Advanced Accounting 2

Chapter Two
(Dividends and Treasury)

Accounting Department
Third stage

2023-2024

Chapter Two
Dividends and Treasury

Types of dividends

Dividends distributions generally are based either on accumulated profit, that is retained earnings, or on some other capital items such as additional paid-in capital. The natural expectation of any stockholder who receives a dividend is that corporation has operated successfully. The following are the dividends types:

1-Cash dividends
2-Stock dividends
3-Scrip dividends
4-Property dividends
5-Liquidation dividends

1- Cash Dividends

Entries For Cash Dividends

Three dates are important in connection with dividends:

(1) the declaration date.
(2) the record date.
(3) the payment date.

Normally, there are two to four weeks between each date. Companies make accounting entries on two of the dates—the declaration date and the payment date.

On the **declaration date**, the board of directors formally declares (authorizes) the cash dividend and announces it to stockholders. Declaration of a cash dividend **commits the corporation to a legal obligation**. The obligation is binding and cannot be rescinded. The company makes an entry to recognize the decrease in retained earnings and the increase in the liability Dividends Payable.

To illustrate, assume that on December 1, 2010, the directors of Media General declare a 50 ¢ per share cash dividend on 100,000 shares of $10 par value common stock. The dividend is $50,000 (100,000 _ 50 ¢) The entry to record the declaration is:

Declaration Date

Dec. 1	**Retained Earnings 50,000**	
		Dividends Payable 50,000
	(To record declaration of cash dividend)	

Dividends Payable is a current liability: it will normally be paid within the next several months.

At the record date, the company determines ownership of the outstanding shares for dividend purposes. The records maintained by the corporation supply this information. In the interval between the declaration date and the record date, the corporation updates its stock ownership records. For Media General, the record date is December 22. No entry is required on this date because the corporation's liability recognized on the declaration date is unchanged.

Record Date
Dec. 22

No entry necessary

On the payment date, the company mails dividend checks to the stockholders and records the payment of the dividend. Assuming that the payment date is January 20 for Media General, the entry on that date is:

Payment Date

Jan. 20	**Dividends Payable**	**50,000**	
	Cash		**50,000**

(To record payment of cash dividend)

Allocating Cash Dividends Between Preferred and Common Stock

preferred stock has priority over common stock in regard to dividends. Holders of cumulative preferred stock must be paid any unpaid prior-year dividends and its current year's dividend before common stockholders receive dividends.

To illustrate, assume that at December 31, 2010, IBR Inc. has 1,000 shares of 8%, $100 par value cumulative preferred stock. It also has 50,000 shares of $10 par value common stock outstanding. The dividend per share for preferred stock is $8 ($100 par value x 8%). The required annual dividend for preferred stock is therefore $8,000 (1,000 x $8). At December 31, 2010, the directors declare a $6,000 cash dividend. In this case, the entire dividend amount goes to preferred stockholders because of their dividend preference. The entry to record the declaration of the dividend is:

Dec. 31	**Retained Earnings**	**6,000**	
	Dividends Payable		**6,000**

(To record $6 per share cash dividend to preferred stockholders)

Because of the cumulative feature, dividends of $2 per share are in arrears on preferred stock for 2010. The company must pay these dividends to preferred stockholders before it can pay any future dividends to common stockholders. IBR should disclose dividends in arrears in the financial statements.

At December 31, 2011, IBR declares a $50,000 cash dividend. The allocation of the dividend to the two classes of stock is as follows

Total dividend		$50,000
Allocated to preferred stock		
Dividends in arrears, 2010 (1,000 × $2)	**$2,000**	
2011 dividend (1,000 × $8)	**8,000**	10,000
Remainder allocated to common stock		$40,000

The entry to record the declaration of the dividend is:

Dec. 31	**Retained Earnings**	**50,000**	
	Dividends Payable		**50,000**

(To record declaration of cash dividends of $10,000 to preferred stock and $40,000 to common stock)

What if IBR's preferred stock were not cumulative? In that case preferred stockholders would have received only $8,000 in dividends in 2011. Common stockholders would have received $42,000.

Example:1

On January 1, Molini Corporation had 95,000 shares of no-par common stock issued and outstanding. The stock has a stated value of $5 per share. During the year, the following occurred.

