

DIVIDENDS

Key Topics to Know

Dividends

- Dividends are paid on common stock and preferred stock.
- The dividend process has three key dates:
 - Date of Declaration: when the company announces that a dividend will be paid
 - Date of Record: when the company determines who owns the stock and therefore who will receive the dividend payment
 - Date of Payment: when the company pays the dividend to the shareholders

Cash Dividends

- Cash dividends are paid in cash.
- Cash dividends per share are calculated by dividing the number of shares by the amount of the dividend declared per share.

Stock Dividends

- Stock dividends are paid in shares of stock.
- Stock dividends are calculated by multiplying the number of shares outstanding by the stock dividend percentage.
- Stock dividends are categorized as large or small based on the percentage of outstanding shares to be granted.

Large Stock Dividends

- Large stock dividends are greater than 25% of the outstanding shares.
- Large stock dividends are accounted for similar to a cash dividend.
- Dollar value of a large stock dividend is calculated by multiplying the number of shares by the par value.

Small Stock Dividends

- Small stock dividends are 25% or less of the outstanding shares.
- Small stock dividends are accounted for similar to a stock split.
- Dollar value of a small stock dividend is calculated by multiplying the number of shares by the market value on the date of declaration.

Journal Entries to Record Dividends

- Journal entries are required on the date of declaration and the date of payment.
- Journal entries are not required on the date of record.
- Journal entries for both cash and stock dividends are shown in the following table

	<u>Date of Declaration</u>		<u>Date of Payment</u>	
<u>Cash</u>	Dividends	xxx	Dividends payable	xxx
	Dividends payable	xxx	Cash	xxx
<u>Small Stock</u>	Dividends (<i>shares x market \$</i>)	xxx	Stock dividend distributable	xxx
	Stock dividend distributable (<i>shares x par \$</i>)	xxx	Common stock	xxx
	Paid-in capital in excess of par	xxx		
<u>Large Stock</u>	Dividends (<i>shares x par \$</i>)	xxx	Stock dividend distributable	xxx
	Stock dividend distributable	xxx	Common stock	xxx

Cumulative Preferred Stock Dividends

- Preferred stock may be cumulative or non-cumulative with respect to dividends.
- Cumulative means that any dividends not declared in a year must be declared in future years before dividends can be declared for common stock.
- Non-cumulative means that any dividends not declared in a year can never be declared in future years.
- Dividends owed but not declared are called dividends in arrears. They are not a liability for the company as declaration is still at the discretion of the company.

Problems

Problem #1 - Dividends per share

Slick, Inc. has stock outstanding as follows: 10,000 shares of \$8 (8%) nonparticipating, noncumulative preferred stock of \$100 par, and 50,000 shares of \$25 par common. During the third year of operation, the corporation paid dividends of \$167,500.

Required: Calculate the dividends per share for each class of stock.

Problem #2 - Entries for cash dividend

On November 15, the board of directors of Parker Corporation declared a cash dividend of 1.00 per share on the 50,000 shares common stock outstanding to stockholders of record on November 30, payable on December 15.

Required: Journalize the necessary entries to record the declaration and payment of the dividend.

Problem #3 - Entries for stock dividend

The board of directors of Home Value Inc., a small chain of home centers, declared a 5% stock dividend when the market price of the common stock was \$ 40 per share. Prior to the stock dividend, the following account balances appear on the balance sheet:

Common Stock, \$25 par, 10,000 shares	\$250,000
Paid-in Capital in excess of par-Common Stock	50,000
Retained Earnings	<u>150,000</u>
Total Stockholders' Equity	\$450,000

Required:

1. Journalize the entries to record the declaration of the dividend and the issuance of the stock certificates.
2. What is the total stockholder's equity at year end after the issuance of the stock dividend?

Problem #4 - Cash dividends paid

The board of directors declared cash dividends totaling \$85,000 during the current year. The comparative balance sheet indicates dividends payable of \$15,000 at the beginning of the year and \$25,000 at the end of the year.

Required: What was the amount of cash dividends paid to stockholders during the year?

