Chapter 11

11. What is the purpose of a *stock split*?

Stockholders' equity:	
Capital stock:	
7% cumulative preferred stock, $100 par value	$ 15,000,000
Common stock, $5 par value, 5,000,000 shares authorized, 4,000,000 shares issued and outstanding	20,000,000
Additional paid-in capital:	
Common stock	44,000,000
Retained earnings	64,450,000
Total stockholders' equity	$143,450,000

From this information, compute answers to the following questions:

a. How many shares of preferred stock have been issued?

b. What is the total amount of the annual dividends to which preferred stockholders are entitled?

c. What was the average issuance price per share of common stock?

d. What is the amount of legal capital and the amount of total paid-in capital?

e. What is the book value per share of common stock, assuming no dividends in arrears?

f. Is it possible to determine the fair market value per share of common stock from the stockholders' equity section above? Explain.

LO11-5, LO11-6

EXERCISE 11.6

Preferred Stock Alternatives

Easy Moncy, Inc., has the following capital structure:

Preferred stock—$25 par value, 10,000 shares authorized, 7,000 shares issued and outstanding	$ 175,000
Common stock—$10 par value, 100,000 shares authorized, 80,000 shares issued and outstanding	800,000
Total paid-in capital	$ 975,000
Retained earnings	550,000
Total stockholders' equity	$1,525,000

The number of issued and outstanding shares of both preferred and common stock have been the same for the last two years. Dividends on preferred stock are 8 percent of par value and have been paid each year the stock was outstanding except for the immediate past year. In the current year, management declares a total dividend of $60,000. Indicate the amount that will be paid to both preferred and common stockholders assuming (**a**) the preferred stock is not cumulative and (**b**) the preferred stock is cumulative.

LO11-4, LO11-7

EXERCISE 11.7

Reporting the Effects of Transactions

Three events pertaining to Lean Machine Co. are described below.

a. Issued common stock for cash.

b. The market value of the corporation's stock increased.

c. Declared and paid a cash dividend to stockholders.

Indicate the immediate effects of the events on the financial measurements in the four columnar headings listed below. Use the code letters **I** for increase, **D** for decrease, and **NE** for no effect.

Event	Current Assets	Stockholders' Equity	Net Income	Net Cash Flow (from any source)
a				

LO11-4 through LO11-7

EXERCISE 11.8

Computing Book Value

The following information is necessary to compute the net assets (stockholders' equity) and book value per share of common stock for Rothchild Corporation:

8% cumulative preferred stock, $100 par	$200,000
Common stock, $5 par, authorized 100,000 shares, issued 60,000 shares	300,000
Additional paid-in capital	452,800
Deficit (negative amount in retained earnings)	146,800
Dividends in arrears on preferred stock, 1 full year	16,000

a. Compute the amount of net assets (stockholders' equity).

b. Compute the book value per share of common stock.

c. Is book value per share (answer to part **b**) the amount common stockholders should expect to receive if Rothchild Corporation were to cease operations and liquidate? Explain.

LO11-9

EXERCISE 11.9

Recording Treasury Stock Transactions

Johnston, Inc., engaged in the following transactions involving treasury stock:

Feb. 10 Purchased for cash 17,000 shares of treasury stock at a price of $25 per share.

June 4 Reissued 6,000 shares of treasury stock at a price of $33 per share.

Dec. 22 Reissued 4,000 shares of treasury stock at a price of $22 per share.

a. Prepare general journal entries to record these transactions.

b. Compute the amount of retained earnings that should be restricted because of the treasury stock still owned at December 31.

c. Does a restriction on retained earnings affect the dollar amount of retained earnings reported in the balance sheet? Explain briefly.

LO11-8

EXERCISE 11.10

Effects of a Stock Split

The common stock of Fido Corporation was trading at $45 per share on October 15, 2014. A year later, on October 15, 2015, it was trading at $80 per share. On this date, Fido's board of directors decided to split the company's common stock.

a. If the company decides on a 2-for-1 split, at what price would you expect the stock to trade immediately after the split goes into effect?

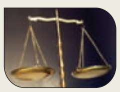
b. If the company decides on a 4-for-1 split, at what price would you expect the stock to trade immediately after the split goes into effect?

c. Why do you think Fido's board of directors decided to split the company's stock?

LO11-9

EXERCISE 11.11

Treasury Stock Presentation



Ashton Company was experiencing financial difficulty late in the current year. The company's income was sluggish, and the market price of its common stock was tumbling. On December 21, the company began to buy back shares of its own stock in an attempt to boost its market price per share and to improve its earnings per share.

a. Is it unethical for a company to purchase shares of its own stock to improve measures of financial performance? Defend your answer.

b. Assume that the company classified the shares of treasury stock as short-term investments in the current asset section of its balance sheet. Is this appropriate? Explain.