Apr. 1 Issued 25,000 additional shares of common stock for $17 per share.

June 15 Declared a cash dividend of $1 per share to stockholders of record on June 30.

July 10 Paid the $1 cash dividend.

Dec. 1 Issued 2,000 additional shares of common stock for $19 per share.

15 Declared a cash dividend on outstanding shares of $1.20 per share to stockholders of record on December 31.

Instructions

(a) Prepare the entries, if any, on each of the three dividend dates.

(b) How are dividends and dividends payable reported in the financial statements prepared at December 31?

(a)	June 15	Retained Earnings (120,000 X $1).........	120,000	
		Dividends Payable		120,000
	July 10	Dividends Payable	120,000	
		Cash..		120,000
	Dec. 15	Retained Earnings (122,000 X $1.20)...	146,400	
		Dividends Payable		146,400

(b) In the retained earnings statement, dividends of $266,400 will be deducted. In the balance sheet, Dividends Payable of $146,400 will be reported as a current liability.

Example:2

Perez Corporation was organized on January 1, 2009. During its first year, the corporation issued 2,000 shares of $50 par value preferred stock and 100,000 shares of $10 par value common stock. At December 31, the company declared the following cash dividends: 2009, $6,000, 2010, $12,000, and 2011, $28,000.

Instructions

(a) Show the allocation of dividends to each class of stock, assuming the preferred stock dividend is 7% and not cumulative.

(b) Show the allocation of dividends to each class of stock, assuming the preferred stock dividend is 8% and cumulative.

(c) Journalize the declaration of the cash dividend at December 31, 2011, under part (b).

(a)

	2007	2008	2009
Total dividend declaration	$6,000	$12,000	$28,000
Allocation to preferred stock	6,000	7,000	7,000
Remainder to common stock	$ 0	$ 5,000	$21,000

(b)

	2007	2008	2009
Total dividend declaration	$6,000	$12,000	$28,000
Allocation to preferred stock	6,000	10,000[1]	8,000
Remainder to common stock	$ 0	$ 2,000	$20,000

[1]Dividends in arrears for Year 1, $2,000 + current dividend for Year 2, $8,000.

(c)	Dec. 31	Retained Earnings	28,000	
		Dividends Payable		28,000

2- Stock Dividends

A stock dividend is a pro rata distribution to stockholders of the corporation's own stock. Whereas a company pays cash in a cash dividend, a company issues shares of stock in a stock dividend. A stock dividend results in a decrease in retained earnings and an increase in paid-in capital. Unlike a cash dividend, a stock dividend does not decrease total stockholders' equity or total assets.

The company has disbursed no cash, and has assumed no liabilities. What are the purposes and benefits of a stock dividend? Corporations issue stock dividends generally, **for one or more of the following reasons.**

1. To satisfy stockholders' dividend expectations without spending cash.
2. To increase the marketability of the corporation's stock. When the number of shares outstanding increases, the market price per share decreases. Decreasing the market price of the stock makes it easier for smaller investors to purchase shares.

Entries For Stock Dividends

To illustrate the accounting for small stock dividends, assume that Medland Corporation has a balance of $300,000 in retained earnings. It declares a 10% stock dividend on its 50,000 shares of $10 par value common stock. The current fair market value of its stock is $15 per share. The number of shares to be issued is 5,000 (10% x 50,000). Therefore, the total amount to be debited to Retained Earnings is $75,000 (5,000 x $15). The entry to record the declaration of the stock dividend is as follows.

Retained Earnings	**75,000**	
Common Stock Dividends Distributable		**50,000**
Paid-in Capital in Excess of Par Value		**25,000**

Effects Of Stock Dividends

How do stock dividends affect stockholders' equity? They change the composition of stockholders' equity, because they transfer to paid-in capital a portion of retained earnings. However, total stockholders' equity remains the same. Stock dividends also have no effect on the par or stated value per share. But the number of shares outstanding increases.

