

## BRIEF EXERCISES



Cite advantages and disadvantages of a corporation (LO1)

**BE10-1** Waldo is planning to start a clothing store helping big and tall men blend in with the crowd. Explain to Waldo the advantages and disadvantages of a corporation in comparison to a sole proprietorship or partnership.

Understand an S corporation (LO1)

**BE10-2** Renaldo heard that an S corporation combines the benefits of a corporation with the benefits of a partnership. Explain to Renaldo the specific benefits of an S corporation and any drawbacks to organizing as an S corporation.

Record issuance of common stock (LO2)

**BE10-3** Western Wear Clothing issues 2,000 shares of its \$0.01 par value common stock to provide funds for further expansion. Assuming the issue price is \$12 per share, record the issuance of common stock.

Record issuance of common stock (LO2)

**BE10-4** Gothic Architecture is a new chain of clothing stores specializing in the color black. Gothic issues 1,000 shares of its \$1 par value common stock at \$20 per share. Record the issuance of the stock. How would the entry differ if Gothic issued no-par value stock?

Record issuance of preferred stock (LO3)

**BE10-5** Equinox Outdoor Wear issues 1,000 shares of its \$0.01 par value preferred stock for cash at \$22 per share. Record the issuance of the preferred shares.

Recognize preferred stock features (LO3)

**BE10-6** Match each of the following preferred stock features with its description.

**Preferred Stock Features**

- \_\_\_\_\_ 1. Convertible
- \_\_\_\_\_ 2. Redeemable
- \_\_\_\_\_ 3. Cumulative

**Description**

- a. Shares receive dividend priority, if a dividend is not paid.
- b. Shares can be sold at a predetermined price.
- c. Shares can be exchanged for common stock.

Determine the amount of preferred stock dividends (LO3)

**BE10-7** Rachel's Designs has 1,000 shares of 6%, \$50 par value cumulative preferred stock issued at the beginning of 2010. All remaining shares are common stock. Due to cash flow difficulties, the company was not able to pay dividends in 2010 or 2011. The company plans to pay total dividends of \$10,000 in 2012. How much of the \$10,000 dividend will be paid to preferred stockholders and how much will be paid to common stockholders?

Record purchase of treasury stock (LO4)

**BE10-8** California Surf Clothing Company issues 1,000 shares of \$1 par value common stock at \$25 per share. Later in the year, the company decides to repurchase 100 shares at a cost of \$28 per share. Record the purchase of treasury stock.

Record sale of treasury stock (LO4)

**BE10-9** Refer to the situation described in BE10-8. Record the transaction if California Surf reissues the 100 shares of treasury stock at \$30 per share. How would it be different if the shares reissue at \$26 per share rather than at \$30 per share?

Record cash dividends (LO5)

**BE10-10** Divine Apparel has 3,000 shares of common stock outstanding. On October 1, the company declares a \$0.50 per share dividend to stockholders of record on October 15. The dividend is paid on October 31. Record all transactions on the appropriate dates for cash dividends.

Record stock dividends (LO6)

**BE10-11** On June 30, the board of directors of Sandals, Inc., declares a 100% stock dividend on its 20,000, \$1 par, common shares. The market price of Sandals common stock is \$25 on June 30. Record the stock dividend.

Analyze a stock split (LO6)

**BE10-12** Refer to the situation described in BE10-11, but assume a 2-for-1 stock split instead of the 100% stock dividend. Explain why Sandals did not record a 2-for-1 stock split. What are the number of shares, par value per share, and market price per share immediately after the 2-for-1 stock split?

**BE10-13** Indicate whether each of the following transactions increases (+), decreases (-), or has no effect (NE) on total assets, total liabilities, and total stockholders' equity. The first transaction is completed as an example.

Indicate effects on total stockholders' equity (LO7)

| Transaction             | Total Assets | Total Liabilities | Total Stockholders' Equity |
|-------------------------|--------------|-------------------|----------------------------|
| Issue common stock      | +            | NE                | +                          |
| Issue preferred stock   |              |                   |                            |
| Purchase treasury stock |              |                   |                            |
| Sale of treasury stock  |              |                   |                            |

**BE10-14** Silk Station has the following accounts at December 31: Common Stock, \$1 par value, 1,000,000 shares; Paid-in Capital, \$17 million; Retained Earnings, \$10 million; and Treasury Stock, 50,000 shares, \$1.1 million. Prepare the stockholders' equity section of the balance sheet.

