Financial Statement Analysis & Valuation, 5th Edition
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Practice Quiz Solutions

Module 8 – Equity Recognition and Owner Financing

1. Assume the following is the 2016 stockholders' equity section from the Cisco Systems, Inc., balance sheet.

Shareholders' Equity (in millions, except par value)	July 30, 2016
Preferred stock, no par value: 5 shares authorized; none issued and outstanding	$ —
Common stock and additional paid-in capital, $0.001 par value: 20,000 shares authorized; 6,331 shares issued and outstanding at July 30, 2016	22,394
Retained earnings	506
Accumulated other comprehensive income	274
Total shareholders' equity	$23,174

For the $22,394 million reported as "common stock and additional paid-in capital," what portion is common stock?

a. $22,394 million
b. $6 million
c. $22,388 million
d. $12 million

Answer: b

Common stock	$ 6*
Additional paid-in capital	22,388
Total	$22,394

* Cisco's common stock has a par value of $0.001.
The common stock account therefore includes, 6,331 million shares issued × $0.001 par value, rounded down to $6 million.

2. Assume the following is the stockholders' equity section from the Abercrombie & Fitch balance sheet.

Shareholders' Equity ($ thousands)	January 30, 2016	January 31, 2015
Class A common stock-$0.01 par value: 150,000,000 shares authorized and 103,300,000 shares issued at January 30, 2016 and January 31, 2015, respectively	$ 1,033	$ 1,033
Paid-in capital	161,678	140,251
Retained earnings	1,357,791	1,076,023
Accumulated other comprehensive income	(796)	—
Deferred compensation	26,206	15,048
Treasury stock at average cost: 15,573,789 and 17,262,943 shares at January 30, 2016 and January 31, 2015, respectively	(550,795)	(563,029)
Total shareholders' equity	$ 995,117	$ 669,326

How many shares are outstanding at its 2016 fiscal year-end?

a. 87,726,211
b. 150,000,000
c. 103,300,000
d. 86,037,057

Answer: a

Outstanding shares are equal to issued shares less repurchased shares. For 2016, Abercrombie & Fitch has 103,300,000 – 15,573,789 = 87,726,211 shares outstanding.

3. Fischer Company has outstanding 8,000 shares of $100 par value, 5% preferred stock, and 50,000 shares of $1 par value common stock. The company has $328,000 of retained earnings. At year-end, the company declares and pays the regular $5 per share cash dividend on preferred stock and a $1.80 per share cash dividend on common stock.

What is the total dividends paid by Fischer Company?

a. $328,000
b. $ 40,000
c. $ 90,000
d. $130,000

Answer: d

RE 130,000
Cash 130,000

RE
130,000 |

Cash
| 130,000

	Balance Sheet									Income Statement				
Transaction	Cash Asset	+	Noncash Assets	=	Liabil-ities	+	Contrib. Capital	+	Earned Capital	Rev-enues	–	Expen-ses	=	Net Income
Declare and pay preferred and common dividends	–130,000 Cash			=					–130,000 Retained Earnings		–		=	

Preferred dividends = $40,000 ($5 × 8,000 shares); Common dividends = $90,000 ($1.80 × 50,000 shares).

4. Assume the following is the stockholders' equity section from Altria's 2016 balance sheet.

December 31 ($ millions)	2016
Common stock, par value $0.33 1/3 per share (2,805,961,317 shares issued)	$ 935
Additional paid-in capital	6,061
Earnings reinvested in the business	54,666
Accumulated other comprehensive losses (including currency translation of $1,317 in 2016)	(1,853)
Cost of repurchased stock (721,696,918 shares in 2016)	(24,102)
Total stockholders' equity	$35,707

At what average price has Altria issued its common stock?

a. $ 2.49
b. $ 0.33
c. $12.73
d. $33.40

Answer: a

Altria issued its common shares at the average price of $2.49 per share. This value is computed as: ($935 million common stock + $6,061 million additional paid-in capital) / 2,805,961,317 shares.

