

CAPITAL STOCK AND EQUITY

**** PROBLEMS IN THIS MODULE INCLUDE TOPICS INCLUDED IN THE DIVIDENDS MODULE ****

Key Topics to Know

Characteristics of a corporation

- Limited liability for owners
- Unlimited life
- Separate existence from the owners
- Files and pays its own taxes
- Operates as a legal person: may enter into contracts, sue and be sued, etc.
- Disadvantage is that dividends paid to owners are taxed twice (once at the corporate level before being paid and again as income to the owner recipient)

Capital Stock

- Capital stock is a generic term referring to all forms of stock.
- 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)
- 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
- Stock may have a par value, an arbitrary value assigned by the corporation.
- Stock may be no-par with or without a stated value (which is just like par value)

Treasury Stock

- Treasury stock is stock issued and subsequently repurchased by a corporation.

Stock Splits

- Stock splits change the number of shares and the par or stated value to adjust the market price of the stock and manage the number of shares outstanding.
- Stock splits do not change the balance in any equity account and do not require a journal entry

Problems

Problem #1 - Journalizing Stock Transactions

C Company reported the following transactions during the year:

- a) Issued for cash 20,000 shares of \$10 par common stock at \$20 per share.
- b) Reacquired 2,000 shares of its common stock at \$16 per share.
- c) Sold 500 of the reacquired shares for \$12 per share.
- d) Sold the remaining 1,500 shares at \$21 per share.
- e) Declared a \$1 per share cash dividend.
- f) Declared a 5% stock dividend when the market price of the common stock was \$30 per share.
- g) Paid the cash dividend.
- h) Issued the stock certificates from the stock dividend in (f)
- i) Declared a 2 for 1 stock split.

Required: Journalize the transactions.

Problem #2 - Entries for issuing par stock

On June 1, W Company issued for cash 10,000 shares of \$20 par common stock at \$24. On July 1, it issued for cash 5,000 shares of \$ 10 par preferred stock at \$14.

- Required:
- a) Journalize the entries for the issuance of stock
 - b) What is the total amount invested (total paid-in capital) by stockholders as of July 1.

Problem #3 - Treasury Stock transactions

On June 1 of the current year, R Company reacquired 2,000 shares of its common stock at \$32 per share. On July 15, they sold 500 of the reacquired shares at \$41 per share. The remaining 1,500 shares were sold at \$30 per share on November 12.

- Required:
- a) Journalize the transactions of June 1, July 15, and November 12.
 - b) What is the balance of Paid-in Capital from Sale of Treasury Stock on December 31 of the current year?

Problem #4 - Effect of stock split

S Company, which had 10,000 shares of common stock outstanding, declared a 3 for 1 stock split.

- Required:
- a) What will be the number of shares outstanding after the split?
 - b) If the common stock had a market value of \$90 per share before the split what would be an approximate market price per share after the split?

Problem #5 - Stockholders' Equity section of a balance sheet

The following accounts and their balances appear in the ledger of D Company which sells boats and accessories, on December 31, the end of the current fiscal year:

Common Stock \$10 par	\$750,000
Paid-in Capital in Excess of Par-Common Stock	150,000
Paid-in Capital in Excess of Par-Preferred Stock	50,000
Paid-in Capital from Sale of Treasury Stock-Common	14,000
Preferred \$5 Stock, \$100 par	500,000
Retained Earnings	617,000
Treasury Stock-Common	18,000

There are 2,000 shares of common stock held as treasury stock; 250,000 of common stock and 20,000 shares of preferred stock are authorized.

- Required: Complete the Stockholders' Equity section of the balance sheet as of December 31 using the format shown below.

Stockholders' Equity

Capital Stock:

Preferred \$____ stock, \$____ par
 (____ shares authorized, ____ shares issued) _____
 Common stock, \$____ par
 (____ shares authorized, ____ shares issued) _____
 Total Capital Stock _____

Additional Paid-In Capital:

Excess of issue price over par – preferred stock _____
 Excess of issue price over par – common stock _____
 Total Paid-In Capital _____

Retained earnings

Less: treasury common stock (____ shares at cost) _____
 Total stockholder' equity _____

Multiple Choice Questions

1. The entry to record the issuance of 2,000 shares of \$10 par-value common stock for \$14 a share consists of a debit to Cash for \$28,000 and a credit to Common Stock for
 - a) \$28,000
 - b) \$20,000 and a credit to Gain on Sale of Common Stock for \$8,000
 - c) \$20,000 and a credit to Treasury Stock for \$8,000
 - d) \$20,000 and a credit to Paid-in Capital in Excess of Par Value—Common Stock for \$8,000

2. The entry to record the issuance of 500 shares of \$10 par-value common stock for \$14 a share consists of a debit to Cash for \$7,000 and a credit to Common Stock for
 - a) \$5,000 and a credit to Treasury Stock for \$2,000.
 - b) \$5,000 and a credit to Paid-in Capital in Excess of Par Value—Common Stock for \$2,000.
 - c) \$5,000 and a credit to Gain on Sale of Common Stock for \$2,000.
 - d) \$7,000.

3. The Paid-in Capital in Excess of Par Value—Preferred Stock account would be shown in the
 - a) Assets section of the balance sheet.
 - b) Stockholders' Equity section of the balance sheet.
 - c) Revenue section of the income statement.
 - d) Expense section of the income statement.

4. The Treasury Stock account is shown on the balance sheet as
 - a) an asset.
 - b) an addition to the Common Stock and Preferred Stock accounts in the Stockholders' Equity section.
 - c) a deduction from the Retained Earnings in the Stockholders' Equity section.
 - d) a deduction from the sum of all other items in the Stockholders' Equity section.