Prepare the stockholders' equity section (LO7)

**BE10-15** The financial statements of **Limited Brands, Inc.**, include the following selected data (\$ in millions): sales, \$9,043; net income, \$220; beginning stockholders' equity, \$2,219; and ending stockholders' equity, \$1,874. Calculate the return on equity.

Calculate the return on equity (LO8)

## EXERCISES



**E10-1** Match (by letter) the following terms with their definitions. Each letter is used only once.

Match terms with their definitions (LO1)

### Terms

- \_\_\_\_\_ 1. Publicly held corporation.
- \_\_\_\_\_ 2. Model Business Corporation Act.
- \_\_\_\_\_ 3. Articles of incorporation.
- \_\_\_\_\_ 4. Limited liability.
- \_\_\_\_\_ 5. Mutual agency.
- \_\_\_\_\_ 6. Double taxation.
- \_\_\_\_\_ 7. S corporation.
- \_\_\_\_\_ 8. Limited liability company.

### Definitions

- a. Shareholders can lose no more than the amount they invest in the company.
- b. Corporate earnings are taxed twice—at the corporate level and individual shareholder level.
- c. Like an S corporation, but there are no limitations on the number of owners as in an S corporation.
- d. Designed to serve as a guide to states in the development of their corporate statutes.
- e. Allows for legal treatment as a corporation, but tax treatment as a partnership.
- f. Has stock traded on a stock exchange such as the New York Stock Exchange (NYSE).
- g. Individual partners in a partnership have the power to bind the business to a contract.
- h. Describes (a) the nature of the firm's business activities, (b) the shares to be issued, and (c) the composition of the initial board of directors.

**E10-2** Your friend, Jonathon Fain, is an engineering major with an entrepreneurial spirit. He wants to start his own corporation and needs your accounting expertise. He has no idea what the following terms mean: (1) authorized stock, (2) issued stock, (3) outstanding stock, (4) preferred stock, and (5) treasury stock.

Explain the meaning of terms used in stockholders' equity (LO2, 3, 4)

**Required:**

Write a note to Jonathon carefully explaining what each term means and how they are different from each other.

Record the issuance of common stock (LO2)

**E10-3** Clothing Frontiers began operations on January 1, 2012, and engages in the following transactions during the year related to stockholders' equity.

January 1 Issues 600 shares of common stock for \$40 per share.

April 1 Issues 100 additional shares of common stock for \$44 per share.

**Required:**

1. Record the transactions, assuming Clothing Frontiers has no-par common stock.
2. Record the transactions, assuming Clothing Frontiers has \$1 par value common stock.
3. Record the transactions, assuming Clothing Frontiers' common stock has a \$1 stated value, rather than a \$1 par value.

Determine the amount of preferred stock dividends (LO3)

**E10-4** Nathan's Athletic Apparel has 1,000 shares of 7%, \$100 par value preferred stock the company issued at the beginning of 2011. All remaining shares are common stock. The company was not able to pay dividends in 2011, but plans to pay dividends of \$15,000 in 2012.

**Required:**

1. Assuming the preferred stock is cumulative, how much of the \$15,000 dividend will be paid to preferred stockholders and how much will be paid to common stockholders in 2012?
2. Assuming the preferred stock is noncumulative, how much of the \$15,000 dividend will be paid to preferred stockholders and how much will be paid to common stockholders in 2012?

Record common stock, preferred stock, and dividend transactions (LO2, 3, 5)

**E10-5** Italian Stallion has the following transactions during the year related to stockholders' equity.

February 1 Issues 5,000 shares of no-par common stock for \$15 per share.

May 15 Issues 500 shares of \$10 par value preferred stock for \$12 per share.

October 1 Declares a cash dividend of \$0.75 per share to all stockholders of record (both common and preferred) on October 15.

October 15 Date of record.

October 31 Pays the cash dividend declared on October 1.

**Required:**

Record each of these transactions.

