CHAPTER 14

Corporations: Dividends, Retained Earnings, and Income Reporting

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Prepare the entries for cash dividends and stock dividends.	1, 2, 3, 4, 5, 6, 7, 8	1, 2, 3	1, 2, 3, 4, 5, 6, 7	1A, 2A, 3A, 4A, 5A	1B, 2B, 3B, 4B, 5B
2. Identify the items reported in a retained earnings statement.	9, 10, 11, 12, 13, 14	4, 5	6, 8, 9	2A, 3A, 4A	2B, 3B, 4B
3. Prepare and analyze a comprehensive stockholders' equity section.	14, 15	6, 7	5, 6, 10, 11, 13, 15, 16	1A, 2A, 3A, 4A, 5A	1B, 2B, 3B, 4B, 5B
4. Describe the form and content of corporation income statements.	15, 16	8	12, 13, 14		
5. Compute earnings per share.	17	9, 10	12, 14, 15, 16, 17	3A	3B

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare dividend entries and stockholders' equity section.	Simple	30–40
2A	Journalize and post transactions; prepare retained earnings statement and stockholders' equity section.	Moderate	30–40
3A	Prepare retained earnings statement and stockholders' equity section, and compute earnings per share.	Moderate	30–40
4A	Prepare the stockholders' equity section, reflecting dividends and stock split.	Moderate	20–30
5A	Prepare the stockholders' equity section, reflecting various events.	Moderate	20–30
1B	Prepare dividend entries and stockholders' equity section.	Simple	30–40
2B	Journalize and post transactions; prepare retained earnings statement and stockholders' equity section.	Moderate	30–40
3B	Prepare retained earnings statement and stockholders' equity section, and compute earnings per share.	Moderate	30–40
4B	Prepare the stockholders' equity section, reflecting dividends and stock split.	Moderate	20–30
5B	Prepare the stockholders' equity section, reflecting various events.	Moderate	20–30

BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Prepare the entries for cash dividends and stock dividends.		Q14-1 Q14-2 Q14-3 Q14-5 Q14-6 Q14-7 Q14-8	Q14-4 BE14-1 BE14-2 BE14-3 E14-1 E14-2 E14-3 E14-4 E14-5 P14-1A P14-2A P14-3A P14-4A P14-5A P14-1B P14-2B P14-3B P14-4B P14-5B	E14-6 E14-7		
2. Identify the items reported in a retained earnings statement.	Q14-12	Q14-9 Q14-11 Q14-13 Q14-14	Q14-10 BE14-4 BE14-5 E14-8 E14-9 P14-2A P14-3A P14-4A P14-2B P14-3B P14-4B	E14-6		
3. Prepare and analyze a comprehensive stockholders' equity section.		Q14-14 Q14-15	BE14-6 BE14-7 E14-5 E14-10 E14-11 E14-13 E14-15 E14-16 P14-1A P14-2A P14-3A P14-4A P14-5A P14-1B P14-2B P14-3B P14-4B P14-5B	E14-6		
4. Describe the form and content of corporation income statements.		Q14-15 Q14-16	BE14-8 E14-12 E14-13 E14-14			
5. Compute earnings per share.		Q14-17	BE14-9 BE14-10 E14-12 E14-14 E14-15 E14-16 E14-17 P14-3A P14-3B			
Broadening Your Perspective			Financial Reporting Decision Making Across the Organization	Communication Comparative Analysis Exploring the Web		All About You Ethics Case

ANSWERS TO QUESTIONS

1. (a) A dividend is a distribution of cash or stock by a corporation to its stockholders on a pro rata (proportional) basis.
(b) Disagree. Dividends may take four forms: cash, property, scrip (promissory note to pay cash), or stock.

2. Sue DeVine is not correct. Adequate cash is only one of the conditions. In order for a cash dividend to occur, a corporation must also have retained earnings and the dividend must be declared by the board of directors.

3. (a) The three dates are:
Declaration date is the date when the board of directors formally declares the cash dividend and announces it to stockholders. The declaration commits the corporation to a binding legal obligation that cannot be rescinded.
Record date is the date that marks the time when ownership of the outstanding shares is determined from the stockholder records maintained by the corporation. The purpose of this date is to identify the persons or entities that will receive the dividend.
Payment date is the date on which the dividend checks are mailed to the stockholders.
(b) The accounting entries and their dates are:
Declaration date—Debit Retained Earnings and Credit Dividends Payable.
No entry is made on the record date.
Payment date—Debit Dividends Payable and Credit Cash.

4. The allocation of the cash dividend is as follows:

Total dividend		$45,000
Allocated to preferred stock		
Dividends in arrears—one year	$10,000	
Current year dividend	10,000	20,000
Remainder allocated to common stock		$25,000

5. A cash dividend decreases assets, retained earnings, and total stockholders' equity. A stock dividend decreases retained earnings, increases paid-in capital, and has no effect on total assets and total stockholders' equity.

