

**Chapter 11– Financial Accounting, 5<sup>th</sup> Edition by Dyckman, Hanlon, Magee, & Pfeiffer**

**Solutions to Practice Quiz**

**Topic: Stockholders' Equity from the Balance Sheet**

**LO: 1**

1. Tyson Corporation issued 350,000 shares of \$1.50 par value capital stock at its date of incorporation for cash at a price of \$6 per share. During the first year of operations, the company earned \$150,000 and declared a dividend of \$50,000. At the end of this first year of operations, the balance of the Common Stock account is:
  - a. \$ 625,000
  - b. \$2,200,000
  - c. \$ 525,000
  - d. \$1,675,000

*Answer:* c

*Rationale:*  $\$350,000 \times \$1.50 = \$525,000$

**Topic: Stock Split**

**LO: 4**

2. In March 2016, Towson Company announced a 4-for-1 stock split. This brought the number of shares outstanding from 88 million shares to \_\_\_\_\_ shares.
  - a. 22 million
  - b. 176 million
  - c. 264 million
  - d. 352 million

*Answer:* d

*Rationale:* A 4-for-1 stock split simply means that the company distributes three additional shares of stock for each share owned by a current shareholder.  $88 \text{ million} \times 4 = 352 \text{ million}$

**Topic: EPS**

**LO: 6**

3. Carlson Company reported net income of \$1,750 million in 2016. The weighted average number of common shares outstanding during 2016 was 525 million shares. Carlson paid \$30 million in dividends on preferred stock, which was convertible into 15 million shares of common stock.

What is the basic earnings per share amount for 2016?

- a. \$3.24
- b. \$3.19
- c. \$3.33
- d. \$3.28

*Answer:* d

*Rationale:*  $(\$1,750 - 30) / 525 = \$3.28$

**Topic: EPS**

**LO: 6**

4. Evans Company reported net income of \$1,050 million in 2016. The weighted average number of common shares outstanding during 2016 was 480 million shares. Evans paid \$50 million in dividends on preferred stock, which was convertible into 40 million shares of common stock.

What is the diluted earnings per share amount for 2016?

- a. \$2.02
- b. \$2.19
- c. \$1.92
- d. \$2.12

*Answer:* a

*Rationale:*  $\$1,050 / 520 = \$2.02$

**Topic: Accounting for Stock Issuance**

**LO: 2**

5. If a company issues 2,000 shares of common stock at a market price of \$25 per share, which of the following is the correct balance sheet entry?
- Increase cash by \$50,000 and increase the contributed capital section by \$50,000
  - Increase cash by \$50,000 and increase earned capital by \$50,000
  - Decrease revenues by \$20,000
  - Stock issuances are not reported on the balance sheet

*Answer: a*

Rationale: Cash increases by the number of shares issued times the market price; contributed capital also increases by the same amount. The latter is broken down into two segments: (1) common stock, which increases by the original par value of the shares sold, and (2) additional paid-in capital, which makes up the balance. Revenue is an Income Statement category and therefore irrelevant in this case.

**Topic: Book Value per Share**

**LO: 5**

6. Shaw Company has total stockholders' equity of \$5,400,000. The company's outstanding capital stock includes 60,000 shares of \$10 par value common stock and 15,000 shares of 6%, \$50 par value preferred stock. There are no dividends in arrears. Based on this information, the book value per share of common stock is:
- \$62.00
  - \$67.50
  - \$90.00
  - \$77.50

*Answer: d*

Rationale:  $\$5,400,000 - (15,000 \times \$50) = \$4,650,000$ ;  $\$4,650,000 / 60,000 = \$77.50$

**Topic: Earned Capital and Dividends**

**LO: 3, 4, 5**

7. Below is the stockholders' equity section of the balance sheet of Craft Corporation (with certain details omitted):

Stockholders' equity:	
6% preferred stock, \$100 par, 10,000 shares authorized and ? shares issued	\$800,000
Common Stock, \$25 par, 50,000 shares authorized, ? shares issued	625,000
Additional paid-in capital:	
Preferred stock	150,000
Common stock	<u>225,000</u>
Total paid-in capital	\$1,800,000
Retained earnings	<u>950,000</u>
Total stockholders' equity .....	<u><u>\$2,750,000</u></u>

The balance in retained earnings at the beginning of the current year was \$675,000, and there were no dividends in arrears. Net income for the current year was \$350,000. Based on this information, what is the amount of the dividends declared on each share of common stock during the current year?

- a. \$1.08
- b. \$3.00
- c. \$4.46
- d. \$2.27

*Answer: a*

Rationale:

Retained earnings, beginning of year	\$ 675,000
Add: Net income for the year	<u>350,000</u>
	\$1,025,000
Less: Retained earnings, end of year	<u>950,000</u>
Total dividends declared during the year	\$ 75,000
Less: Total dividend declared to preferred stockholders (6% x \$800,000 = \$48,000)	<u>(48,000)</u>
Total dividend declared to common stockholders	<u>\$ 27,000</u>
Dividend declared per share of common stock (\$27,000/25,000)	<u><u>\$1.08</u></u>

**Topic: Treasury Stock**

**LO: 1, 2**

8. Treasury stock that is reissued at a price above its cost results in which of the following?:
- Total paid-in capital is increased.
  - The corporation recognizes a gain to be recorded on the income statement.
  - Retained earnings is increased.
  - The reissued price is treated as an extraordinary item in the corporation's income statement.

*Answer: a*

Rationale: In this case Cash would be debited, Treasury stock would be credited and Additional Paid-In Capital would be credited. The result is an increase in total paid-in capital.

**Topic: Accounting for Stock Transactions**

**LO: 1, 2**

9. On January 1, 2016, Morgan Company issued 60,000 shares of its total 200,000 authorized shares of \$4 par value common stock for \$4 per share. On December 31, 2016, Morgan Company's common stock is trading at \$8 per share.

If Morgan Company does not issue any more common stock in 2016, how does the increase in value of its outstanding stock affect Morgan?

- This increase in market value of outstanding stock is not recorded in the financial statements of Morgan Company.
- Morgan should recognize additional net income for 2016 of \$4 per share, or \$240,000.
- Each shareholder must pay an additional \$4 per share to Morgan.
- Paid-in capital at December 31, 2016, is \$480,000 (or 60,000 shares times \$8 per share).

*Answer: a*

Rationale: Market value increase is not recognized for outstanding stock.

**Topic: Preferred Stock Characteristics**

**LO: 1, 7**

10. Which of the following is *not* a characteristic of most preferred stocks?
- Preference as to dividends.
  - No voting power.
  - Detachable conversion options are not valued on the balance sheet.
  - Preference as to assets in the event of liquidation of the company.

*Answer: C*

Rationale: Detachable conversion options are valued on the balance sheet separate from the security.