Record issuance of stock and treasury stock transactions (LO2, 3, 4)

**E10-6** Finishing Touches has two classes of stock authorized: 8%, \$10 par preferred, and \$1 par value common. The following transactions affect stockholders' equity during 2012, its first year of operations:

January 2 Issues 100,000 shares of common stock for \$25 per share.

February 6 Issues 2,000 shares of 8% preferred stock for \$12 per share.

September 10 Repurchases 10,000 shares of its own common stock for \$30 per share.

December 15 Reissues 5,000 shares of treasury stock at \$35 per share.

**Required:**

Record each of these transactions.

Prepare the stockholders' equity section (LO7)

**E10-7** Refer to the information in E10-6. In its first year of operations, Finishing Touches has income of \$150,000 and pays dividends at the end of the year of \$95,000 (\$1 per share) on all common shares outstanding and \$1,600 on all preferred shares outstanding.

**Required:**

Prepare the stockholders' equity section of the balance sheet for Finishing Touches as of December 31, 2012.

**E10-8** On March 15, **American Eagle** declares a quarterly cash dividend of \$0.075 per share payable on April 13 to all stockholders of record on March 30.

Record cash dividends (LO5)

**Required:**

Record American Eagle's declaration and payment of cash dividends for its 220 million shares.

**E10-9** Power Drive Corporation designs and produces a line of golf equipment and golf apparel. Power Drive has 100,000 shares of common stock outstanding as of the beginning of 2012. Power Drive has the following transactions affecting stockholders' equity in 2012.

Record common stock, treasury stock, and cash dividends (LO2, 4, 5)

- March 1 Issues 55,000 additional shares of \$1 par value common stock for \$52 per share.
- May 10 Repurchases 5,000 shares of treasury stock for \$55 per share.
- June 1 Declares a cash dividend of \$1.50 per share to all stockholders of record on June 15. (*Hint: Dividends are not paid on treasury stock.*)
- July 1 Pays the cash dividend declared on June 1.
- October 21 Reissues 2,500 shares of treasury stock purchased on May 10 for \$60 per share.

**Required:**

Record each of these transactions.

**E10-10** Refer to the information in E10-9. Power Drive Corporation has the following beginning balances in its stockholders' equity accounts on January 1, 2012: Common Stock, \$100,000; Paid-in Capital, \$4,500,000; and Retained Earnings, \$2,000,000. Net income for the year ended December 31, 2012, is \$600,000.

Prepare the stockholders' equity section (LO7)

**Required:**

Taking into consideration all of the transactions recorded in E10-9, prepare the stockholders' equity section of the balance sheet for Power Drive Corporation as of December 31, 2012.

**E10-11** Refer to the information in E10-9. Power Drive Corporation has the following beginning balances in its stockholders' equity accounts on January 1, 2012: Common Stock, \$100,000; Paid-in Capital, \$4,500,000; and Retained Earnings, \$2,000,000. Net income for the year ended December 31, 2012, is \$600,000.

Prepare a statement of stockholders' equity (LO7)

**Required:**

Taking into consideration all the transactions recorded in E10-9, prepare the statement of stockholders' equity for Power Drive Corporation for the year ended December 31, 2012, using the format provided.

**POWER DRIVE CORPORATION**  
**Statement of Stockholders' Equity**  
**For the year ended December 31, 2012**

|                            | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|----------------------------|-----------------|----------------------------------|----------------------|-------------------|----------------------------------|
| Balance, January 1         | \$100,000       | \$4,500,000                      | \$2,000,000          | \$ -0-            | \$6,600,000                      |
| Issued common stock        |                 |                                  |                      |                   |                                  |
| Repurchased treasury stock |                 |                                  |                      |                   |                                  |
| Cash dividends             |                 |                                  |                      |                   |                                  |
| Sold treasury stock        |                 |                                  |                      |                   |                                  |
| Net income                 |                 |                                  |                      |                   |                                  |
| Balance, December 31       | _____           | _____                            | _____                | _____             | _____                            |

Indicate effects on total stockholders' equity (LO7)

**E10–12** Indicate whether each of the following transactions increases (+), decreases (–), or has no effect (NE) on total assets, total liabilities, and total stockholders' equity. The first transaction is completed as an example.