6. A corporation generally issues stock dividends for one of the following reasons:
(1) To satisfy stockholders' dividend expectations without spending cash.
(2) To increase the marketability of its stock by increasing the number of shares outstanding and thereby decreasing the market price per share. Decreasing the market price of the stock makes the shares easier to purchase for smaller investors.
(3) To emphasize that a portion of stockholders' equity that had been reported as retained earnings has been permanently reinvested in the business and therefore is unavailable for cash dividends.

7. In a stock split, the number of shares is increased in the same proportion that par value is decreased. Thus, in the Meenen Corporation the number of shares will increase to 60,000 = (30,000 X 2) and the par value will decrease to $5 = ($10 ÷ 2). The effect of a split on market value is generally inversely proportional to the size of the split. In this case, the market price would fall to approximately $60 per share ($120 ÷ 2).

8. The different effects of a stock split versus a stock dividend are:

Item	Stock Split	Stock Dividend
Total paid-in capital	No change	Increase
Total retained earnings	No change	Decrease
Total par value (common stock)	No change	Increase
Par value per share	Decrease	No Change

9. A prior period adjustment is a correction of an error in previously issued financial statements. The correction is reported in the current year's retained earnings statement as an adjustment of the beginning balance of retained earnings.

10. The understatement of depreciation in a prior year overstates the beginning retained earnings balance. The retained earnings statement presentation is:

Balance, January 1, as reported	$210,000
Correction for understatement of prior year's depreciation	(50,000)
Balance, January 1, as adjusted	$160,000

11. The purpose of a retained earnings restriction is to indicate that a portion of retained earnings is currently unavailable for dividends. Restrictions may result from the following causes: legal, contractual, or voluntary.

12. Retained earnings restrictions are generally reported in the notes to the financial statements.

13. The debits and credits to retained earnings are:

Debits	Credits
1. Net loss	1. Net income
2. Prior period adjustments for overstatement of net income	2. Prior period adjustments for understatement of net income
3. Cash and stock dividends	
4. Some disposals of treasury stock	

14. Juan is incorrect. Only the ending balance of retained earnings is reported in the stockholders' equity section.

15. Gene should be told that although many factors affect the market price of a stock at a given time, the reported net income is one of the most significant factors. When companies announce increases or decreases in net income, the market price of their stock usually increases or decreases immediately. Net income also provides an indication of the amount of dividends that a company can distribute. In addition, net income leads to a growth in retained earnings, which is often reflected in a stock's market price.

16. The unique feature of a corporation income statement is a separate section that shows income taxes or income tax expense. The presentation is as follows:

Income before income taxes	$500,000
Income tax expense	150,000
Net income	$350,000

17. Earnings per share means earnings per share of common stock. Preferred stock dividends are subtracted from net income in computing EPS in order to obtain income available to common stockholders.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 14-1

Nov. 1	Retained Earnings (80,000 X $1/share)	80,000	
	Dividends Payable		80,000
Dec. 31	Dividends Payable	80,000	
	Cash		80,000

BRIEF EXERCISE 14-2

Dec. 1	Retained Earnings (5,000 X $16)	80,000	
	Common Stock Dividends Distributable (5,000 X $10)		50,000
	Paid-in Capital in Excess of Par Value (5,000 X $6)		30,000
31	Common Stock Dividends Distributable	50,000	
	Common Stock		50,000

BRIEF EXERCISE 14-3

	Before Dividend	After Dividend
(a) Stockholders' equity		
Paid-in capital		
Common stock, $10 par	$2,000,000	$2,200,000
In excess of par value	—	80,000
Total paid-in capital	2,000,000	2,280,000
Retained earnings	500,000	220,000
Total stockholders' equity	$2,500,000	$2,500,000
(b) Outstanding shares	200,000	220,000
(c) Book value per share	$12.50	$11.36

BRIEF EXERCISE 14-4

KERNS INC.
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1	$220,000
Add: Net income	140,000
	360,000
Less: Dividends	85,000
Balance, December 31	$275,000

BRIEF EXERCISE 14-5

PERSINGER INC.
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1 as reported		$800,000
Correction for overstatement of net income in prior period (depreciation expense error)		(50,000)
Balance, January 1, as adjusted		750,000
Add: Net income		120,000
		870,000
Less: Cash dividend	$90,000	
Stock dividend	8,000	98,000
Balance, December 31		$772,000

BRIEF EXERCISE 14-6

Return on stockholders' equity ratio:

$$\$386 \div \frac{\$2,210 + \$2,510}{2} = 16.4\%$$

BRIEF EXERCISE 14-7

Return on common stockholders' equity $\dfrac{\$152,000}{(\$700,000 + \$820,000) \div 2} = 20\%$

BRIEF EXERCISE 14-8

DIXEN CORPORATION
Income Statement
For the Year Ended December 31, 2008

Sales	$450,000
Cost of goods sold	205,000
Gross profit	245,000
Operating expenses	75,000
Income from operations	170,000
Other revenues and gains	50,000
Income before income taxes	220,000
Income tax expense ($220,000 X 30%)	66,000
Net income	$154,000

BRIEF EXERCISE 14-9

Earnings per share = $1.90, or ($380,000 ÷ 200,000)

BRIEF EXERCISE 14-10

Earnings per share = $1.80, or [($380,000 – $20,000) ÷ 200,000]

SOLUTIONS TO EXERCISES

EXERCISE 14-1

(a)

June 15	Retained Earnings (120,000 X $1)	120,000	
	Dividends Payable		120,000
July 10	Dividends Payable	120,000	
	Cash		120,000
Dec. 15	Retained Earnings (122,000 X $1.20)	146,400	
	Dividends Payable		146,400

(b) In the retained earnings statement, dividends of $266,400 will be deducted. In the balance sheet, Dividends Payable of $146,400 will be reported as a current liability.