Problem #5 - Cumulative dividends

T Company has 10,000 shares of \$5 par value, 4% cumulative and nonparticipating preferred stock and 100,000 shares of \$10 par value common stock outstanding. The company paid total cash dividends of \$1,000 in its first year of operation.

Required: Determine the cash dividend that must be paid to preferred stockholders in the second year before any dividend is paid to common stockholders.

Multiple Choice Questions

1. A Company has 4,000 shares of 5 percent, \$100 par-value preferred stock and 50,000 shares of \$2 par-value common stock outstanding. If the board of the directors decides to distribute dividends totaling \$100,000, the common stockholders will receive a dividend of
 - a) \$1.00 a share
 - b) \$1.60 a share
 - c) \$2.00 a share
 - d) \$2.40 a share

2. B Company has 10,000 shares of 6 percent, \$50 par-value cumulative preferred stock and 50,000 shares of \$4 par-value common stock outstanding. Last year, no dividends were paid. This year, the company decided to pay a dividend of \$80,000. The common stockholders will receive a dividend of
 - a) \$0.40 a share
 - b) \$1.00 a share
 - c) \$1.60 a share
 - d) \$2.00 a share

3. A liability for the payment of cash dividends is recorded
 - a) on the date the board of directors publicly declares its intention to pay the dividends.
 - b) only when cumulative preferred dividends are passed over (not paid) and are in arrears.
 - c) at the end of any year during which common stock dividends were not paid.
 - d) at the end of every year that the corporation makes a profit.

4. N Company reported a net income of \$120,000 for its fiscal year and declared and paid cash dividends of \$60,000. A stock dividend recorded at \$40,000 was also distributed during the year. If the ending balance of the Retained Earnings account was \$200,000, the beginning balance is
 - a) \$160,000.
 - b) \$180,000.
 - c) \$200,000.
 - d) \$220,000.

5. E Company had 10,000 shares of \$10 par value common stock outstanding when the board of directors declared a stock dividend of 3,000 shares. At the time of the stock dividend, the market value per share was \$12. The entry to record this dividend is:
- a) Debit Retained Earnings \$36,000; credit Common Stock Dividend Distributable \$36,000.
 - b) Debit Retained Earnings \$36,000; credit Common Stock Dividend Distributable \$30,000; credit Paid-In Capital in Excess of Par Value, Common Stock \$6,000.
 - c) Debit Retained Earnings \$30,000; credit Common Stock Dividend Distributable \$30,000.
 - d) Debit Common Stock Dividend Distributable \$36,000; credit Retained Earnings \$36,000.
6. G Company had 50,000 shares of \$20 par value common stock outstanding on July 1. Later that day the board of directors declared a 10% stock dividend when the market value of each share was \$27. The entry to record this dividend is:
- a) Debit Retained Earnings \$135,000; credit Common Stock Dividend Distributable \$135,000.
 - b) Debit Retained Earnings \$135,000; credit Cash \$135,000.
 - c) Debit Retained Earnings \$100,000; credit Common Stock Dividend Distributable \$100,000.
 - d) Debit Retained Earnings \$135,000; credit Common Stock Dividend Distributable \$100,000; credit Paid-In Capital in Excess of Par Value, Common Stock \$35,000.
7. A stock dividend is recorded with a transfer from:
- a) Retained earnings to contributed capital.
 - b) Retained earnings to assets.
 - c) Contributed capital to retained earnings.
 - d) Assets to contributed capital.
8. Which of the following is true of a stock dividend?
- a) The decision to declare a stock dividend resides with the shareholders.
 - b) Does not affect total equity, but transfer amounts between the components of equity.
 - c) It is a liability on the balance sheet.
 - d) Reduces a corporation's assets and stockholders' equity.

