CHAPTER 17

EARNINGS PER SHARE AND RETAINED EARNINGS

CONTENT ANALYSIS OF EXERCISES AND PROBLEMS

Number	Content	Time Range (minutes)
E17-1	Weighted Average Shares. (Moderate) Stock dividend, stock split, reacquisition.	10-20
E17-2	Comparative EPS. (Easy) Weighted average shares, stock split, stock dividend, comparative analysis.	10-20
E17-3	Basic EPS. (Easy) Weighted average shares. Nonconvertible preferred dividends. Compute price/earnings ratio.	10-15
E17-4	Basic EPS. (Easy) Weighted average shares. Stock dividend, nonconvertible preferred stock, income statement presentation.	10-20
E17-5	Impact on EPS and Rankings. (Moderate) Convertible stocks and bonds, computation of impact and ranking of securities.	10-20
E17-6	Share Options and EPS. (Easy) Share options. Compute diluted EPS. IFRS discussion.	5-15
E17-7	Convertible Preferred Stock and EPS. (Moderate) Weighted average shares. Diluted EPS calculation.	10-20
E17-8	Convertible Bonds and EPS. (Moderate) Weighted average shares. Diluted EPS calculation.	10-20
E17-9	Convertible Securities and EPS. (Moderate) Convertible preferred stocks and bonds. Diluted EPS calculation. Individual dilution. Income statement and disclosure.	10-20
E17-10	Convertible Securities and EPS. (Moderate) Convertible preferred stocks and bonds. Diluted EPS calculations. Individual dilution. Income statement presentation.	10-20
E17-11	Dividends. (Moderate) Participating, nonparticipating, partially participating preferred stock. Cumulative, noncumulative. Arrears. Compute amounts to be paid. Compute dividend yields.	15-20
E17-12	Various Dividends. (Moderate) Journal entries for payment of cash, property, and stock dividends.	10-15

Number	Content	Time Range (minutes)
E17-13	Various Dividends. (Moderate) Journal entries for payment of cash, property, stock, and scrip dividends. Balance sheet presentation.	10-20
E17-14	Stock Dividends. (Easy) Journal entries on the date of declaration and the date of issuance for large and small stock dividends. Stockholders' equity presentation.	10-20
E17-15	Stock Dividends. (Easy) Comparison of the impact of a small stock dividend and a large stock dividend on the stockholders' equity section of the balance sheet.	10-15
E17-16	Prior Period Adjustments. (Moderate) Corrections to retained earnings, preparation of the statement of retained earnings.	10-20
E17-17	Restrictions. (Easy) Disclose bond and treasury stock restrictions.	5-10
E17-18	Retained Earnings Statement. (Moderate) Prior period adjustments, cash and stock dividends, stock retirement, acquisition of treasury stock.	10-20
E17-19	Retained Earnings Statement. (Moderate) Prior period adjustments, cash and stock dividends, stock retirement, acquisition of treasury stock.	10-20
E17-20	Stockholders' Equity. (Moderate) Balance sheet preparation. Preferred, common, treasury stock.	10-20
E17-21	Changes in Stockholders' Equity. (Moderate) Given the prior year-end balance sheet and a list of transactions, prepare a statement of changes in stockholders' equity. Compute return on stockholders' equity.	10-20
P17-1	Income Statement and Basic EPS. (Moderate) Preparation of multiple-step income statement. Results of discontinued operations, extraordinary gain, weighted average.	20-30
P17-2	Comparative Income Statements and Basic EPS. (Moderate) Preparation of multiple-step income statements for two years. Extraordinary items, stock dividend, weighted average. Compute and discuss price/earnings ratios.	30-45
P17-3	EPS. (Moderate) Weighted average shares, stock split, share options, convertible stocks. Income statement disclosure. IFRS discussion.	30-45
P17-4	Impact on EPS, Rankings, and Computations. (Challenging) Convertible stocks and bonds. Determination of impact and ranking. Computations.	30-45