EXERCISE 14-2

(a)

	2007	2008	2009
Total dividend declaration	$6,000	$12,000	$28,000
Allocation to preferred stock	6,000	7,000	7,000
Remainder to common stock	$ 0	$ 5,000	$21,000

(b)

	2007	2008	2009
Total dividend declaration	$6,000	$12,000	$28,000
Allocation to preferred stock	6,000	10,000[1]	8,000
Remainder to common stock	$ 0	$ 2,000	$20,000

[1]Dividends in arrears for Year 1, $2,000 + current dividend for Year 2, $8,000.

(c)

Dec. 31	Retained Earnings	28,000	
	Dividends Payable		28,000

EXERCISE 14-3

(a)	Retained Earnings (21,000* X $18)	378,000	
	Common Stock Dividends Distributable (21,000 X $10)		210,000
	Paid-in Capital in Excess of Par Value (21,000 X $8)		168,000

*[($1,000,000 ÷ $10) + 40,000] X 15%.

(b)	Retained Earnings (36,000* X $20)	720,000	
	Common Stock Dividends Distributable (36,000 X $5)		180,000
	Paid-in Capital in Excess of Par Value (36,000 X $15)		540,000

*[($1,000,000 ÷ 5) + 40,000] X 15%.

EXERCISE 14-4

	Before Action	After Stock Dividend	After Stock Split
Stockholders' equity			
Paid-in capital			
Common stock	$ 300,000	$ 315,000	$ 300,000
In excess of par value	0	6,000	0
Total paid-in capital	300,000	321,000	300,000
Retained earnings	900,000	879,000	900,000
Total stockholders' equity	$1,200,000	$1,200,000	$1,200,000
Outstanding shares	30,000	31,500	60,000
Book value per share	$40.00	$38.10	$20.00

EXERCISE 14-5

(a) (1) Book value before the stock dividend was \$7.25 (\$580,000 ÷ 80,000).

(2) Book value after the stock dividend is \$6.59 (\$580,000 ÷ 88,000).

(b)

Common stock	
Balance before dividend	\$400,000
Dividend shares (8,000 X \$5)	40,000
New balance	\$440,000
Paid-in capital in excess of par value	
Balance before dividend	\$ 25,000
Excess over par of shares issued (8,000 X \$10)	80,000
New balance	\$105,000
Retained earnings	
Balance before dividend	\$155,000
Dividend (8,000 X \$15)	120,000
New balance	\$ 35,000

EXERCISE 14-6

	Paid-in Capital		
Item	Capital Stock	Additional	Retained Earnings
1.	NE	NE	D
2.	I	NE	NE
3.	NE	NE	NE
4.	I	I	D
5.	NE	NE	D
6.	NE	NE	NE
7.	NE	NE	NE
8.	I	I	NE

EXERCISE 14-7

1.	Dec. 31	Retained Earnings	50,000	
		Interest Expense		50,000
2.	31	Retained Earnings	8,000	
		Dividends Payable	10,000	
		Common Stock Dividends Distributable		10,000
		Paid-in Capital in Excess of Par Value		8,000
3.	31	Common Stock	2,000,000	
		Retained Earnings		2,000,000

EXERCISE 14-8

FELTER CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1, as reported		$550,000
Correction for overstatement of 2007 net income (depreciation error)		(40,000)
Balance, January 1, as adjusted		510,000
Add: Net income		350,000
		860,000
Less: Cash dividends	$120,000	
Stock dividends	60,000	180,000
Balance, December 31		$680,000

EXERCISE 14-9

SASHA COMPANY
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1, as reported		$310,000
Correction for understatement of 2006 net income		20,000
Balance, January 1, as adjusted		330,000
Add: Net income		285,000
		615,000
Less: Cash dividends	$100,000[1]	
Stock dividends	150,000[2]	(250,000)
Balance, December 31		$365,000

[1](200,000 X $.50/sh) [2](200,000 X .05 X $15/sh)

EXERCISE 14-10

KELLY GROUCUTT COMPANY
Balance Sheet (Partial)
December 31, 2008

Paid-in capital		
Capital stock		
Preferred stock	$125,000	
Common stock	400,000	
Total capital stock		$ 525,000
Additional paid-in capital		
In excess of par value—preferred stock	75,000	
In excess of par value—common stock	100,000	
Total additional paid-in capital		175,000
Total paid-in capital		700,000
Retained earnings		334,000*
Total paid-in capital and retained earnings		1,034,000
Less treasury stock—common		(40,000)
Total stockholder's equity		$ 994,000