| Transaction               | Total Assets | Total Liabilities | Total Stockholders' Equity |
|---------------------------|--------------|-------------------|----------------------------|
| Issue common stock        | +            | NE                | +                          |
| Issue preferred stock     |              |                   |                            |
| Repurchase treasury stock |              |                   |                            |
| Sale of treasury stock    |              |                   |                            |
| Declare cash dividend     |              |                   |                            |
| Pay cash dividend         |              |                   |                            |
| 100% stock dividend       |              |                   |                            |
| 2-for-1 stock split       |              |                   |                            |

Prepare the stockholders' equity section (LO7)

**E10–13** United Apparel has the following balances in its stockholders' equity accounts on December 31, 2012: Treasury Stock, \$750,000; Common Stock, \$500,000; Preferred Stock, \$2,600,000; Retained Earnings, \$1,700,000; and Additional Paid-in Capital, \$7,800,000.

**Required:**

Prepare the stockholders' equity section of the balance sheet for United Apparel as of December 31, 2012.

Calculate and analyze ratios (LO8)

**E10–14** The financial statements of **Limited Brands, Inc.**, include the following selected data (in millions):

| (\$ in millions)                 | 2009    | 2008     |
|----------------------------------|---------|----------|
| Sales                            | \$9,043 | \$10,134 |
| Net income                       | \$220   | \$718    |
| Stockholders' equity             | \$1,874 | \$2,219  |
| Shares outstanding (in millions) | 321     | –        |
| Stock price                      | \$7.92  | –        |

**Required:**

1. Calculate the return on equity in 2009. Compare it with the amount calculated for **Deckers Outdoor** and **Timberland** in the chapter.
2. Calculate the return on the market value of equity in 2009. Compare it with the amount calculated for Deckers Outdoor and Timberland in the chapter.
3. Calculate earnings per share in 2009. Why is it not reasonable to compare it with the earnings per share for Deckers Outdoor and Timberland?
4. Calculate the price-earnings ratio in 2009. Compare it with the amount calculated for Deckers Outdoor and Timberland in the chapter.

Calculate and analyze ratios (LO8)

**E10–15** Financial information for Forever 18 includes the following selected data (in millions):

| (\$ in millions)                 | 2012    | 2011    |
|----------------------------------|---------|---------|
| Net income                       | \$210   | \$180   |
| Dividends on preferred stock     | \$25    | \$20    |
| Shares outstanding (in millions) | 240     | 220     |
| Stock price                      | \$11.52 | \$10.47 |

**Required:**

1. Calculate earnings per share in 2011 and 2012. Did earnings per share increase in 2012?
2. Calculate the price-earnings ratio in 2011 and 2012. In which year is the stock priced lower in relation to reported earnings?

## PROBLEMS: SET A



**P10-1A** Match (by letter) the following terms with their definitions. Each letter is used only once.

Match terms with their definitions (LO1)

### Terms

- \_\_\_\_\_ 1. Cumulative.
- \_\_\_\_\_ 2. Retained earnings.
- \_\_\_\_\_ 3. Outstanding stock.
- \_\_\_\_\_ 4. Limited liability.
- \_\_\_\_\_ 5. Treasury stock.
- \_\_\_\_\_ 6. Issued stock.
- \_\_\_\_\_ 7. Angel investors.
- \_\_\_\_\_ 8. Paid-in capital.
- \_\_\_\_\_ 9. Authorized stock.
- \_\_\_\_\_ 10. Redeemable.

### Definitions

- a. The amount invested by stockholders.
- b. Shares available to sell.
- c. Shares can be returned to the corporation at a predetermined price.
- d. The earnings not paid out in dividends.
- e. Shares actually sold.
- f. Shares receive priority for future dividends, if dividends are not paid in a given year.
- g. Shares held by investors.
- h. Shareholders can lose no more than the amount they invested in the company.
- i. Wealthy individuals in the business community willing to risk investment funds on a promising business venture.
- j. The corporation's own stock that it reacquired.