5. When a corporation reacquires its own shares of stock, the Treasury Stock account is usually debited for
 - a) par value of the shares reacquired.
 - b) the price paid to reacquire the shares.
 - c) the original issue price of the shares.
 - d) the current market value of the shares.

6. Treasury stock is
 - a) stock previously paid for in full by a stockholder, then repurchased by the issuing corporation.
 - b) donated by stockholders.
 - c) always preferred stock.
 - d) categorized under Paid-in Capital on the balance sheet and added to preferred and common stock.

7. Preferred stock which confers rights to prior periods' unpaid dividends even if they were not declared is called:
 - a) Noncumulative preferred stock.
 - b) Participating preferred stock.
 - c) Convertible preferred stock.
 - d) Cumulative preferred stock.

8. Ultimate Sportswear has \$100,000 of 8% noncumulative, nonparticipating, preferred stock outstanding. Ultimate Sportswear also has \$500,000 of common stock outstanding. In the company's first year of operation, no dividends were paid. During the second year, the company paid cash dividends of \$30,000. This dividend should be distributed as follows:
 - a) \$16,000 preferred; \$14,000 common.
 - b) \$7,500 preferred; \$22,500 common.
 - c) \$8,000 preferred; \$22,000 common.
 - d) \$0 preferred; \$30,000 common.

9. Alto Company issued 7% preferred stock with a \$100 par value. This means that:
 - a) Preferred shareholders have a guaranteed dividend.
 - b) The amount of the potential dividend is \$7 per year per preferred share.
 - c) Preferred shareholders are entitled to 7% of the annual income.
 - d) The market price per share will approximate \$100 per share.

10. On September 1, Ziegler Corporation had 50,000 shares of \$5 par value common stock, and \$1,500,000 of retained earnings. On that date, when the market price of the stock is \$15 per share, the corporation issues a 2-for-1 stock split. The general journal entry to record this transaction is:
- a) No entry is made for this transaction.
 - b) Debit Retained Earnings \$750,000; credit Common Stock \$750,000.
 - c) Debit Retained Earnings \$250,000; credit Common Stock \$250,000.
 - d) Debit Retained Earnings \$250,000; credit Stock Split Payable \$250,000.
11. Which of the following decreases when a corporation purchases treasury stock?
- a) Authorized shares
 - b) Issued shares
 - c) Treasury shares
 - d) Outstanding shares
12. S Company 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
13. S Company issued 100 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) credit to Cash for \$1,000
 - b) credit to Paid-in-Capital in Excess of Par for \$1,000
 - c) credit to Common Stock for \$1,000
 - d) debit to Paid-in-Capital in Excess of Par for \$1,000
14. 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

15. 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

Solutions to Problems

Problem #1 - Journalizing Stock Transactions

a)	Cash	400,000	
	Common stock		200,000
	PIC in excess of par		200,000
b)	Treasury stock	32,000	
	Cash		32,000
c)	Cash	6,000	
	Retained Earnings	2,000	
	Treasury stock		8,000
d)	Cash	31,500	
	PIC-treasury stock		7,500
	Treasury stock		24,000
e)	Cash dividends	20,000	
	Cash dividends payable		20,000
f)	Stock dividends	30,000	
	Stock dividends distributable		10,000
	PIC in excess of par-common		20,000
g)	Cash dividends payable	20,000	
	Cash		20,000
h)	Stock dividends distributable	10,000	
	Common stock		10,000
i)	No entries are required for a stock split. Shares increase to 40,000 and par decreases to \$5 per share.		

Problem #2 - Entries for issuing par stock

- | | | | |
|--|---------|---------|--|
| a) June 1: | | | |
| Cash | 240,000 | | |
| Common stock | | 200,000 | |
| PIC in excess of par-common | | 40,000 | |
| July 1: | | | |
| Cash | 70,000 | | |
| Preferred stock | | 50,000 | |
| PIC in excess of par-preferred | | 20,000 | |
| b) Total amount invested by all stockholders as of July 1: | | | |
| \$310,000 = \$240,000 + \$70,000 | | | |

Problem #3 - Treasury Stock transactions

- | | | | |
|------------------------------|--------|--------|--------|
| a) June 1: | | | |
| Treasury stock | 64,000 | | |
| Cash | | | 64,000 |
| July 15: | | | |
| Cash | 20,500 | | |
| Treasury stock | | 16,000 | |
| PIC-treasury stock | | 4,500 | |
| Nov 12: | | | |
| Cash | 45,000 | | |
| PIC-treasury stock | 3,000 | | |
| Treasury stock | | | 48,000 |
| b) Credit balance of \$1,500 | | | |

Problem #4 - Effect of stock split

- a) 30,000 shares
- b) \$30 per share

Problem #5 - Stockholders' Equity section of a balance sheet

Paid-in capital:		
Preferred \$5 stock, \$100 par (20,000 shares authorized, 5,000 shares issued)	\$500,000	
Excess of issue price over par	<u>50,000</u>	\$ 550,000
Common stock, \$10 par (250,000 shares authorized, 75,000 shares issued)	750,000	
Excess of issue price over par	<u>150,000</u>	900,000
From sales of treasury stock		<u>14,000</u>
Total paid-in capital		\$1,464,000
Retained earnings		<u>617,000</u>
Total		\$2,081,000
Deduct treasury common stock (2,000 shares at cost)	<u>18,000</u>	
Total stockholder' equity		\$2,063,000

Solutions to Multiple Choice Questions

- | | |
|-----|---|
| 1. | D |
| 2. | B |
| 3. | B |
| 4. | D |
| 5. | B |
| 6. | A |
| 7. | D |
| 8. | C |
| 9. | B |
| 10. | A |
| 11. | D |
| 12. | A |
| 13. | C |
| 14. | B |
| 15. | B |