*$250,000 + $140,000 – $56,000

EXERCISE 14-11

ORTIZ INC.
Balance Sheet (Partial)
December 31, 200X

Stockholders' equity		
Paid-in capital		
Capital stock		
8% Preferred stock, $5 par value, 40,000 shares authorized, 30,000 shares issued		**$ 150,000**
Common stock, no par, $1 stated value, 400,000 shares authorized, 300,000 shares issued and 290,000 outstanding	**$ 300,000**	
Common stock dividends distributable	**30,000**	**330,000**
Total capital stock		**480,000**
Additional paid-in capital		
In excess of par value— preferred stock	**344,000**	
In excess of stated value— common stock	**1,200,000**	
Total additional paid-in capital		**1,544,000**
Total paid-in capital		**2,024,000**
Retained earnings (see Note R)		**800,000**
Total paid-in capital and retained earnings		**2,824,000**
Less: Treasury stock (10,000 common shares)		**74,000**
Total stockholders' equity		**$2,750,000**

Note R: **Retained earnings is restricted for plant expansion, $100,000.**

EXERCISE 14-12

(a)

PATEL CORPORATION
Income Statement
For the Year Ended December 31, 2008

Sales		$800,000
Cost of goods sold		465,000
Gross profit		335,000
Operating expenses		110,000
Income from operations		225,000
Other revenues and gains	$92,000	
Other expenses and losses	(32,000)	60,000
Income before income taxes		285,000
Income tax expense ($285,000 X 20%)		57,000
Net income		$228,000

(b) Earnings per share = $3.96, or [($228,000 – $30,000) ÷ 50,000]

EXERCISE 14-13

(a)

MIKE SINGLETARY CORPORATION
Income Statement
For the Year Ended December 31, 2008

Net sales	$ 600,000
Cost of goods sold	360,000
Gross profit	240,000
Operating expenses	153,000
Income from operations	87,000
Interest expense	7,500
Income before income taxes	79,500
Income tax expense (30% X $79,500)	23,850
Net income	$ 55,650

(b) $\dfrac{\text{Net income – preferred dividends}}{\text{Average common stockholders' equity}} = \dfrac{\$55,650 - \$15,000}{\$200,000} = 20.3\%$

EXERCISE 14-14

Net income: $2,000,000 – $1,200,000 = $800,000;
$800,000 – (30% X $800,000) = $560,000

Preferred dividends: (50,000 X $20) X 8% = $80,000

Average common shares outstanding: 200,000

Earnings per share:

$$\frac{\$560,000 - \$80,000}{200,000} = \underline{\underline{\$2.40}}$$

EXERCISE 14-15

	2008	2007
Earnings per share	$\frac{\$290,000 - \$20,000}{100,000} = \$2.70$	$\frac{\$200,000 - \$20,000}{80,000} = \$2.25$
Return on common stockholders' equity	$\frac{\$290,000 - \$20,000}{\$1,200,000} = 22.5\%$	$\frac{\$200,000 - \$20,000}{\$900,000} = 20.0\%$

EXERCISE 14-16

	2008	2007
Earnings per share	$\frac{\$290,000 - \$20,000}{150,000} = \$1.80$	$\frac{\$248,000 - \$20,000}{180,000} = \$1.27$
Return on common stockholders' equity	$\frac{\$290,000 - \$20,000}{\$1,800,000} = 15.0\%$	$\frac{\$248,000 - \$20,000}{\$1,900,000} = 12.0\%$

EXERCISE 14-17

(a) $$\frac{\$241,000 - \$16,000}{100,000} = \$2.25$$

(b) $$\frac{\$241,000 - \$16,000}{90,000^*} = \$2.50$$

*100,000 – 10,000 = 90,000.

SOLUTIONS TO PROBLEMS

PROBLEM 14-1A

(a)

Feb.	1	Retained Earnings (60,000 X $1)	60,000	
		Dividends Payable		60,000
Mar.	1	Dividends Payable	60,000	
		Cash		60,000
Apr.	1	Memo—two-for-one stock split increases number of shares to 120,000 = (60,000 X 2) and reduces par value to $10 per share.		
July	1	Retained Earnings (12,000 X $13)	156,000	
		Common Stock Dividends Distributable (12,000 X $10)		120,000
		Paid-in Capital in Excess of Par Value (12,000 X $3)		36,000
	31	Common Stock Dividends Distributable	120,000	
		Common Stock		120,000
Dec.	1	Retained Earnings (132,000 X $.50)	66,000	
		Dividends Payable		66,000
	31	Income Summary	350,000	
		Retained Earnings		350,000

(b)

Common Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			1,200,000
Apr.	1	2 for 1 split—new par $10				
July	31				120,000	1,320,000

PROBLEM 14-1A (Continued)