9. Y Company's board of directors votes to declare a cash dividend of \$1.00 per share on its 12,000 common shares outstanding. The journal entry to record the declaration of the cash dividend is:
- a) Debit Dividend Expense \$12,000; credit Cash \$12,000.
 - b) Debit Dividend Expense \$12,000; credit Common Dividend Payable \$12,000.
 - c) Debit Dividends \$12,000; credit Common Dividend Payable \$12,000.
 - d) Debit Common Dividend Payable \$12,000; credit Retained Earnings \$12,000.
10. A liability for stock dividends exists:
- a) On the date of declaration.
 - b) On the date of record.
 - c) On the date of payment.
 - d) No liability is recorded for stock dividends.
11. G Company has \$200,000 of 6% noncumulative, nonparticipating, preferred stock outstanding. G Company also has \$600,000 of common stock outstanding. During its first year, the company paid cash dividends of \$30,000. This dividend should be distributed as follows:
- a) \$12,000 preferred; \$18,000 common.
 - b) \$30,000 preferred; \$0 common.
 - c) \$6,000 preferred; \$24,000 common.
 - d) \$15,000 preferred; \$15,000 common.
12. A Company issued 7% preferred stock with a \$100 par value. This means that:
- a) The amount of the potential dividend is \$7 per year per preferred share.
 - b) Preferred shareholders are entitled to 7% of the annual income.
 - c) Preferred shareholders have a guaranteed dividend.
 - d) The market price per share will approximate \$100 per share.
13. The annual per share dividend requirement of a 6%, \$80 par value preferred stock that was issued for \$85 is:
- a) \$4.80
 - b) \$5.10
 - c) \$6.00
 - d) \$8.00

14. H Company's outstanding stock consists of 7,000 shares of cumulative 5% preferred stock with a \$10 par value and 3,000 shares of common stock with a \$1 par value. During the first three years of operation, the corporation declared and paid the following total cash dividends.

<u>Year</u>	<u>Dividend Declared</u>
1	\$0
2	\$6,000
3	\$32,000

The amount of dividends paid to preferred and common shareholders in 2018 is:

- a) \$3,500 preferred; \$28,500 common.
 - b) \$1,000 preferred; \$31,000 common.
 - c) \$4,500 preferred; \$27,500 common.
 - d) 8,000 preferred; \$24,000 common.
15. The issuance of a stock dividend will
- a) Decrease total assets.
 - b) Increase retained earnings.
 - c) Decrease paid-in capital.
 - d) Not affect total equity.

Solutions to Problems

Problem #1 - Dividends per share

Preferred Stock Dividend: \$8 per share X 10,000 shares = \$80,000

Total dividends paid \$167,500 - \$80,000 to preferred shareholders
= \$87,500 for common shareholders

Common Stock Dividend: \$87,500 / 50,000 shares = \$1.75 per share

Problem #2 - Entries for cash dividend

Nov 15:		
Cash dividends	50,000	
Dividends payable		50,000

Nov 30:
No entry required

Dec 15:		
Dividends payable	50,000	
Cash		50,000

Problem #3 - Entries for stock dividend

a)		
Stock dividends	20,000	
Stock dividends distributable		12,500
Paid-in capital in excess of par-common stock		7,500
Stock dividends distributable	12,500	
Common stock		12,500

b) Total Stockholders' Equity after the stock dividend is \$450,000 (the same as it was before the stock split)

Problem #4 - Cash dividends paid

Cash dividends declared	\$85,000
Plus dividends payable at beginning of year	15,000
Less Dividends payable at end of year	<u>(25,000)</u>
Cash dividends paid during year	\$75,000

Problem #5 – Cumulative dividends

Preferred stock dividend: $10,000 \text{ shares} * \$5/\text{share} * 4\% = \$2,000$

Prior year: Dividend Paid = \$1,000; \$1,000 in arrears

Current year: \$1,000 in arrears + \$2,000 current dividend = \$3,000

Preferred dividends per year:

Shares	10,000
Par value	\$5
Dividend rate	<u>4%</u>
	\$2,000

Prior year dividends in arrears:

Owed	\$2,000
Paid	<u>1,000</u>
In arrears	1,000

Current year:

In arrears	\$1,000
For current year	<u>2,000</u>
Cash dividends paid during year	\$3,000

Solutions to Multiple Choice Questions

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