**P10-2A** Donnie Hilfiger has two classes of stock authorized: \$1 par preferred and \$0.01 par value common. As of the beginning of 2012, 200 shares of preferred stock and 3,000 shares of common stock have been issued. The following transactions affect stockholders' equity during 2012:

Record equity transactions and indicate the effect on the balance sheet equation (LO2, 3, 4, 5)

- |          |    |  |
|----------|----|--|
| March    | 1  | Issues 1,000 shares of common stock for \$32 per share.  |
| May      | 15 | Repurchases 600 shares of treasury stock for \$25 per share.   |
| July     | 10 | Reissues 100 shares of treasury stock purchased on May 15 for \$30 per share.  |
| October  | 15 | Issues 100 shares of preferred stock for \$35 per share.   |
| December | 1  | Declares a cash dividend on both common and preferred stock of \$0.75 per share to all stockholders of record on December 15.<br>(Hint: Dividends are not paid on treasury stock.) |
| December | 31 | Pays the cash dividends declared on December 1.  |



Donnie Hilfiger has the following beginning balances in its stockholders' equity accounts on January 1, 2012: Preferred Stock, \$200; Common Stock, \$30; Additional Paid-in Capital, \$66,000; and Retained Earnings, \$25,500. Net income for the year ended December 31, 2012, is \$9,800.

### Required:

- Record each of these transactions.
- Indicate whether each of these transactions would increase (+), decrease (-), or have no effect (NE) on total assets, total liabilities, and total stockholders' equity by completing the following chart.



| <u>Transaction</u>        | <u>Total Assets</u> | <u>Total Liabilities</u> | <u>Total Stockholders' Equity</u> |
|---------------------------|---------------------|--------------------------|-----------------------------------|
| Issue common stock        |                     |                          |                                   |
| Repurchase treasury stock |                     |                          |                                   |
| Reissue treasury stock    |                     |                          |                                   |
| Issue preferred stock     |                     |                          |                                   |
| Declare cash dividends    |                     |                          |                                   |
| Pay cash dividends        |                     |                          |                                   |

Indicate effect of stock dividends and stock splits (LO6)

**P10-3A** Sammy's Sportshops has been very profitable in recent years and has seen its stock price steadily increase to over \$100 per share. The CFO thinks the company should consider either a 100% stock dividend or a 2-for-1 stock split.

**Required:**

- Complete the following chart comparing the effects of a 100% stock dividend versus a 2-for-1 stock split on the stockholders' equity accounts, shares outstanding, par value, and share price.

|                             | <u>Before</u> | <u>After 100% Stock Dividend</u> | <u>After 2-for-1 Stock Split</u> |
|-----------------------------|---------------|----------------------------------|----------------------------------|
| Common stock, \$1 par value | \$ 1,000      |                                  |                                  |
| Additional paid-in capital  | 49,000        |                                  |                                  |
| Total paid-in capital       | 50,000        |                                  |                                  |
| Retained earnings           | 22,850        |                                  |                                  |
| Total stockholders' equity  | \$72,850      |                                  |                                  |
| Shares outstanding          | 1,000         |                                  |                                  |
| Par value per share         | \$1           |                                  |                                  |
| Share price                 | \$110         |                                  |                                  |

- What is the primary reason companies declare a large stock dividend or a stock split?

Analyze the stockholders' equity section (LO7)

**P10-4A** The stockholders' equity section of Velcro World is presented here.

| <b>VELCRO WORLD</b>                  |           |
|--------------------------------------|-----------|
| <b>Balance Sheet (partial)</b>       |           |
| (\$ in thousands)                    |           |
| Stockholders' equity:                |           |
| Preferred stock, \$1 par value       | \$ 5,000  |
| Common stock, \$1 par value          | 20,000    |
| Additional paid-in capital           | 575,000   |
| Total paid-in capital                | 600,000   |
| Retained earnings                    | 278,000   |
| Treasury stock, 10,000 common shares | (220,000) |
| Total stockholders' equity           | \$658,000 |

**Required:**

Based on the stockholders' equity section of Velcro World, answer the following questions. Remember that all amounts are presented in thousands.

- How many shares of preferred stock have been issued?
- How many shares of common stock have been issued?
- If the common shares were issued at \$20 per share, at what price per share were the preferred shares issued?
- If retained earnings at the beginning of the period was \$240 million and \$20 million was paid in dividends during the year, what was the net income for the year?
- What was the average cost per share of the treasury stock acquired?