5. Assume the following is the stockholders' equity section of the 2016 Caterpillar, Inc., balance sheet.

Stockholders' Equity ($ millions)	2016	2015	2014
Common stock of $1.00 par value; Authorized shares: 900,000,000; Issued shares (2016, 2015, and 2014—814,894,624) at paid-in amount	$1,859	$1,231	$1,059
Treasury stock (2016—144,027,405 shares; 2015-129,020,726 shares; 2014—127,370,544 shares) at cost	(4,637)	(3,277)	(2,914)
Profit employed in the business	11,808	9,937	8,450
Accumulated other comprehensive income	(598)	(424)	(517)
Total stockholders' equity	$8,432	$7,467	$6,078

At what average cost has Caterpillar repurchased its stock as of year-end 2016?

a. $ 2.07
b. $ 2.28
c. $32.20
d. $10.35

Answer: c

Caterpillar purchased treasury shares, on average, for $32.20 per share; this is computed as paid-in amount $4,637 million / 144,027,405 shares.

6. Assume the following is the stockholders' equity section of the 2016 Merck & Co., Inc., balance sheet.

Stockholders' Equity ($ millions)	**2016**
Common stock, one cent par value; Authorized-5,400,000,000 shares; Issued—2,976,223,337 shares—2016	$ 29.8
Other paid-in capital	6,900.0
Retained earnings	37,918.9
Accumulated other comprehensive income	52.3
	44,901.0
Less treasury stock, at cost; 794,299,347 shares—2016	26,984.4
Total stockholders' equity	$17,916.6

How many common shares are outstanding as of December 31, 2016?

a. 5,400,000,000
b. 2,976,223,337
c. 3,770,552,684
d. 2,181,923,990

Answer: d

Shares issued – Treasury shares = Shares outstanding
2,976,223,337 – 794,299,347 = 2,181,923,990 shares outstanding

7. Assume the following is the stockholders' equity section of the 2016 balance sheet for Procter & Gamble Company and its statement of stockholders' equity.

Amounts in millions; June 30	**2016**	**2015**
Shareholders' Equity		
Convertible Class A preferred stock, stated value $1 per share (600 shares authorized)	$ 1,451	$ 1,483
Non-Voting Class B preferred stock, stated value $1 per share (200 shares authorized)	—	—
Common stock, stated value $1 per share (10,000 shares authorized; shares outstanding: 2016-3,975.8, 2015-2,976.6)	3,976	2,977
Additional paid-in capital	57,856	3,030
Reserve for ESOP debt retirement.	(1,288)	(1,259)
Accumulated other comprehensive income	(518)	(1,566)
Treasury stock, at cost (shares held: 2016-797.0, 2015-503.7)	(34,235)	(17,194)
Retained earnings	35,666	31,004
Total shareholders' equity	$62,908	$18,475

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Consolidated Statement of Shareholders' Equity										
Dollars in millions/ shares in thousands	Common Shares Outstanding	Common Stock	Preferred Stock	Add'l Paid-in Capital	Reserve for ESOP Debt Retirement	Accum. Other Compre-hensive Income	Treasury Stock	Retained Earnings	Total	Total Compre-hensive Income
Bal. June 30, 2015	2,472,934	$2,977	$1,483	$3,030	$(1,259)	$(1,566)	$(17,194)	$31,004	$18,475	
Net Earnings								8,684	8,684	$8,684
Other comprehensive income: Financial statement translation						1,316			1,316	1,316
Net investment hedges, net of $472 tax						(786)			(786)	(786)
Other, net of tax benefits						518			518	518
Total comprehensive income										$9,732
Dividends to shareholders: Common								(3,555)	(3,555)	
Preferred, net of tax benefits								(148)	(148)	
Treasury purchases	(297,132)			(9)			(16,821)		(16,830)	
Employee plan issuances	36,763	16		1,308			887	(319)	1,892	
Preferred stock Conversions	3,788		(32)	5			27		—	
Gillette acquisition	962,488	983		53,522			(1,134)		53,371	
Change in ESOP debt reserve					(29)				(29)	
Bal. June 30, 2016	3,178,841	$3,976	$1,451	$57,856	$(1,288)	$ (518)	$(34,235)	$35,666	$62,908	

How many shares of common stock did Procter & Gamble issue when convertible class A preferred stock was converted during fiscal 2016?

a. 36,763,000
b. 3,788,000
c. 962,488,000
d. 600,000,000

Answer: b

During fiscal 2016, P&G issued 3.788 million shares of common stock when Class A preferred stock was converted. The statement of shareholders' equity also reveals that these common shares came from treasury stock.

