E9-34. Identifying and Analyzing Financial Statement Effects of Stock Transactions (LO1)
Lipe Company reports the following transactions relating to its stock accounts in the current year.
Issued 10,000 shares of $1 par value common stock at $25 cash per share.
Feb. 20
\[ \text{Cash} \quad \text{Common Stock} \quad \$250,000 \]
\[ \text{Additional Paid-In Capital - com} \quad 250,000 \]
Issued 15,000 shares of $100 par value, 8% preferred stock at $275 cash per share.
Feb. 21
\[ \text{Cash} \quad \text{Preferred Stock Pref} \quad 4,125,000 \]
\[ \text{Additional Paid-In Capital - prf} \quad 1,500,000 \]
\[ \text{Cash Preferred Stock} \quad 2,625,000 \]
Purchased 2,000 shares of its own common stock at $15 cash per share.
June 30
\[ \text{Cash} \quad \text{Treasury Stock} \quad 30,100 \]
\[ \text{Treasury Stock} \quad 30,100 \]
Sold 1,000 shares of its treasury stock at $21 cash per share.
Sep. 25
\[ \text{Cash} \quad \text{Treasury Stock} \quad 2,100 \]
\[ \text{Additional Paid-In Capital} \quad 15,000 \]
\[ \text{Treasury Stock} \quad 6,100 \]

Following is the stockholders' equity section from Altria's 2010 balance sheet.

<table>
<thead>
<tr>
<th>December 31 ($ million)</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock, par value $0.33 1/2 per share (2,805,961,317 shares issued)</td>
<td>$935</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>5,751</td>
</tr>
<tr>
<td>Earnings reinvested in the business</td>
<td>23,469</td>
</tr>
<tr>
<td>Accumulated other comprehensive losses</td>
<td>(1,484)</td>
</tr>
<tr>
<td>Cost of repurchased stock (717,221,651 shares in 2010)</td>
<td>(23,469)</td>
</tr>
<tr>
<td>Total stockholders' equity attributable to Altria Group, Inc.</td>
<td>5,192</td>
</tr>
<tr>
<td>Noncontrolling Interests</td>
<td>9,353</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>$5,195</td>
</tr>
</tbody>
</table>

a. Show the computation to derive the $935 million for common stock.
   \[ 2,805,961,317 \div 3 = 935,320 = 935 \text{ million} \]

b. At what average price has Altria issued its common stock?
   \[ \frac{935 + 5,751}{2} = 2,806 \text{ million} \]

c. How many shares of Altria common stock are outstanding as of December 31, 2010?
   \[ 2,806 - 717 = 2,089 \text{ million} \]

d. At what average cost has Altria repurchased its treasury stock as of December 31, 2010?
   \[ 32.73 \]

e. Why would a company such as Altria want to repurchase $23,469 million of its common stock?
   "To return cash to shareholders in lieu of cash dividends. Immediate cash benefits shareholders by reducing the cost of equity via share repurchases, suggesting the company's strong financial position and confidence in its future growth prospects."

f. What does the Noncontrolling Interests account of $3 million represent? Share of subsidiaries not purchased in acquisitions.

- 5% preferred stock, $100 par value, 10,000 shares authorized; 4,000 shares issued and outstanding $ 400,000
- Common stock, $5 par value, 200,000 shares authorized; 50,000 shares issued and outstanding 250,000
- Paid-in capital in excess of par value—preferred stock 40,000
- Paid-in capital in excess of par value—common stock 300,000
- Retained earnings 656,000
- Total stockholders' equity $1,646,000

a. The following transactions, among others, occurred during 2012. Prepare the entries to represent the events.

Apr 1
\[
\begin{align*}
\text{Declared and issued a 100% stock dividend on all outstanding shares of common stock. The market value of the stock was $11 per share.} \\
\text{Retained Earnings} & \times \frac{50,000 \times \$5}{200,000} = 250,000 \\
\text{Common Stock} & \\
\end{align*}
\]

Declared and issued a 3% stock dividend on all outstanding shares of common stock. The market value of the stock was $14 per share.

Dec 7
\[
\begin{align*}
\text{Declared and paid (1) the annual cash dividend on the preferred stock and (2) a cash dividend of 80 cents per common share.} \\
\text{Retained Earnings} & \times 3\% \times \$100,000 \times \frac{1}{14} = 42,000 \\
\text{Common Stock} & \\
\text{Preferred Stock} & 15,000 \\
\text{Common Stock} & 27,000 \\
\end{align*}
\]

b. Compute retained earnings for 2012 assuming that the company reports 2012 net income of $253,000.

\[
\begin{align*}
\text{R/ES} & = 656,000 + 253,000 - 250,000 - 42,000 - 20,000 - 82,400 \\
& = 574,600 \\
\end{align*}
\]
Module 9—Review Questions

1. Which best describes the par value of a stock?
   A) An amount set in the corporate charter for each share of stock
   B) The value of the stock if it is not sold for a premium or discount
   C) The current market value of the stock
   D) The value at which stock shares were originally issued
   E) None of the above

2. Which of the following statements is FALSE?
   A) When a large stock dividend is paid out, retained earnings are reduced by the par value of the stock.
   B) When there is a purchase or sale of common stock, there is never a gain or loss recorded.
   C) Retained earnings is a type of contributed capital that can be paid out as dividends.
   D) When employee stock options are granted, compensation expense should be recorded.
   E) When common stock is sold, the cash account generally increases.