**P10-5A** Refer to the information provided in P10-2A.

**Required:**

Taking into consideration all the transactions during 2012, respond to the following for Donnie Hilfiger:

1. Prepare the stockholders' equity section of the balance sheet as of December 31, 2012.
2. Prepare the statement of stockholders' equity for the year ended December 31, 2012.
3. Explain how *Requirements* 1 and 2 are similar and how they are different.

**P10-6A** Major League Apparel has two classes of stock authorized: 5%, \$10 par preferred, and \$1 par value common. The following transactions affect stockholders' equity during 2012, its first year of operations:

|          |    |  |
|----------|----|--|
| January  | 2  | Issue 100,000 shares of common stock for \$60 per share.   |
| February | 14 | Issue 50,000 shares of preferred stock for \$11 per share.   |
| May      | 8  | Repurchase 10,000 shares of its own common stock for \$50 per share.   |
| May      | 31 | Reissue 5,000 shares of treasury stock for \$55 per share.   |
| December | 1  | Declare a cash dividend on its common stock of \$0.50 per share and a \$25,000 (5% of par value) cash dividend on its preferred stock payable to all stockholders of record on December 15. The dividend is payable on December 30. ( <i>Hint: Dividends are not paid on treasury stock.</i> ) |
| December | 30 | Pay the cash dividends declared on December 1.   |

**Required:**

1. Record each of these transactions.
2. Prepare the stockholders' equity section of the balance sheet as of December 31, 2012. Net income for the year was \$480,000.

**P10-7A Abercrombie & Fitch** is a close competitor of **Deckers Outdoor** and **Timberland** in the apparel industry. Selected financial data for Abercrombie is provided as follows:

| (\$ in millions)                           | <u>2009</u>    | <u>2008</u>    |
|--|----------------|----------------|
| Sales                                      | \$3,540        | \$3,750        |
| Net income                                 | 272            | 476            |
| Total assets                               | <u>\$2,848</u> | <u>\$2,568</u> |
| Total liabilities                          | \$1,003        | \$ 949         |
| Stockholders' equity                       | <u>1,845</u>   | <u>1,619</u>   |
| Total liabilities and stockholders' equity | <u>\$2,848</u> | <u>\$2,568</u> |
| Shares outstanding (in millions)           | <u>103</u>     | <u>—</u>       |
| Stock price                                | <u>\$29</u>    | <u>—</u>       |

**Required:**

1. Calculate the return on equity for Abercrombie in 2009. How does it compare with the return on equity for Deckers Outdoor and Timberland reported in the chapter?
2. Calculate the return on the market value of equity for Abercrombie in 2009. How does it compare with the return on the market value of equity for Deckers Outdoor and Timberland reported in the chapter?
3. Why is the return on the market value of equity for Abercrombie, Deckers Outdoor, and Timberland so much lower than the return on equity?
4. Calculate the price-earnings ratio for Abercrombie in 2009. How does it compare with the price-earnings ratio for Deckers Outdoor and Timberland reported in the chapter? Which is trading at a lower price per dollar of earnings?

Understand stockholders' equity and the statement of stockholders' equity (LO7)



Record equity transactions and prepare the stockholders' equity section (LO2, 3, 4, 5, 7)



Calculate and analyze ratios (LO8)



## PROBLEMS: SET B

Match terms with their definitions (LO1 to 8)

**P10-1B** Match (by letter) the following terms with their definitions. Each letter is used only once.

### Terms

- \_\_\_\_\_ 1. PE ratio.
- \_\_\_\_\_ 2. Stockholders' equity section of the balance sheet.
- \_\_\_\_\_ 3. Accumulated deficit.
- \_\_\_\_\_ 4. Growth stocks.
- \_\_\_\_\_ 5. 100% stock dividend.
- \_\_\_\_\_ 6. Statement of stockholders' equity.
- \_\_\_\_\_ 7. Treasury stock.
- \_\_\_\_\_ 8. Value stocks.
- \_\_\_\_\_ 9. Return on equity.
- \_\_\_\_\_ 10. Retained earnings.