	Before Dividend	After Dividend
Stockholders' equity		
Paid-in capital		
Common stock, $10 par	$500,000	$550,000
Paid-in capital in excess of par value	—	25,000
Total paid-in capital	500,000	575,000
Retained earnings	300,000	225,000
Total stockholders' equity	**$800,000**	**$800,000**
Outstanding shares	**50,000**	**55,000**
Par value per share	**$10.00**	**$10.00**

In this example, total paid-in capital increases by $75,000, and retained earnings decreases by the same amount. Note also that total stockholders' equity remains unchanged at $800,000.

3- **Scrip dividends:**

A scrip dividend, means that instead of paying a dividend now, the corporation has elected to pay it at some later date. The scrip issued to stockholders as dividend in a special form of notes payable "and should be reported in balance sheet as liability"

If the scrip bears interest, the interest portion of cash payable should be debited to interest expense and not treated as part of dividend.

Example1:

Baran Corporation, declared a scrip dividend on May 1in the form of two months promissory notes (N/P) amounting to 80 cent a share on 5,000 outstanding shares and payable on June 30, the interest on the N/P is 10 % per year and matured on July 27.

Solution: 5,000 x 0.80 = $4,000

May 1: **Dr. Retained Earnings 4,000**

Cr. N/P (stockholders) 4,000

Declared scrip dividends

June 30: 4,000 x 10% x 2/12 = $67

Dr. N/P (stock holders) 4,000

Interest Expense 67

Cr. Cash 4,067

Paid scrip dividends by cash

4- property Dividends

Dividends payable in assets of the corporation other than cash are called **property dividends** or **dividends in kind**. Property dividends may be merchandise, real estate, or investments, or whatever form the board of directors designates When declaring a property dividend, the corporation should **restate at fair value the property it will distribute**, **recognizing any gain or loss** as the difference between the property's fair value and carrying value at date of declaration. The corporation may then record the declared dividend as a debit to Retained Earnings (or Property Dividends Declared) and a credit to Property Dividends Payable, at an amount equal to the fair value of the distributed property. Upon distribution of the dividend, the corporation debits Property Dividends Payable and credits the account containing the distributed asset (restated at fair value).

For example, Trendler, Inc. transferred to stockholders some of its equity investments costing $1,250,000 by declaring a property dividend on December 28, 2019, to be distributed on January 30, 2020, to stockholders of record on January 15, 2020. At the date of declaration, the securities have a fair value of $2,000,000. Trendler makes the entries

At date of declaration (December 28, 2019)		
Equity Investments	750,000	
Unrealized Holding Gain or Loss—Income ($2,000,000 – $1,250,000)		750,000
Retained Earnings (Property Dividends Declared)	2,000,000	
Property Dividends Payable		2,000,000
At date of distribution (January 30, 2020)		
Property Dividends Payable	2,000,000	
Equity Investments		2,000,000

5- Liquidating Dividends

Some corporations use paid-in capital as a basis for dividends. Without proper disclosure of this fact, stockholders may erroneously believe the corporation has been operating at a profit.

To avoid this type of deception, intentional or unintentional, a clear statement of the source of every dividend should accompany the dividend check.

Dividends based on other than retained earnings are sometimes described as **liquidating dividends**. This term implies that such dividends are a return of the stockholder's investment rather than of profits. In other words, **any dividend not based on earnings reduces corporate paid-in capital and to that extent**, **it is a liquidating dividend**.

Companies in the extractive industries may pay dividends equal to the total of accumulated income and depletion. The portion of these dividends in excess of accumulated income represents a return of part of the stockholder's investment.

For example, McChesney Mines Inc. issued a "dividend" to its common stockholders of $1,200,000. The cash dividend announcement noted that stockholders should consider $900,000 as income and the remainder a return of capital. McChesney Mines records the dividend as shown in **Illustration 15.12**.

At date of declaration		
Retained Earnings	900,000	
Paid-in Capital in Excess of Par—Common Stock	300,000	
Dividends Payable		1,200,000
At date of payment		
Dividends Payable	1,200,000	
Cash		1,200,000

Stock Splits

A stock split, like a stock dividend, involves issuance of additional shares to stockholders according to their percentage ownership. A stock split results in a reduction in the par or stated value per share. **The purpose of a stock split is to increase the marketability of the stock by lowering its market value per share**. The effect of a split on market value is generally inversely proportional to the size of the split. For example, after a recent 2-for-1 stock split, the market value of Nike's stock fell from $111 to approximately $55. The lower market value stimulated market activity, and within one year the stock was trading above $100 again. In a stock split, the number of shares increases in the same proportion that par or stated value per share decreases. For example, in a 2-for-1 split, one share of $10 par value stock is exchanged for two shares of $5 par value stock. A stock split does not have any effect on total paid-in capital, retained earnings, or total stockholders' equity. But the number of shares outstanding increases, and par value per share decreases. Illustration shows these effects for Medland Corporation, assuming that it splits its 50,000 shares of common stock on a 2-for-1 basis.

