

# **Advanced Accounting 2**

## **Chapter Three (Dividend preference and financial statements)**

**Accounting Department  
Third stage**

**2023-2024**

## Chapter Three

### Dividend preference and financial statements

There are **four types** of the effects of dividend preference, and they are: -

- 1- Preferred stock is non-cumulative and non-participating.
- 2- Preferred stock is cumulative and non-participating and dividends were not paid on preferred stock in preceding years
- 3- Preferred stock non-cumulative and fully participating
- 4- Preferred stock is cumulative and fully participating and dividends were not paid on the preferred stock in the preceding years.

The example given below illustrates the effects of various dividend preference on dividend distribution to common and preferred stock holders:

**Example 1:** The capital structure of Mazin Corp. is as follows:

Preferred stock, \$20 par value, 10,000 shares authorized , 8,000 shares issued and outstanding	\$	160,000
Common stock, \$10 par value, 100,000 shares authorized , 70,000 shares issued and outstanding		700,000
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Total paid-in capital	\$	860,000
Retained earnings		640,000
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Total stockholders' equity	\$	1,500,000
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During the current year, management declared a dividend of \$60,000. Dividend on preferred stock 4% of par value and have been paid each year except for the immediate past year. The number of shares issued and outstanding of both types of stocks have not changed for the last two years.

**Required:**

**Calculate the amount of dividend that will be paid to preferred stockholders and common stockholders if:**

1. The preferred stock is noncumulative.
2. The preferred stock is cumulative.

**Solution:**

Annual dividend on preferred stock:  $160,000 \times .04 = \$6,400$

**(1). If the preferred stock is noncumulative:**

Total dividend declared	\$60,000
<u>Dividend to preferred stockholders (current year) (6,400)</u>	
Dividend to common stockholders	<u><b>\$53,600</b></u>

**(2). If the preferred stock is cumulative:**

Total dividend declared	\$60,000
Dividend to preferred stockholders	
Dividend for current Year	6,400
<u>Dividend for last year</u>	<u>6,400 (12,800)</u>
Dividend to common stockholders	<u><b>\$47,200</b></u>

**Example 2:** Gaylan Co. declared cash dividends of \$50,000. The company has \$60,000 retained earnings, the preferred stock is \$100,000 at 5% and common stock is \$200,000. The company did not pay the dividends in the last two years.

Required:

A- calculate the dividends to both Preferred and Common stock in the following cases:

1- The preferred stock is non-cumulative

2- The preferred stock is cumulative

B- Record the entries

**Example 3:** In 2018 Hawkar Co. decided to distribute cash dividends in amount of \$80,000, the company did not pay dividends for **the last three years**. The outstanding common shares are 10,000 shares with par value of \$30, and the outstanding preferred 5% shares are 5,000 shares with par value of \$20. The company has \$120,000 in Retained Earnings.

Required: Calculate the amount of dividends to preferred and common stock

1- The preferred stock is non-cumulative and non-participating

2- The preferred stock is cumulative and non-participating

3- The preferred stock is non-cumulative and participating  
(10 cents paid to common stock)

4- The preferred stock is cumulative and participating  
(10 cents paid to common stock)

Solution:1

Details	Preferred stock	Common stock	Total
Preferred stock (5%) $5000 \times \$20 \times 5\% = 5,000$	5,000		5,000
Common stock: $80,000 - 5,000 = 75,000$		75,000	75,000
Total	5,000	75,000	80,000

2-

Details	Preferred stock	Common stock	Total
Preferred stock (5%) $50000 \times \$20 \times 5\% = 5,000$			
$5,000 \times 3$ (three last years)	15,000		15,000
Current year	5,000		5,000
Common shares: $80,000 - 20,000 = 60,000$		60,000	60,000
Total	20,000	60,000	80,000

3-

Details	Preferred stock	Common stock	Total
Preferred stock (5%) 50,000 x \$20 x 5%=5,000	5,000		5,000
Common stock 10% 10,000 x 30 x 10%		30,000	30,000
80,000-5000-30,000 = 45,000 remaining			
Pref: 45,000 x100,000/400,000	11,250		11,250
Com:45,000 x300,000/400,000		33,750	33,750
<b>Total</b>	<b>16,250</b>	<b>63,750</b>	<b>80,000</b>

4-

Details	Preferred stock	Common stock	Total
Preferred stock (5%) 50,000 x \$20 x 5%=5,000 5,000 x 3 = 15,000 (last three years)	15,000		15,000
Current year	5,000		5,000
Common stock 10% 10,000 x 30 x 10%		30,000	30,000
80,000-20,000-30,000 =30,000 remaining			
Pref: 30,000 x100,000/400,000	7,500		7,500
Com:30,000 x300,000/400,000		22,500	22,500
<b>Total</b>	<b>27,500</b>	<b>52,500</b>	<b>80,000</b>

**Example 4:** Assume that in 2020, Mason Company is to distribute \$50,000 as cash dividends, its outstanding common stock has a par value of \$400,000, and its 6% percent preferred stock has a par value of \$100,000. Mason would distribute dividends to each class, employing the assumptions given, as follows.

1. If the preferred stock is noncumulative and nonparticipating:

	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
6% of \$100,000	\$6,000		\$ 6,000
The remainder to common		\$44,000	44,000
Totals	<u>\$6,000</u>	<u>\$44,000</u>	<u>\$50,000</u>

2. If the preferred stock is cumulative and nonparticipating, and Mason Company did not pay dividends on the preferred stock in the preceding two years:

	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Dividends in arrears, 6% of \$100,000 for 2 years	\$12,000		\$12,000
Current year's dividend, 6% of \$100,000	6,000		6,000
The remainder to common		\$32,000	32,000
Totals	<u>\$18,000</u>	<u>\$32,000</u>	<u>\$50,000</u>

3. If the preferred stock is noncumulative and is fully participating:

	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Current year's dividend, 6%	\$ 6,000	\$24,000	\$30,000
Participating dividend of 4%	4,000	16,000	20,000
Totals	<u>\$10,000</u>	<u>\$40,000</u>	<u>\$50,000</u>

The participating dividend was determined as follows.

Current year's dividend:

Preferred, 6% of \$100,000 = \$ 6,000

Common, 6% of \$400,000 = 24,000

\$ 30,000

Amount available for participation (\$50,000 – \$30,000)

\$ 20,000

Par value of stock that is to participate (\$100,000 + \$400,000)

\$500,000

Rate of participation (\$20,000 ÷ \$500,000)

4%

Participating dividend:

Preferred, 4% of \$100,000

\$ 4,000

Common, 4% of \$400,000

16,000

\$ 20,000

4. If the preferred stock is cumulative and is fully participating, and Mason Company did not pay dividends on the preferred stock in the preceding two years:

	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Dividends in arrears, 6% of \$100,000 for 2 years	\$12,000		\$12,000
Current year's dividend, 6%	6,000	\$24,000	30,000
Participating dividend, 1.6% (\$8,000 ÷ \$500,000)	1,600	6,400	8,000
Totals	<u>\$19,600</u>	<u>\$30,400</u>	<u>\$50,000</u>

**Example 5 :** Dilbar Co. is very successful company and pays dividends every year except for the last two years. The company decided to distribute cash dividends in amount of \$50,000. The outstanding common shares are 10,000 shares with par value of \$10, and the outstanding preferred 5% shares are 10,000 shares with par value of \$20. The company has \$100,000 in Retained Earnings.

Calculate the dividends for Common and preferred stocks:

- 1- The preferred stock is non-cumulative and non-participating
- 2- The preferred stock is cumulative and participating  
(10 cents paid to common stock)