Number	Content	Time Range (minutes)
P17-5	Comprehensive: EPS. (Challenging) Weighted average shares, stock dividends, share options, convertible stocks and bonds. Extraordinary loss. Basic and diluted EPS computation. Income statement disclosures.	30-45
P17-6	Comprehensive: EPS. (Challenging) Weighted average shares, share options. Convertible stocks and bonds. Basic and diluted EPS computation. Income statement disclosure.	30-45
P17-7	(AICPA adapted). EPS. (Moderate) Weighted average shares, stock split, reacquisition, stock warrants, convertible stocks and bonds. Basic and diluted EPS computation. Income statement presentation.	30-45
P17-8	(AICPA adapted). EPS. (Moderate) Weighted average shares, share options, stock warrants, convertible bonds. Basic and diluted EPS computation.	30-45
P17-9	Dividends. (Moderate) Fully participating, partially participating, nonparticipating preferred stock. Cumulative, noncumulative. Computation of amounts to be paid.	30-45
P17-10	(AICPA adapted). Dividends. (Moderate) Nonparticipating, noncumulative preferred stock. Fully participating, cumulative. Five years net income or loss given. Worksheet to show maximum amount available for cash dividends.	20-30
P17-11	Comprehensive: Dividends. (Moderate) Cash, stock, and property dividends, stock split, reacquisition. Journal entries and stockholders' equity presentation.	30-45
P17-12	Comprehensive: Dividends. (Moderate) Cash, stock, and property dividends, reacquisition, stock split. Journal entries and stockholders' equity presentation.	30-45
P17-13	Dividends. (Moderate) Small and large stock dividends, cash (normal and liquidating) and property dividends. Journal entries and stockholders' equity presentation.	35-50
P17-14	Retained Earnings Statement. (Moderate) Restrictions, stock retirement, stock split, stock and cash dividends, prior period adjustment, reissuance of treasury stock.	30-45
P17-15	Retained Earnings Statement. (Moderate) Cash and stock dividends, retirement, prior period adjustment. Journal entries and statement of retained earnings.	20-30
P17-16	Comprehensive: Retained Earnings Journal Entries and Statement. (Challenging) Stock retirement, stock dividend, reacquisition, restrictions, cash dividends, prior period adjustments.	30-45

Number	Content	Time Range (minutes)
P17-17	Corrections. (Challenging) Account analysis with correcting journal entries. Preparation of corrected stockholders' equity section.	30-45
P17-18	(AICPA adapted). Comprehensive: Retained Earnings and Stockholders' Equity. (Moderate) Preparation of retained earnings statement and stockholders' equity section of balance sheet.	30-45
P17-19	(AICPA adapted). Comprehensive: Retained Earnings and Stockholders' Equity. (Moderate) Preparation of retained earnings statement and stockholders' equity section of balance sheet.	30-45
P17-20	Comprehensive: Stockholders' Equity. (Challenging) Journal entries. Reacquisition, reissuance, retirement. Cost method for treasury stock. Donation, dividends. Statement of changes in stockholders' equity. Balance sheet disclosure with related notes.	35-50
P17-21	Comprehensive: Stockholders' Equity. (Challenging) Journal entries. Reissuance of treasury stock. Share option plan, donation, dividends. Statement of changes in stockholders' equity. Balance sheet disclosure with related notes. Compute return on stockholders' equity.	35-50
P17-22	(AICPA adapted). Stockholders' Equity. (Moderate) Share option plan, employee share purchase plan. Preparation of stockholders' equity section with related notes.	30-45
P17-23	(AICPA adapted). Comprehensive: Liabilities and Stockholders' Equity. (Challenging) Preparation of long-term liabilities and stockholders' equity sections of balance sheet. Computation of interest expense.	45-60
P17-24	(AICPA adapted). Comprehensive: Stockholders' Equity. (Moderate) Determine amounts of prior period adjustment, cash dividends (preferred and common), property dividends, common shares issued, treasury stock, and EPS numerator.	30-40

ANSWERS TO QUESTIONS

Q17-1 A simple capital structure is one that consists only of common stock outstanding (or also has non-convertible preferred stock outstanding).

Q17-2 For a corporation with a simple capital structure, basic earnings per share is computed by dividing net income (less preferred dividends) by the weighted average number of common shares outstanding during the period.

Q17-3 The "weighted average" number of shares is the equivalent whole shares of common stock outstanding during the period. It is calculated by starting with the actual number of common shares outstanding at the beginning of the period and multiplying this "layer" of shares by the fraction of the year it is outstanding until more common stock is issued or reacquired. These new shares are added to the existing number of shares and the new layer is multiplied by the fraction of the year it is outstanding. This process is continued for all the issuances during the year. The resulting equivalent whole units for all of the layers are added to determine the weighted average number of common shares for the period.

Q17-4 For computing earnings per share, stock dividends and splits are given retroactive recognition. That is, regardless of when they were actually issued, stock dividends and splits are assumed to have occurred at the beginning of the earliest period for which comparative financial statements are presented. This assumption enables a corporation to express all comparative earnings per share figures in terms of its most recent capital structure.

Q17-5 Several securities such as share options and warrants, convertible preferred stock and convertible bonds, participating securities and two-class stocks, and contingent shares might be found in the complex capital structure of a corporation.

Q17-6 The two earnings per share amounts generally reported by a corporation with a complex capital structure are basic earnings per share and diluted earnings per share. Besides common shares outstanding, diluted earnings per share include all dilutive potential common shares (options and warrants, convertible preferred stock and bonds).

