

## Corporations: Effects on Retained Earnings and the Income Statement

Chapter 12

## Stock Dividend

- ▶ Proportional distribution of corporation's own stock to shareholders
- ▶ Does not change **total** stockholders' equity

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## Why do Companies Issue Stock Dividends?

### Conserve cash

- Continue dividends without using cash

### Reduce market price

- Increased supply of shares may cause price to fall

### Reward investors

- Shareholders feel they have received something of value

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## Entries for Stock Dividend

### Small

- ▶ Distribution is less than 20 to 25% of issued shares

### Large

- ▶ Distribution is greater than or equal to 25% of issued shares

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## Exercise 12-13

GENERAL JOURNAL					
DATE		DESCRIPTION	REF	DEBIT	CREDIT
Apr	30	Retained earnings (45 x \$17)			
		Common stock (45 x \$1)			
		Paid-in capital in excess of par-C/S			

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## Exercise 12-13 (continued)

Seabury Occupational Therapy, Inc. Stockholders' Equity April 30, 2010	
Paid-in capital:	
Common stock, \$1 par, 1,000 shares authorized, 495 issued	\$ 495
Paid-in capital in excess of par	2,520
Total paid-in capital	3,015
Retained earnings	127,235
Total stockholders' equity	<u>\$ 130,250</u>

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## Learning Objective 1

Account for stock dividends

## Learning Objective 2

Account for stock splits

### Stock Splits

- ▶ Increases:
  - the number of shares authorized, issued and outstanding
- ▶ Decreases:
  - par value per share
  - market value
- ▶ Balances in the accounts are unchanged
- ▶ Record in a memorandum entry

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### Stock Split Example

A company has 25,000 shares of \$10 par common stock outstanding

A 2-for-1 stock split is declared

Results in 50,000 shares of \$5 par common stock outstanding

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### Effects of Dividends and Stock Splits

Event	Common stock	Paid-in capital in excess of par	Retained earnings	Total stockholders' equity
Cash dividend				
Stock dividend				
Stock split				

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## Learning Objective 3

Account for treasury stock

## Treasury Stock

- ▶ Shares that a company has issued and later reacquired
- ▶ Why do corporations purchase their own stock?

## Accounting for Treasury Stock



## Treasury Stock Journal Entries

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Treasury stock			
	Cash			
	<i>To record purchase of treasury shares</i>			

## Treasury Stock Journal Entries

If treasury stock is sold above cost, the excess is credited to "Paid-in capital from treasury stock transactions"

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Cash			
	Treasury stock (at cost)			
	Paid-in capital from treasury stock transactions			

## Treasury Stock: Sale Below Cost

If treasury stock is sold below cost, the shortfall is debited to "Paid-in capital from treasury stock transactions"

**IF** there is a sufficient balance

Otherwise, Retained earnings is debited for any remaining shortfall

## Treasury Stock Journal Entries: Sale Below Cost

Situation 1 – Paid-in capital from treasury stock has a sufficient balance to cover the shortfall

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Cash			
	Paid-in capital from treasury stock transactions			
	Treasury stock (at cost)			

## Treasury Stock Journal Entries: Sale Below Cost

Situation 2 – Paid-in capital from treasury stock has a balance too small to cover shortfall

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Cash			
	Paid-in capital from treasury stock transactions			
	Retained earnings			
	Treasury stock (at cost)			

For amount that zeros out account

## Treasury Stock Journal Entries: Sale Below Cost

Situation 3 – Paid-in capital from treasury stock has a zero balance

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Cash			
	Retained earnings			
	Treasury stock (at cost)			

## Learning Objective 4

Report restrictions on retained earnings

## Restrictions and Appropriations of Retained Earnings

### Restrictions

- ▶ Requirement by lenders to maintain a minimum level of equity
- ▶ Reported in the notes to the financial statements

### Appropriations

- ▶ Restrictions on retained earnings recorded by formal journal entries
- ▶ Board of Directors may designate purpose of appropriation

## Learning Objective 5

Complete a corporate income statement including earnings per share

Any Corporation Income Statement	
Sales revenue	
Cost of goods sold	
Gross profit	
Operating expenses	
Operating income	
Other gains (losses)	
Income from continuing operations before income tax	
Income tax expense	
Income from continuing operations	
Discontinued operations, net of tax	
Income before extraordinary items	
Extraordinary loss, net of tax	
Net Income	