Common Stock Dividends Distributable

Date		Explanation	Ref.	Debit	Credit	Balance
July	1				120,000	120,000
	31			120,000		0

Paid-in Capital in Excess of Par Value

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			200,000
July	1				36,000	236,000

Retained Earnings

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			600,000
Feb.	1	Cash dividend		60,000		540,000
July	1	Stock dividend		156,000		384,000
Dec.	1	Cash dividend		66,000		318,000
	31	Net income			350,000	668,000

(c)

CAROLINAS CORPORATION
Balance Sheet (Partial)
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, $10 par value, 132,000 shares issued and outstanding	$1,320,000
Additional paid-in capital	
In excess of par value	236,000
Total paid-in capital	1,556,000
Retained earnings	668,000
Total stockholders' equity	$2,224,000

PROBLEM 14-2A

(a)

July	1	Retained Earnings [($800,000 ÷ $5) X $.50]	80,000	
		Dividends Payable—Common Stock		80,000
Aug.	1	Retained Earnings	25,000	
		Accumulated Depreciation		25,000
Sept.	1	Dividends Payable—Common Stock	80,000	
		Cash		80,000
Dec.	1	Retained Earnings (16,000 X $18)	288,000	
		Common Stock Dividends Distributable (16,000 X $5)		80,000
		Paid-in Capital in Excess of Par Value—Common Stock (16,000 X $13)		208,000
	15	Retained Earnings (12,000 X $3)	36,000	
		Dividends Payable—Preferred Stock		36,000
	31	Income Summary	355,000	
		Retained Earnings		355,000

(b)

Preferred Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			600,000

Common Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			800,000

PROBLEM 14-2A (Continued)

Common Stock Dividends Distributable

Date		Explanation	Ref.	Debit	Credit	Balance
Dec.	1				80,000	80,000

Paid-in Capital in Excess of Par Value—Preferred Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			200,000

Paid-in Capital in Excess of Par Value—Common Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			300,000
Dec.	1				208,000	508,000

Retained Earnings

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			800,000
July	1	Cash dividend—common		80,000		720,000
Aug.	1	Prior period adjustment—depreciation		25,000		695,000
Dec.	1	Stock dividend—common		288,000		407,000
Dec.	15	Cash dividend—preferred		36,000		371,000
Dec.	31	Net income			355,000	726,000

(c)

HASHMI COMPANY
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1, as reported		$ 800,000
Correction of 2007 depreciation		25,000
Balance, January 1, as adjusted		775,000
Add: Net income		355,000
		1,130,000
Less: Cash dividends—preferred	$ 36,000	
Stock dividends—common	288,000	
Cash dividends—common	80,000	404,000
Balance, December 31		$ 726,000

(d)

HASHMI COMPANY
Balance Sheet (Partial)
December 31, 2008

Stockholders' equity		
Paid-in capital		
Capital stock		
6% Preferred stock, $50 par value, 12,000 shares issued		$ 600,000
Common stock, $5 par value, 160,000 shares issued	$800,000	
Common stock dividends distributable (16,000 shares)	80,000	880,000
Total capital stock		1,480,000
Additional paid-in capital		
In excess of par value—preferred stock	200,000	
In excess of par value—common stock	508,000	
Total additional paid-in capital		708,000
Total paid-in capital		2,188,000
Retained earnings (see Note B)		726,000
Total stockholders' equity		$2,914,000

<u>Note B:</u> Retained earnings is restricted for plant expansion, $200,000.

PROBLEM 14-3A

(a)

Retained Earnings

Sept. 1	Prior Per. Adj.	63,000	Jan. 1	Balance	1,170,000
Oct. 1	Cash Dividend	250,000	Dec. 31	Net Income	585,000
Dec. 31	Stock Dividend	400,000			
			Dec. 31	Balance	1,042,000

(b)

DOLD CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1, as reported		$1,170,000
Correction of overstatement of 2007 net income because of understatement of depreciation		(63,000)
Balance, January 1, as adjusted		1,107,000
Add: Net income		585,000
		1,692,000
Less: Cash dividends	$250,000	
Stock dividends	400,000	650,000
Balance, December 31		$1,042,000

(c)

DOLD CORPORATION
Partial Balance Sheet
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
6% Preferred stock, $50 par value, cumulative, 20,000 shares authorized, 15,000 shares issued and outstanding	$ 750,000

DOLD CORPORATION (Continued)

Common stock, $10 par value, 500,000 shares authorized, 250,000 shares issued and outstanding	$2,500,000	
Common stock dividends distributable	250,000	2,750,000
Total capital stock		3,500,000
Additional paid-in capital		
In excess of par value—preferred stock	250,000	
In excess of par value—common stock	400,000	
Total additional paid-in capital		650,000
Total paid-in capital		4,150,000
Retained earnings (see Note X)		1,042,000
Total stockholders' equity		$5,192,000

Note X: Retained earnings is restricted for plant expansion, $200,000.