### Definitions

- a. A debit balance in Retained Earnings.
- b. Priced high in relation to current earnings as investors expect future earnings to be higher.
- c. Effectively the same as a 2-for-1 stock split.
- d. The earnings not paid out in dividends.
- e. The stock price divided by earnings per share.
- f. Summarizes the *changes* in the balance in each stockholders' equity account *over a period of time*.
- g. Priced low in relation to current earnings.
- h. Measures the ability of company management to generate earnings from the resources that owners provide.
- i. Shows the balance in each equity account *at a point in time*.
- j. The corporation's own stock that it reacquired.

Record equity transactions and indicate the effect on the balance sheet equation (LO2, 3, 4, 5)

**P10-2B** Nautical has two classes of stock authorized: \$10 par preferred, and \$1 par value common. As of the beginning of 2012, 100 shares of preferred stock and 2,000 shares of common stock have been issued. The following transactions affect stockholders' equity during 2012:

- |         |    |  |
|---------|----|--|
| March   | 1  | Issue 2,000 additional shares of common stock for \$15 per share.  |
| April   | 1  | Issue 200 additional shares of preferred stock for \$30 per share.   |
| June    | 1  | Declare a cash dividend on both common and preferred stock of \$0.50 per share to all stockholders of record on June 15. |
| June    | 30 | Pay the cash dividends declared on June 1.   |
| August  | 1  | Repurchase 200 shares of common treasury stock for \$12 per share.   |
| October | 1  | Reissue 100 shares of treasury stock purchased on August 1 for \$14 per share.   |

Nautical has the following beginning balances in its stockholders' equity accounts on January 1, 2012: Preferred Stock, \$1,000; Common Stock, \$2,000; Paid-in Capital, \$18,500; and Retained Earnings, \$10,500. Net income for the year ended December 31, 2012, is \$7,150.

### Required:

- Record each of these transactions.
- Indicate whether each of these transactions would increase (+), decrease (-), or have no effect (NE) on total assets, total liabilities, and total stockholders' equity by completing the following chart.

| <u>Transaction</u>        | <u>Total Assets</u> | <u>Total Liabilities</u> | <u>Total Stockholders' Equity</u> |
|---------------------------|---------------------|--------------------------|-----------------------------------|
| Issue common stock        |                     |                          |                                   |
| Issue preferred stock     |                     |                          |                                   |
| Declare cash dividends    |                     |                          |                                   |
| Pay cash dividends        |                     |                          |                                   |
| Repurchase treasury stock |                     |                          |                                   |
| Reissue treasury stock    |                     |                          |                                   |

**P10-3B** The Athletic Village has done very well the past year, and its stock price is now trading at \$82 per share. Management is considering either a 100% stock dividend or a 2-for-1 stock split.

Indicate effect of stock dividends and stock splits (LO6)

**Required:**

Complete the following chart comparing the effects of a 100% stock dividend versus a 2-for-1 stock split on the stockholders' equity accounts, shares outstanding, par value, and share price.

|                                | <u>Before</u>   | <u>After 100% Stock Dividend</u> | <u>After 2-for-1 Stock Split</u> |
|--------------------------------|-----------------|----------------------------------|----------------------------------|
| Common stock, \$0.01 par value | \$ 10           |                                  |                                  |
| Additional paid-in capital     | 24,990          |                                  |                                  |
| Total paid-in capital          | 25,000          |                                  |                                  |
| Retained earnings              | 15,000          |                                  |                                  |
| Total stockholders' equity     | <u>\$40,000</u> | <u></u>                          | <u></u>                          |
| Shares outstanding             | <u>1,000</u>    |                                  |                                  |
| Par value per share            | <u>\$0.01</u>   |                                  |                                  |
| Share price                    | <u>\$82</u>     |                                  |                                  |

**P10-4B** The stockholders' equity section of The Seventies Shop is presented here.

Analyze the stockholders' equity section (LO7)

| THE SEVENTIES SHOP              |                  |
|---------------------------------|------------------|
| Balance Sheet (partial)         |                  |
| (\$ in thousands)               |                  |
| Stockholders' equity:           |                  |
| Preferred stock, \$50 par value | \$ -0-           |
| Common stock, \$5 par value     | 15,000           |
| Additional paid-in capital      | 45,000           |
| Total paid-in capital           | 60,000           |
| Retained earnings               | 48,000           |
| Treasury stock                  | (2,700)          |
| Total stockholders' equity      | <u>\$105,300</u> |

**Required:**

Based on the stockholders' equity section of The Seventies Shop, answer the following questions. Remember that all amounts are presented in thousands.