## Income from Continuing Operations

- Measures profitability of the ongoing operations

Any Corporation Income Statement	
Sales revenue	
Cost of goods sold	
Gross profit	
Operating expenses	
Operating income	
Other gains (losses)	
Income from continuing operations before income tax	
Income tax expense	
Income from continuing operations	

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## Special Items

- Reported after income from continuing operations

Discontinued operations

Extraordinary items

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## Discontinued Operations

- Segment of a business that has been sold
- Reported separately because they will not be around in the future
- Shown net of tax

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## Extraordinary Items

- Both unusual and infrequent
- Reported net of income tax effect

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## Earnings Per Share (EPS)

- Most widely used business statistic
- Measures amount of net income for each share of common stock outstanding
- Key measure of success in business

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Earnings per share

Net income – preferred dividends

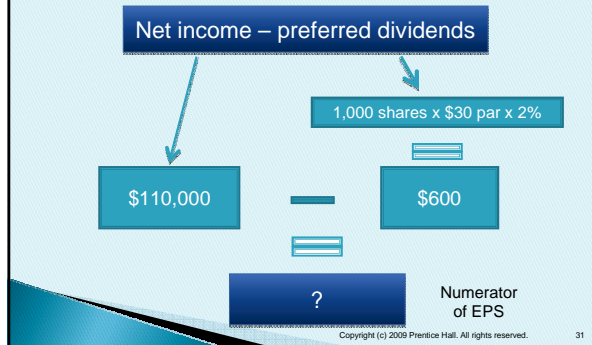
Average number of common shares outstanding

EPS figures are reported for:

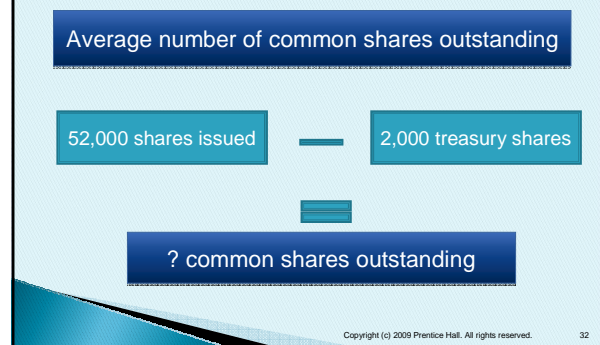
Income from continuing operations
Income from discontinued operations
Income before extraordinary items
Extraordinary gains or losses
Net Income (Loss)

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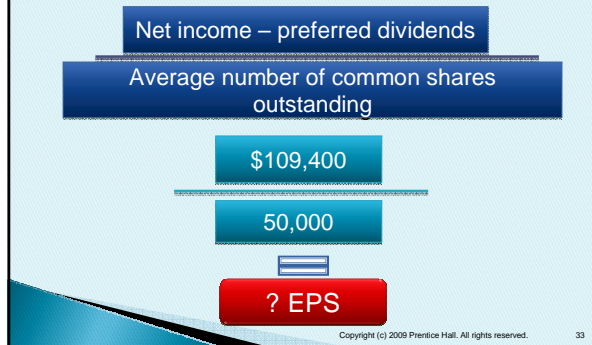
## Exercise 12-21



## Exercise 12-21 (continued)



## Exercise 12-21 (continued)



## Statement of Retained Earnings

Any Corporation Statement of Retained Earnings For the year ended December 31, 2011	
Retained earnings, December 31, 2010	\$\$\$\$
Plus: Net income	\$\$\$\$
Less: Dividends	(\$\$\$)
Retained earnings, December 31, 2011	\$\$\$\$

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## Prior Period Adjustments

- ▶ Corrections to Retained earnings for errors of an earlier period
  - ▶ Correcting entry includes
    - Debit or credit to Retained Earnings for error amount
    - Debit or credit to asset or liability account that was misstated
  - ▶ Reported on Statement of Retained Earnings
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## Comprehensive Income

- ▶ Change in total stockholders' equity from all sources other than from its owners
  - ▶ Net income plus or minus
    - Unrealized gains/losses on certain investments
    - Foreign currency translation adjustments
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**End of Chapter 12**