(d) $\frac{\$585,000 - \$45,000}{240,000} = \$2.25$

*15,000 X $3 = $45,000

(e)

Total cash dividend		$250,000
Allocated to preferred stock		
Dividend in arrears—2007 (15,000 X $3)	$45,000	
2008 dividend	45,000	90,000
Remainder to common stock		$160,000

PROBLEM 14-4A

(a)

PATTINI CORPORATION
Partial Balance Sheet
March 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
90,000 shares issued and outstanding	$1,400,000
Retained earnings	410,000
Total stockholders' equity	$1,810,000

(b)

PATTINI CORPORATION
Partial Balance Sheet
June 30, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
360,000 shares issued and outstanding	$1,400,000
Retained earnings	410,000
Total stockholders' equity	$1,810,000

(c)

PATTINI CORPORATION
Partial Balance Sheet
September 30, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
378,000 shares issued and outstanding	$1,634,000*
Retained earnings	176,000**
Total stockholders' equity	$1,810,000

*$1,400,000 + [(360,000 X .05) X $13] **$410,000 – $234,000

(d)

PATTINI CORPORATION
Partial Balance Sheet
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
378,000 shares issued and outstanding	$1,634,000
Retained earnings	337,000*
Total stockholders' equity	$1,971,000

*$176,000 – ($.50 X 378,000) + $350,000

PROBLEM 14-5A

Preliminary analysis (in thousands)—NOT REQUIRED

	Common Stock	Common Stock Dividends Distributable	Retained Earnings	Total
Balance, Jan. 1	$1,500	$200	$600	$2,300
1. Issued 50,000 shares for stock dividend	200	(200)		0
2. Issued 30,000 shares for cash	180			180
3. Corrected error in 2006 net income			70	70
4. Declared cash dividend			(80)	(80)
5. Net income for year			300	300
Balance, Dec. 31	$1,880	$ 0	$890	$2,770

YADIER INC.
Stockholders' Equity Section of Balance Sheet
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value, 580,000 shares issued and outstanding	$1,880,000
Retained earnings	890,000
Total stockholders' equity	$2,770,000

PROBLEM 14-1B

(a)	Jan. 15	Retained Earnings (100,000 X $1)	100,000	
		Dividends Payable		100,000
	Feb. 15	Dividends Payable	100,000	
		Cash		100,000
	Apr. 15	Retained Earnings (10,000 X $15)	150,000	
		Common Stock Dividends Distributable (10,000 X $10)		100,000
		Paid-in Capital in Excess of Par Value (10,000 X $5)		50,000
	May 15	Common Stock Dividends Distributable	100,000	
		Common Stock (10,000 X $10)		100,000
	July 1	Memo—two-for-one stock split increases the number of shares outstanding to 220,000, or (110,000 X 2) and reduces par value to $5 per share.		
	Dec. 1	Retained Earnings (220,000 X $.50)	110,000	
		Dividends Payable		110,000
	31	Income Summary	250,000	
		Retained Earnings		250,000

(b)

Common Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			1,000,000
May	15				100,000	1,100,000
July	1	2 for 1 stock split— new par value = $5				

PROBLEM 14-1B (Continued)

Common Stock Dividends Distributable

Date		Explanation	Ref.	Debit	Credit	Balance
Apr.	15				100,000	100,000
May	15			100,000		0

Paid-in Capital in Excess of Par Value

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			200,000
Apr.	15				50,000	250,000

Retained Earnings

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			540,000
	15	Cash dividends		100,000		440,000
Apr.	15	Stock dividends		150,000		290,000
Dec.	1	Cash dividends		110,000		180,000
	31	Net income			250,000	430,000

(c)

VERLIN CORPORATION
Balance Sheet (Partial)
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, $5 par value, 220,000 shares issued and outstanding	$1,100,000
Additional paid-in capital	
In excess of par value	250,000
Total paid-in capital	1,350,000
Retained earnings	430,000
Total stockholders' equity	$1,780,000

PROBLEM 14-2B

(a)	July	1	Retained Earnings	40,000	
			[($800,000 ÷ $10) X $.50]		
			Dividends Payable—Common Stock		40,000
	Aug.	1	Accumulated Depreciation	72,000	
			Retained Earnings		72,000
	Sept.	1	Dividends Payable—Common Stock	40,000	
			Cash		40,000
	Dec.	1	Retained Earnings (8,000 X $16)	128,000	
			Common Stock Dividends Distributable (8,000 X $10)		80,000
			Paid-in Capital in Excess of Par Value—Common Stock		48,000
			(8,000 X $6)		
		15	Retained Earnings (5,000 X $7)	35,000	
			Dividends Payable—Preferred Stock		35,000
		31	Income Summary	350,000	
			Retained Earnings		350,000

(b)

Preferred Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			500,000

Common Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			800,000

PROBLEM 14-2B (Continued)

Common Stock Dividends Distributable

Date		Explanation	Ref.	Debit	Credit	Balance
Dec.	1				80,000	80,000

Paid-in Capital in Excess of Par Value—Preferred Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			100,000

Paid-in Capital in Excess of Par Value—Common Stock

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			200,000
Dec.	1				48,000	248,000