- How many shares of preferred stock have been issued?
- How many shares of common stock have been issued?
- Total paid-in capital is \$60 million. At what price per share were the common shares issued?
- If retained earnings at the beginning of the period was \$40 million and net income during the year was \$10,850,000, how much was paid in dividends for the year?
- If the treasury stock was reacquired at \$18 per share, how many shares were reacquired?
- How much was the dividend per share? (*Hint:* Dividends are not paid on treasury stock.)

Understand stockholders' equity and the statement of stockholders' equity (LO7)

**P10-5B** Refer to the information provided in P10-2B.

**Required:**

Taking into consideration all the transactions during 2012, respond to the following for Nautical:

1. Prepare the stockholders' equity section of the balance sheet as of December 31, 2012.
2. Prepare the statement of stockholders' equity for the year ended December 31, 2012.
3. Explain how *Requirements* 1 and 2 are similar and how they are different.

Record equity transactions and prepare the stockholders' equity section (LO2, 3, 4, 5, 7)



**P10-6B** National League Gear has two classes of stock authorized: 6%, \$20 par preferred, and \$5 par value common. The following transactions affect stockholders' equity during 2012, National League's first year of operations:

|          |    |   |
|----------|----|---|
| February | 2  | Issue 1 million shares of common stock for \$25 per share.  |
| February | 4  | Issue 500,000 shares of preferred stock for \$22 per share.   |
| June     | 15 | Repurchase 100,000 shares of its own common stock for \$20 per share.   |
| August   | 15 | Reissue 75,000 shares of treasury stock for \$35 per share.   |
| November | 1  | Declare a cash dividend on its common stock of \$1 per share and a \$600,000 (6% of par value) cash dividend on its preferred stock payable to all stockholders on record on November 15.<br>( <i>Hint: Dividends are not paid on treasury stock.</i> ) |
| November | 30 | Pay the dividends declared on November 1.   |

**Required:**

1. Record each of these transactions.
2. Prepare the stockholders' equity section of the balance sheet as of December 31, 2012. Net income for the year was \$4,800,000.

Calculate and analyze ratios (LO8)

**P10-7B Gap** is a close competitor of **Deckers Outdoor** and **Timberland** in the teenage apparel industry. Gap also owns the **Old Navy** and **Banana Republic** clothing chains. Gap reported higher earnings than Deckers Outdoor and Timberland in 2009. Does that mean Gap is more profitable? Maybe, but we need to control for the differences in company size in order to accurately compare the profitability of the companies. Selected financial data for Gap is provided as follows:

| (\$ in millions)                           | 2009            | 2008            |
|--|-----------------|-----------------|
| Sales                                      | \$14,526        | \$15,763        |
| Net income                                 | 967             | 833             |
| Total assets                               | <u>\$ 7,564</u> | <u>\$ 7,838</u> |
| Total liabilities                          | \$ 3,177        | \$ 3,564        |
| Stockholders' equity                       | <u>4,387</u>    | <u>4,274</u>    |
| Total liabilities and stockholders' equity | <u>\$ 7,564</u> | <u>\$ 7,838</u> |
| Shares outstanding (in millions)           | <u>694</u>      | <u>-</u>        |
| Stock price                                | <u>\$16</u>     | <u>-</u>        |

**Required:**

1. Calculate the return on equity for Gap in 2009. How does it compare with the return on equity for Deckers Outdoor and Timberland reported in the chapter?
2. Calculate the return on the market value of equity for Gap in 2009. How does it compare with the return on the market value of equity for Deckers Outdoor and Timberland reported in the chapter?
3. Why is the return on the market value of equity for Gap so much lower than the return on equity?
4. Calculate the price-earnings ratio for Gap in 2009. How does it compare with the price-earnings ratio for Deckers Outdoor and Timberland reported in the chapter? Which is trading at a lower price per dollar of earnings?