Q17-7 The treasury stock method is used to determine the change in the number of shares for a corporation's diluted earnings-per-share calculations when the corporation has share options, warrants, and similar arrangements outstanding. The increase in the denominator is the difference between the assumed shares issued and the assumed shares reacquired (using the average market price) under the arrangements.

Q17-8 To develop the ranking, the if-converted method is used. First, the impact of the conversion of each convertible security upon earnings per share is computed. This impact is calculated by dividing the change in the numerator (that is, the savings in preferred dividends or interest expense) by the increased number of common shares issuable upon conversion. Second, the ranking is developed with the convertible security having the lowest (and, therefore, most dilutive) numerical value impact on diluted earnings per share listed first and the remaining securities listed in sequential order according to the magnitude of their impact on diluted earnings per share. The dilutive securities are then sequentially entered into the diluted earnings per share calculation according to the ranking.

Q17-9 The additional disclosures made by a corporation in the notes to its financial statements include a schedule identifying and reconciling the numerators and denominators on which both basic and diluted earnings per share figures are calculated. In addition, the schedule includes the amount of preferred dividends deducted to determine the income available to common stockholders, the potential common shares that were not included in diluted EPS because they were antidilutive, and a description of any material impact on the common shares outstanding of subsequent conversions after the close of the accounting period but before the issuance of the financial report.

Q17-10 Under IFRS, if a company has potentially dilutive stock options, it will use the treasury stock method to determine the dilutive effect of these options. However, IFRS do not require a company to include any unrecognized compensation cost in the assumed proceeds from issuing the stock. Under U.S. GAAP, any unrecognized compensation cost is added to the assumed proceeds from issuing the stock which, in turn, decreases the incremental number of shares in the denominator of the EPS calculation. The exclusion of the unrecognized compensation cost under IFRS would result in lower earnings per share amounts being reported under IFRS relative to U.S. GAAP.

Q17-11 Even though the loss is unusual and infrequent, IFRS do not have the concept of extraordinary items. Therefore, Parker Company would make no EPS disclosure related to this loss.

Q17-12 The four important dates are (1) the date of declaration, (2) the ex-dividend date, (3) the date of record, and (4) the date of payment. On the date of declaration, the corporation makes a journal entry to reduce retained earnings and establish the liability. No journal entry is made on the ex-dividend date; this is the date the stock stops selling with attached dividends. A memorandum entry is made on the date of record indicating that stockholders of record on that date are entitled to the dividend. On the date of payment, the Cash account is reduced and the liability eliminated.

Q17-13 Stockholders of fully participating preferred stock share with the common stockholders in any extra dividends. These extra dividends are distributed proportionally based on the respective total par value of each class of stock.

Stockholders of partially participating preferred stock are limited in their participation to a fixed rate (based on their respective par value) or amount per share.

Q17-14 A property dividend is considered a nonreciprocal nonmonetary exchange where the corporation gives up an asset and receives no asset or service in return. The exchange is recorded at its fair value. Consequently, on the date of declaration, a corporation first writes up or down the property (for example, stock held in another company) to be used in the dividend to its fair value on that date and recognizes a gain or loss. It then makes a second entry to reduce retained earnings and establish the dividend liability.

Q17-15 An ordinary stock dividend consists of the issuance of the same class of stock (i.e. common on common) for the dividend. A special stock dividend involves the distribution of a different class of stock (i.e. preferred on common) for the dividend.

Q17-16 A small stock dividend is one that presumably has no significant impact on the market price per share of the stock. A stock dividend of less than 20 to 25% of the previously outstanding shares is considered a small stock dividend. A stock dividend involving a greater percentage distribution of shares is considered a large stock dividend.

Neither a small nor a large stock dividend affects total stockholders' equity, although each affects the components of stockholders' equity. In the case of a small stock dividend, a corporation transfers an amount equal to the fair value of the newly issued shares from retained earnings to contributed capital on the date of declaration. For a large stock dividend, a corporation transfers an amount equal to the par value of the shares from retained earnings to contributed capital on the date of declaration.

Q17-17 A liquidating dividend is treated as a reduction in contributed capital whereas a normal cash dividend is treated as a reduction in retained earnings.

Q17-18 A corporation treats a correction of a material error made in a previous year as a prior period adjustment. The asset or liability account balance is corrected and retained earnings is increased or decreased for the amount of the error. Any related effect on income taxes is similarly recorded. The corporation reports the effect of the error (net of income taxes) on its current year's statement of retained earnings as an adjustment to the beginning retained earnings balance, as previously reported.

Q17-19 A corporation may restrict its retained earnings to meet legal requirements (for example, treasury stock), to meet contractual restrictions (for example, bond provisions), or because of discretionary actions (for example, self-insurance). It reports a restriction in an explanatory note to its financial statements.

Q17-20 The suggested format is shown below. The two most common elements are net income and dividends.