Retained Earnings

Date		Explanation	Ref.	Debit	Credit	Balance
Jan.	1	Balance	✓			500,000
July	1	Cash dividends—common		40,000		460,000
Aug.	1	Prior period adjustment			72,000	532,000
Dec.	1	Stock dividends—common		128,000		404,000
	15	Cash dividends—preferred		35,000		369,000
	31	Net income			350,000	719,000

(c)

HOLMES, INC.
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1, as reported		$500,000
Correction of 2007 depreciation		72,000
Balance, January 1, as adjusted		572,000
Add: Net income		350,000
		922,000
Less: Cash dividends—preferred	$ 35,000	
Stock dividends—common	128,000	
Cash dividends—common	40,000	203,000
Balance, December 31		$719,000

(d)

HOLMES, INC.
Balance Sheet (Partial)
December 31, 2008

Stockholders' equity		
Paid-in capital		
Capital stock		
7% Preferred stock, $100 par value, 5,000 shares issued		$ 500,000
Common stock, $10 par value, 80,000 shares issued	$800,000	
Common stock dividends distributable	80,000	880,000
Total capital stock		1,380,000
Additional paid-in capital		
In excess of par value—preferred stock	100,000	
In excess of par value—common stock	248,000	
Total additional paid-in capital		348,000
Total paid-in capital		1,728,000
Retained earnings		719,000
Total stockholders' equity		$2,447,000

PROBLEM 14-3B

(a)

Retained Earnings

Nov. 1	Cash Dividend	600,000	Jan. 1	Balance	2,450,000
Dec. 31	Stock Dividend	360,000	Dec. 31		840,000
			Dec. 31	Balance	2,330,000

(b)

TAGUCI CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1		$2,450,000
Add: Net income		840,000
		3,290,000
Less: Cash dividends	$600,000	
Stock dividends	360,000	960,000
Balance, December 31		$2,330,000

(c)

TAGUCI CORPORATION
Partial Balance Sheet
December 31, 2008

Stockholders' equity		
Paid-in capital		
Capital stock		
6% Preferred stock, $100 par value, noncumulative, callable at $125, 20,000 shares authorized, 10,000 shares issued and outstanding		$1,000,000
Common stock, no par, $5 stated value, 600,000 shares authorized, 400,000 shares issued and outstanding	$2,000,000	
Common stock dividends distributable	200,000	2,200,000
Total capital stock		3,200,000

TAGUCI CORPORATION (Continued)

Additional paid-in capital		
In excess of par value—preferred stock	$ 200,000	
In excess of stated value—common stock	1,180,000	
Total additional paid-in capital		1,380,000
Total paid-in capital		4,580,000
Retained earnings (see Note A)		2,330,000
Total stockholders' equity		$6,910,000

Note A: Retained earnings is restricted for plant expansion, $100,000.

(d) $\frac{\$840,000 - \$60,000*}{325,000} = \$2.40$

*10,000 X $6 = $60,000

(e)	Total dividend	$600,000
	Allocated to preferred stock—current year only	60,000
	Remainder to common stock	$540,000

PROBLEM 14-4B

(a)

ERWIN CORPORATION
Partial Balance Sheet
March 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
150,000 shares issued and outstanding	$2,800,000
Retained earnings	850,000
Total stockholders' equity	$3,650,000

(b)

ERWIN CORPORATION
Partial Balance Sheet
JUNE 30, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
600,000 shares issued and outstanding	$2,800,000
Retained earnings	850,000
Total stockholders' equity	$3,650,000

(c)

ERWIN CORPORATION
Partial Balance Sheet
September 30, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
630,000 shares issued and outstanding	$3,190,000*
Retained earnings	460,000**
Total stockholders' equity	$3,650,000

*$2,800,000 + [(600,000 X .05) X $13] **$850,000 – $390,000

PROBLEM 14-4B (Continued)

(d)

ERWIN CORPORATION
Partial Balance Sheet
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
630,000 shares issued and outstanding	**$3,190,000**
Retained earnings	**845,000***
Total stockholders' equity	**$4,035,000**

***$460,000 – ($.50 X 630,000) + $700,000**

PROBLEM 14-5B

Preliminary analysis (in thousands)—NOT REQUIRED

	Common Stock	Common Stock Dividends Distributable	Retained Earnings	Total
Balance, Jan. 1	$3,000	$400	$1,200	$4,600
1. Issued 100,000 shares for stock dividend	400	(400)		0
2. Issued 40,000 shares for cash	200			200
3. Corrected error in 2006 net income			140	140
4. Declared cash dividend			(500)	(500)
5. Net income for year			600	600
Balance, Dec. 31	$3,600	$ 0	$1,440	$5,040

MORALES INC.
Stockholders' Equity Section of Balance Sheet
December 31, 2008

Stockholders' equity	
Paid-in capital	
Capital stock	
Common stock, no-par value,	
1,140,000 shares issued and outstanding	$3,600,000
Retained earnings	1,440,000
Total stockholders' equity	$5,040,000

BYP 14-1 FINANCIAL REPORTING PROBLEM

According to the Consolidated Statement of Common Shareholders' Equity, the company declared dividends on common stock of $1,684 million during the year-ended December 31, 2005.