3. Which of the following equity carve outs would be categorized as a “spin-off”?
   A) ABC, Inc. declared a dividend to its regular stockholders the shares of West Texas Systems, Inc.
   B) DEF, Inc. sold its Dallas regional stores for cash to Costco, Inc.
   C) GHI, Inc. traded its San Antonio Motels to Motel 6 for common stock of Motel 6.
   D) JKL, Inc. traded its shares of Home Restaurants, Inc. for shares of JKL common stock.
   E) MNO, Inc. received cash for shares of Local Hardware, Inc.

4. The 2012 financial statements of Fixx Corporation report that the company paid dividends of $17,350,000 to its preferred shareholders before paying dividends to its common shareholders. This practice is called:
   A) Liquidation preference
   B) Treasury preference
   C) Dividend preference
   D) Stock ownership preference
   E) Fixed stock preference

5. Which of the following is NOT a correct statement about “noncontrolling interest”?
   A) Noncontrolling interest is reported as a component of stockholders’ equity on the balance sheet.
   B) Noncontrolling interest represents their claim to their proportionate share of the net assets and net income of the subsidiary in which they own stock.
   C) Noncontrolling interest is a residual claim, similar to other shareholders.
   D) Noncontrolling interests are entitled to preference in dividends and payouts in liquidation.

6. Which of the following statements is FALSE about an employee stock option plan?
   A) At the time the option program is awarded, the employees have completed the work required to receive the stock option.
   B) Compensation expense is recorded at the time the options are awarded.
   C) The number of shares involved is determined when employees are awarded the stock options.
   D) Compensation expense is recorded as employees complete the work required by the stock option.
   E) Employees may purchase the shares of stock under the stock option at any time.

7. Which of the following statements is most TRUE about a restricted stock grant program for employees?
   A) At the time the grant program is set up, the employees have already completed the work required to receive the shares.
   B) Compensation expense occurs at the time the stock grant program is started.
   C) The number of shares involved is not determined until after employees do the required work.
   D) Compensation expense is recorded as employees complete the work required by the stock grant program.
   E) Employees may purchase the restricted shares at any time.
Exercise Following is the stockholders' equity section of the 2012 balance sheet for Kling Company:

<table>
<thead>
<tr>
<th>STOCKHOLDERS' EQUITY</th>
<th>October 31 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock: $0.20 par value, authorized 600,000 shares; 100,000 shares issued</td>
<td>$ 20,000</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>351,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>330,000</td>
</tr>
<tr>
<td>Treasury stock: 10,000 shares</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>$601,000</td>
</tr>
</tbody>
</table>

a. Compute the number of shares outstanding at October 31, 2012.
   \[ 100,000 - 10,000 = 90,000 \]

b. At what average issue price were the shares issued?
   \[ \frac{37,400}{100,000} = 0.374 \]

c. At what average cost were the treasury shares purchased?
   \[ \frac{100,000}{10,000} = 10.00 \]

Exercise 3V2 Co. had the following accounts in their owners' equity as of December 31, 2011:

- Common stock: $1 par value, authorized 500,000 shares; 200,000 shares issued and outstanding $ 200,000
- Additional paid-in capital 300,000
- Retained earnings 1,000,000
- Total stockholders' equity $1,500,000

3V2 had net income of $500,000 during 2012. On July 1, 2012 the company declared a 10% stock dividend when the share price was $10 per share. On December 31, 2012 the company declared and paid a $1 per share cash dividend.

REQUIRED:

a. How many shares are outstanding at the end of 2012?
   \[ 200,000 \times 1.10 = 220,000 \]

b. What is the amount of the "Additional paid-in capital" at the end of 2012?
   \[ 300,000 + (600,000 - 9) \times 20,000 = 480,000 \]

c. What is the balance in Retaining earnings at the end of 2012?
   \[ \frac{100,000}{\text{Net Income} + 500,000} \]
   \[ \text{ST. DIVIDEND} - 200,000 \]
   \[ \text{CASH DIVIDENDS} - 200,000 \]
   \[ \text{108,000} \]

SHORT ANSWER

1. All Consumer, Inc. has 100,000 outstanding shares of $1 par common stock with a current market price of $500.

   a. What would be the impact of a 10% stock dividend on the balance sheet accounts?
      \[ \times 10,000 \times 500 = 500,000 \text{ Retained earnings decrease} \]
      \[ \text{Common stock:} 10,000 \times 100 \text{ Common stock decrease} \]
      \[ \text{APIC - Common:} 100,000 \times 10 \text{ APIC increase} \]

   b. What would be the impact on a 10-for-1 stock split on the balance sheet accounts?
      \[ \frac{1000}{10} = 100 \text{ per share decrease with 1000 shares outstanding} \]

2. What is meant by divesting a part of a company as a "spin-off"?
   Issue shares of equity carve out as a dividend.