	Before Stock Split	After Stock Split
Stockholders' equity		
Paid-in capital		
Common stock	$500,000	$500,000
Paid-in capital in excess of par value	–0–	–0–
Total paid-in capital	500,000	500,000
Retained earnings	300,000	300,000
Total stockholders' equity	**$800,000**	**$800,000**
Outstanding shares	**50,000**	**100,000**
Par value per share	**$10.00**	**$5.00**

A stock split does not affect the balances in any stockholders' equity accounts. Therefore, it is not necessary to journalize a stock split

Item	Stock Split	Stock Dividend
Total paid-in capital	No change	Increase
Total retained earnings	No change	Decrease
Total par value (common stock)	No change	Increase
Par value per share	Decrease	No change

Retained Earnings Statement

The **retained earnings statement** shows the changes in retained earnings during the year. The company prepares the statement from the Retained Earnings account. Illustration shows (in account form) transactions that affect retained earnings.

Retained Earnings	
1. Net loss	1. Net income
2. Prior period adjustments for overstatement of net income	2. Prior period adjustments for understatement of net income
3. Cash dividends and stock dividends	
4. Some disposals of treasury stock	

As indicated, net income increases retained earnings, and a net loss decreases retained earnings. Prior period adjustments may either increase or decrease retained earnings. Both cash dividends and stock dividends decrease retained earnings. The circumstances under which treasury stock transactions decrease retained earnings

example

Vega Corporation has retained earnings of $5,130,000 on January 1, 2010. During the year, Vega earned $2,000,000 of net income. It declared and paid a $250,000 cash dividend. In 2010,Vega recorded an adjustment of $180,000 due to the understatement
(from a mathematical error) of 2009 depreciation expense. **Prepare a retained earnings statement for 2010.**

Solution

VEGA CORPORATION

Retained Earnings Statement
For the Year Ended December 31, 2010

Balance, January 1, as reported	$5,130,000
Correction for overstatement of net income in prior period (depreciation error)	(180,000)
Balance, January 1, as adjusted	4,950,000
Add: Net income	2,000,000
	6,950,000
Less: Cash dividends	250,000
Balance, December 31	$6,700,000

Stockholders' Equity

Frost Company
Stockholders' Equity
December 31, 2020

Capital stock		
Preferred stock, $100 par value, 7% cumulative, 100,000 shares authorized, 30,000 shares issued and outstanding		$ 3,000,000
Common stock, no-par, stated value $10 per share, 500,000 shares authorized, 400,000 shares issued		4,000,000
Common stock dividend distributable, 20,000 shares		200,000
Total capital stock		7,200,000
Additional paid-in capital[20]		
Excess over par—preferred	$150,000	
Excess over stated value—common	840,000	990,000
Total paid-in capital		8,190,000
Retained earnings		4,360,000
Total paid-in capital and retained earnings		12,550,000
Less: Cost of treasury stock (2,000 shares, common)		190,000
Accumulated other comprehensive loss[21]		360,000
Total stockholders' equity		$12,000,000

Example:3

On January 1, 2010, Deweese Corporation had $1,000,000 of common stock outstanding that was issued at par. It also had retained earnings of $750,000.The company issued 40,000 shares of common stock at par on July 1 and earned net income of $400,000 for the year.

Instructions
Journalize the declaration of a 15% stock dividend on December 10, 2010, for the following
independent assumptions.
1. Par value is $10, and market value is $18.
2. Par value is $5, and market value is $20.