The company declared dividends on common stock of $1,438 million during the year ended December 25, 2004.

BYP 14-2 COMPARATIVE ANALYSIS PROBLEM

(a)

	PepsiCo	Coca-Cola
Earnings per share	$\frac{\$4,078 - \$3}{1,669} = \$2.44$	$\frac{\$4,872 - \$0}{2,392} = \$2.04$
Return on common stockholders' equity	$\frac{\$4,078 - \$3}{(\$13,572 + \$14,320) \div 2} = 29.2\%$	$\frac{\$4,872 - \$0}{(\$15,935 + \$16,355) \div 2} = 30.2\%$

The return on common stockholders' equity can be used to compare the profitability of two companies. It shows how many dollars of net income were earned for each dollar invested by the owners. Since this ratio is expressed as a percent instead of a dollar amount like earnings per share, it can be used to compare PepsiCo and Coca-Cola. During 2005, Coca-Cola was slightly (3%) more profitable than PepsiCo based on their respective returns on common stockholders' equity. Earnings per share measures cannot be compared across companies because they may use vastly different numbers of shares to finance the company.

(b) **PepsiCo paid cash dividends of $1,642 million and Coca-Cola paid $2,678 million of cash dividends in 2005.**

BYP 14-3 EXPLORING THE WEB

Answers will vary depending on the company chosen by the student.

BYP 14-4 DECISION MAKING ACROSS THE ORGANIZATION

Journal entries—NOT REQUIRED

July	1	Retained Earnings	70,000	
		(140,000 X $0.50)		
		Dividends Payable		70,000
Aug.	1	Accumulated Depreciation	72,000	
		Retained Earnings		72,000
Sept.	1	Dividends Payable	70,000	
		Cash		70,000
Dec.	1	Retained Earnings (14,000 X $12)	168,000	
		Common Stock Dividends Distributable		168,000
	15	Retained Earnings (4,000 X $9)	36,000	
		Dividends Payable		36,000
	31	Income Summary	320,000	
		Retained Earnings		320,000

(a)

FERNANDEZ, INC.
Retained Earnings Statement
For the Year Ended December 31, 2008

Balance, January 1, as previously reported		$500,000
Correction of 2007 depreciation		72,000
Balance, January 1, as corrected		572,000
Add: Net income		320,000
		892,000
Less: Cash dividends—preferred	$ 36,000	
Stock dividends—common	168,000	
Cash dividends—common	70,000	274,000
Balance, December 31		$618,000

BYP 14-4 (Continued)

(b) Treating the overstatement of 2007 depreciation expense as an adjustment of 2008 income would be incorrect because it applies to the prior year's income statement and would distort depreciation expense for 2008.

(c) Companies issue stock dividends instead of cash dividends to satisfy stockholders' dividend expectations without spending cash and to increase the marketability of the corporation's stock.

BYP 14-5 COMMUNICATION ACTIVITY

Dear Mom and Dad,

Thanks for calling me about your investments in Cormier Corporation and Fegan, Inc.

The effect to you as stockholders is the same for both a stock dividend and a stock split. In each case, the number of shares you own will increase. Following the stock dividend, you will own 110 shares of Cormier [100 + (100 X 10%)]. After the stock split, you will own 200 shares of Fegan (100 X 2).

The total value of your investments should remain approximately the same as before the stock dividend and stock split. The reason is that the market value per share will likely decrease in proportion to the additional shares that you will own. If there is a change in value, it is more likely to be higher than lower.

The effects of the stock dividend and stock split on the corporations are limited entirely to the stockholders' equity sections as follows:

Stockholders' Equity Item	After Stock Dividend	After Stock Split
Total capital stock	Increase	No change
Par value per share	No change	Decrease
Total paid-in capital	Increase	No change
Total retained earnings	Decrease	No change
Total stockholders' equity	No change	No change

I hope this answers your questions, Mom and Dad. If you have any additional questions, please give me a call.

Love,

P.S. Please send money.

BYP 14-6 ETHICS CASE

(a) The stakeholders in this situation are:

- Tom Henson, president of Garcia Corporation.
- Andrea Lane, financial vice-president.
- The stockholders of Garcia Corporation.

(b) There is nothing unethical in issuing a stock dividend. But the president's order to write a press release convincing the stockholders that the stock dividend is just as good as a cash dividend is unethical. A stock dividend is not a cash dividend and does not necessarily place the stockholder in the same position. A stock dividend is a "paper" dividend—the issuance of a stock certificate, not a check (cash).

(c) The stock dividend results in a decrease in retained earnings and an increase of the same amount in paid-in capital with no change in total stockholders' equity. There is no change in total assets and no change in total liabilities and stockholders' equity.

As a stockholder, preference for a cash dividend versus a stock dividend is dependent upon one's investment objective—income (cash flow) or growth (reinvestment).