LO11-4

EXERCISE 11.12

Authorized Stock

The 2012 balance sheet for **Kimberly-Clark Corporation** indicates that the company has 1.2 billion shares of common stock authorized, of which approximately 428.6 million have been issued. In addition, the company holds 39.3 million shares in treasury.

a. How many additional shares of common stock could **Kimberly-Clark** sell?

b. How are the shares that have not yet been issued included in the company's balance sheet? Do they represent an asset of the company?

LO11-4, LO11-9

EXERCISE 11.13

Accounting Terminology

Minor Company, is authorized to sell 1,200,000 shares of $10 par value common stock and 60,000 shares of $100 par value 6 percent preferred stock. As of the end of the current year, the company has actually sold 550,000 shares of common stock at $12 per share and 40,000 shares of preferred stock at $110 per share. In addition, of the 550,000 shares of common that have been sold, 25,000 shares have been repurchased at $23 per share and are currently being held in treasury to be used to meet the future requirements of a stock option plan that the company intends to implement.

a. Prepare the general journal entries required to record all of the above transactions.

b. Prepare the stockholders' equity section of Minor's balance sheet to reflect the transactions you have recorded.

LO11-4, LO11-5, LO11-7, LO11-9

PROBLEM 11.8A

Reporting Stockholders' Equity with Treasury Stock

Early in 2013, Feller Corporation was formed with authorization to issue 50,000 shares of $1 par value common stock. All shares were issued at a price of $8 per share. The corporation reported net income of $95,000 in 2013, $27,500 in 2014, and $75,700 in 2015. No dividends were declared in any of these three years.

In 2014, the company purchased its own shares for $35,000 in the open market. In 2015, it reissued all of its treasury stock for $40,000.

Instructions

a. Prepare the stockholders' equity section of the balance sheet at December 31, 2015. Include a supporting schedule showing your computation of retained earnings at the balance sheet date. (Hint: Income increases retained earnings.)

b. As of December 31, compute the company's book value per share of common stock.

c. Explain how the treasury stock transactions in 2014 and 2015 were reported in the company's statement of cash flows.

LO11-4, LO11-5, LO11-7 through LO11-9

PROBLEM 11.9A

Reporting Stockholders' Equity with Treasury Stock and Stock Splits

Early in 2011, Herndon Industries was formed with authorization to issue 250,000 shares of $10 par value common stock and 30,000 shares of $100 par value cumulative preferred stock. During 2011, all the preferred stock was issued at par, and 120,000 shares of common stock were sold for $16 per share. The preferred stock is entitled to a dividend equal to 10 percent of its par value before any dividends are paid on the common stock.

During its first five years of business (2011 through 2015), the company earned income totaling $3,700,000 and paid dividends of 50 cents per share each year on the common stock outstanding.

On January 2, 2013, the company purchased 20,000 shares of its own common stock in the open market for $400,000. On January 2, 2015, it reissued 10,000 shares of this treasury stock for $250,000. The remaining 10,000 were still held in treasury at December 31, 2015.

Instructions

a. Prepare the stockholders' equity section of the balance sheet for Herndon Industries at December 31, 2015. Include supporting schedules showing (1) your computation of any paid-in capital on treasury stock and (2) retained earnings at the balance sheet date. (Hint: Income increases retained earnings, whereas dividends reduce retained earnings. Dividends are not paid on shares of stock held in treasury.)

b. As of December 31, compute Herndon's book value per share of common stock. (Hint: Book value per share is computed only on the shares of stock outstanding.)

c. At December 31, 2015, shares of the company's common stock were trading at $30. Explain what would have happened to the market price per share had the company split its stock 3-for-1 at this date. Also explain what would have happened to the par value of the common stock and to the number of common shares outstanding.

Problem Set B

connect ACCOUNTING

LO11-4 through LO11-6

PROBLEM 11.1B

Stockholders' Equity in a Balance Sheet

Early in 2012, Searfoss, Inc., was organized with authorization to issue 2,000 shares of $100 par value preferred stock and 300,000 shares of $1 par value common stock. Five hundred shares of the preferred stock were issued at par, and 80,000 shares of common stock were sold at $15 per share. The preferred stock pays a 10 percent cumulative dividend.

During the first four years of operations (2012 through 2015), the corporation earned a total of $1,950,000 and paid dividends of 40 cents per share in each year on its outstanding common stock.

Instructions

a. Prepare the stockholders' equity section of the balance sheet at December 31, 2015. Include a supporting schedule showing your computation of the amount of retained earnings reported. Assume the call price of preferred stock is $110 per share as of December 31, 2015. (Hint: Income increases retained earnings, whereas dividends decrease retained earnings.)

b. Are there any dividends in arrears on the company's preferred stock at December 31, 2015? Explain your answer.

c. Assume that interest rates increase steadily from 2012 through 2015. Would you expect the market price of the company's preferred stock to be higher or lower than its call price of $110 at December 21, 2015? (The call price is the amount the company must pay to repurchase the shares from the stockholders.)