Example:4

On October 31, the stockholders' equity section of Huth Company consists of common stock $300,000 and retained earnings $900,000. Huth is considering the following two courses of action: (1) declaring a 5% stock dividend on the 30,000, $10 par value shares outstanding, or (2) effecting a 2-for-1 stock split that will reduce par value to $5 per share. The current market price is $14 per share.

Instructions
Prepare a tabular summary of the effects of the alternative actions on the components of stockholders' equity, outstanding shares, and par value per share. Use the following column headings: Before Action, After Stock Dividend, and After Stock Split.

Example:5

On October 1, Kosko Corporation's stockholders' equity is as follows.

Common stock, $5 par value	$400,000
Paid-in capital in excess of par value	25,000
Retained earnings	155,000
Total stockholders' equity	$580,000

On October 1, Kosko declares and distributes a 10% stock dividend when the market value of the stock is $15 per share.

Instructions
(a) Compute the par value per share (1) before the stock dividend and (2) after the stock dividend.
(b) Indicate the balances in the three stockholders' equity accounts after the stock dividend shares have been distributed.

Example:6

Before preparing financial statements for the current year, the chief accountant for Reynolds Company discovered the following errors in the accounts.

1. The declaration and payment of $50,000 cash dividend was recorded as a debit to Interest Expense $50,000 and a credit to Cash $50,000.
2. A 10% stock dividend (1,000 shares) was declared on the $10 par value stock when the market value per share was $18.The only entry made was: Retained Earnings (Dr.) $10,000 and Dividend Payable (Cr.) $10,000.The shares have not been issued.
3. A 4-for-1 stock split involving the issue of 400,000 shares of $5 par value common stock for 100,000 shares of $20 par value common stock was recorded as a debit to Retained Earnings $2,000,000 and a credit to Common Stock $2,000,000.

Instructions
Prepare the correcting entries at December 31.

Example:7

On January 1, 2010, Felter Corporation had retained earnings of $550,000. During the year, Felter had the following selected transactions.

1. Declared cash dividends $120,000.

2. Corrected overstatement of 2009 net income because of depreciation error $40,000.

3. Earned net income $350,000.

4. Declared stock dividends $60,000.

Instructions

Prepare a retained earnings statement for the year.

Example:8

Sasha Company reported retained earnings at December 31, 2009, of $310,000. Sasha had 200,000 shares of common stock outstanding throughout 2010.

The following transactions occurred during 2010.

1. An error was discovered: in 2008, depreciation expense was recorded at $70,000, but the correct amount was $50,000.

2. A cash dividend of $0.50 per share was declared and paid.

3. A 5% stock dividend was declared and distributed when the market price per share was $15 per share.

4. Net income was $285,000.

Instructions

Prepare a retained earnings statement for 2010.

Example:9

Kelly Groucutt Company reported the following balances at December 31, 2009: common stock $400,000; paid-in capital in excess of par value $100,000; retained earnings $250,000. During 2010, the following transactions affected stockholder's equity.

1. Issued preferred stock with a par value of $125,000 for $200,000.

2. Purchased treasury stock (common) for $40,000.

3. Earned net income of $140,000.

4. Declared and paid cash dividends of $56,000.

Instructions

Prepare the stockholders' equity section of Kelly Groucutt Company's December 31, 2010, balance sheet.

Example:10

On January 1, 2010, Carolinas Corporation had the following stockholders' equity accounts.

Common Stock ($20 par value, 60,000 shares issued and outstanding)	$1,200,000
Paid-in Capital in Excess of Par Value	200,000
Retained Earnings	600,000

During the year, the following transactions occurred.

Feb. 1 Declared a $1 cash dividend per share to stockholders of record on February 15, payable March 1.

Mar. 1 Paid the dividend declared in February.

Apr. 1 Announced a 2-for-1 stock split. Prior to the split, the market price per share was $36.

July 1 Declared a 10% stock dividend to stockholders of record on July 15, distributable July31. On July 1, the market price of the stock was $13 per share.

31 Issued the shares for the stock dividend.

Dec. 1 Declared a $0.50 per share dividend to stockholders of record on December 15, payable January 5, 2011.

31 Determined that net income for the year was $350,000.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances, and post the entries to the stockholders' equity accounts. (*Note*: Open additional stockholders' equity accounts as needed.)

(c) Prepare a stockholders' equity section at December 31.