.5 interest × 30%).

GRIFFIN INC.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2016
(IN MILLIONS)

Revenues		$50.00
Expenses:		
Depreciation	$ 4.20	
Interest on bonds payable	0.50	
Other expenses	27.90	
Income tax (30% rate)	5.22	
Total expenses		37.82
Net income		$12.18

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Alternative B. If Griffin issued preferred stock and purchased the asset, the transactions would be as follows. (*Note:* This assumes that the transaction to purchase the asset and to depreciate the asset were recorded under either alternative.)

Journal Entry Analysis			
Jan. 1	Cash	8	
	Preferred Stock		2
	Additional Paid-In Capital—Preferred		6
	To record issuance of stock.		

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash 8				Preferred Stock 2					
				Additional Paid-In Capital—Preferred 6					

Journal Entry Analysis			
Dec. 31	Retained Earnings	0.2*	
	Cash (200,000 × $10 × 10%)		0.2
	To record the dividend paid.		

*The above entry records the dividend on the additional 200,000 shares of stock issued. The total number of shares outstanding is 300,000.

Balance Sheet					Income Statement				
ASSETS	=	LIABILITIES	+	STOCKHOLDERS' EQUITY	REVENUES	–	EXPENSES	=	NET INCOME
Cash (0.2)				Retained Earnings (0.2)					

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GRIFFIN INC.
BALANCE SHEET
DECEMBER 31, 2016
(IN MILLIONS)

Assets		
Cash		$ 7.6
Other current assets		6.4
Equipment (net of accumulated depreciation)		7.0
Other long-term assets		45.0
Total assets		$66.0
Liabilities		
Other current liabilities	$ 4.0	
Other long-term liabilities	12.0	
Total liabilities		$16.0
Stockholders' Equity		
Preferred stock	$ 3.0	
Additional paid-in capital on preferred stock	8.0	
Common stock	4.0	
Additional paid-in capital on common stock	16.0	
Retained earnings	19.0	
Total stockholders' equity		50.0
Total liabilities and stockholders' equity		$66.0

GRIFFIN INC.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2016
(IN MILLIONS)

Revenues		$50.00
Expenses:		
Depreciation	$ 4.20	
Other expenses	27.90	
Income tax (30% rate)	5.37	
Total expenses		37.47
Net Income		$12.53

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