8. Beta Laboratories reported the following footnote related to its convertible debentures.

> **2.75% series A and B debentures** During the third quarter of fiscal 2016, we sold 2.75% Series A Convertible Senior Debentures and 2.75% Series B Convertible Senior Debentures for an aggregate amount of $1.6 billion, net of the underwriters' discount and related fees and expenses of $46 million. The debentures were issued at a price of $1,000 per debenture and were issued under our universal shelf. The debentures rank equal in priority with all of the existing and future unsecured and unsubordinated indebtedness and senior in right of payment to all of the existing and future subordinated indebtedness. The terms governing the debentures limit our ability to create liens, secure certain indebtedness and merge with or sell substantially all of our assets to another entity. The debentures are convertible into shares of common stock only if (1) the average sale price of our common stock is at least equal to 120% of the applicable conversion price, (2) the average trading price of the debentures is less than 97% of the product of the sale price of the common stock and the conversion rate, (3) the debentures have been called for redemption by us or (4) certain specified corporate actions occur.

How will Beta Laboratories account for the conversion of the 2.75% debentures, if and when conversion occurs? Specifically, will Beta Laboratories recognize any gain or loss related to conversion?

a. Gain or loss is recorded for unamortized discount or premium at time of conversion
b. Gain or loss is recorded as difference between market value of stock and book value of debentures at time of conversion
c. Gain or loss is recorded as difference between market value of stock and market value of debentures at time of conversion
d. No gain or loss from conversion is reported

Answer: d

When the bonds are converted, Beta Laboratories will remove the face amount of the bonds from the balance sheet together with any remaining unamortized discount or premium. Beta Laboratories will account for the issuance of the common stock as if it had received proceeds equal to the bonds' face value, Then, Beta Laboratories would separate and assign these proceeds to common stock (at par value) and additional paid-in capital. Thus, no gain or loss from conversion is reported.

9. White Corp. has outstanding 40,000 shares of $5 par value common stock. At year-end, the company declares and issues a 6% common stock dividend when the market price of the stock is $22 per share.

   What will be the entry to retained earnings as a result of this stock dividend?

   a. $40,800 credit
   b. $12,000 debit
   c. $40,800 debit
   d. $52,800 debit

   Answer: d

RE 52,800
CS 12,000
APIC 40,800

RE: 52,800 |

CS: | 12,000

APIC: | 40,800

Transaction	Cash Asset	+	Noncash Assets	=	Liabil-ities	+	Contrib. Capital	+	Earned Capital	Rev-enues	–	Exp-enses	=	Net Income
	Balance Sheet									**Income Statement**				
Declare and pay stock dividends				=			+12,000 Common Stock +40,800 Add'l Paid-in Capital		–52,800 Retained Earnings		–		=	

Stock dividend = $52,800: market price of the shares distributed (40,000 x 6% x $22).

10. On September 1, Reedy Company has 500,000 shares of $30 par value ($330 market value) common stock that are issued and outstanding. Its balance sheet on that date shows the following account balances relating to its common stock:

Common stock …………………………………	15,000,000
Paid-in capital in excess of par value ……….	9,000,000

   On September 2, Reedy splits its stock 3-for-2 and reduces the par value to $20 per share. How many shares of common stock are issued and outstanding immediately after the stock split?

   a. 500,000 shares
   b. 333,333 shares
   c. 750,000 shares
   d. 15,000,000 shares

   Answer: c

   Immediately after the 3-for-2 stock split, the company has 750,000 shares of $20 par value common stock [500,000 shares x (3/2) = 750,000 shares] issued and outstanding.