Beginning retained earnings, as previously reported
Plus (minus): Prior period (and retrospective) adjustments (net of income tax effect)
Adjusted beginning retained earnings
Plus (minus): Net income (loss)
Minus: Dividends (specifically identified, including per share amounts)
Reductions due to retirement or reacquisition of capital stock
Reductions due to conversion of bonds or preferred stock
Ending retained earnings

Q17-21 A corporation might include in the accumulated other comprehensive income section of its stockholders' equity the following items (amounts accumulated to date):

1. Unrealized increases (gains) or decreases (losses) in the fair value of investments in available-for-sale securities.

2. Translation adjustments from converting the financial statements of a company's foreign operations to U.S. dollars.

3. Certain gains and losses on "derivative" financial instruments.

4. Certain pension plan gains, losses, and prior service cost adjustments.

Q17-22 GAAP requires a corporation to disclose the separate changes in all its stockholders' equity accounts as well as the changes in the number of shares of capital stock. Typically, the corporation will summarize these changes in its statement of changes in stockholders' equity. This statement frequently will include the changes in retained earnings. Examples of changes included are the issuance of capital stock, the issuance and exercise of share options, transactions involving treasury stock, net income, and dividends.

ANSWERS TO MULTIPLE CHOICE

1. d	3. d	5. a	7. c	9. c
2. b	4. c	6. b	8. a	10. a

SOLUTIONS TO REVIEW EXERCISES

RE17-1

Months Shares Are Outstanding	Shares Outstanding	x	Fraction of Year Outstanding	=	Equivalent Whole Units
January – June	10,000	x	6/12	=	5,000
July – August	15,000	x	2/12	=	2,500
September - December	14,400	X	4/12	=	4,800
					12,300

RE17-2

Net Income $13,000
Preferred dividends (4,000)
Earnings and shares $ 9,000/4,500 shares = $2.00 Basic earnings per share

RE17-3

Shares issued from assumed exercise:	2,000
Shares assumed reacquired:	
Proceeds / Average Market Price Per Share = 2,000 x ($14 + $1) / $20 = $30,000 / $20 =	(1,500)
Assumed increment in common shares for computing diluted earnings per share	500

RE17-4

Security	Impact
6% Preferred stock	$4,800 / 2,000 = $2.40

RE17-5

Security	Impact
9% Bonds	$6,300 / 2,500 = $2.52

RE17-6

Explanation	Earnings (Adjustments)	/	Shares (Adjustments)	=	Earnings per share
Basic earnings per share	$4,000	/	1,000	=	$4.00 Basic
Savings in dividends*	1,000				
Increment in shares			1,000		
Diluted earnings and shares	$5,000	/	2,000	=	$2.50 Diluted

RE17-6 (continued)

*Calculation:

Security			Impact		
Preferred	$1,000 / 200 x 5	=	$1,000 / 1,000	=	$1.00

RE17-7

		Preferred	Common
10% dividend to preferred (on $22,000 par)		$2,200	
Common dividend (equal to 10% of $44,000 par)			$4,400
Extra dividend proportionate to par values:			
Total to allocate	$10,200		
Allocated ($2,200 + $4,400)	(6,600)		
Remainder (1/3 to preferred, 2/3 to common)	$ 3,600	$1,200	$2,400
Dividends to each class of stock		$3,400	$6,800

RE17-8

Investment in Violet Company Bonds ($77,000 - $58,000)	19,000	
Gain on Disposal of Investments		19,000
Retained Earnings	77,000	
Property Dividends Payable		77,000

RE17-9

Retained Earnings ($30 x 7,500)	225,000	
Common Stock to be Distributed		75,000*
Additional Paid-in Capital From Stock Dividend		150,000

*Calculation:
15% x 50,000 = 7,500 shares issued for stock dividend; 7,500 x $10 = $75,000

RE17-10

	Debit	Credit
Retained Earnings ($10 par x 25,000)	250,000*	
Common Stock to be Distributed		250,000

*Calculation:
50% x 50,000 = 25,000 shares issued for stock dividend; 25,000 x $10 = $250,000

RE17-11

Retained Earnings, January 1	$22,250
Plus: Net income	10,000
Minus: Dividends	(3,200)
Retained earnings, December 31	$29,050

RE17-12

	Debit	Credit
Retained Earnings	40,000	
Interest Payable		40,000
Income Tax Refund Receivable	12,000	
Retained Earnings		12,000

SOLUTIONS TO EXERCISES

E17-1

20,000 x 1.10 x 2.00	=	44,000 x 3/12 =	11,000
25,000 x 1.10 x 2.00	=	55,000 x 2/12 =	9,167
29,000 x 1.10 x 2.00	=	63,800 x 4/12 =	21,267
63,800 - 1,000	=	62,800 x 2/12 =	10,467
62,800 + 1,000	=	63,800 x 1/12 =	5,317
	Weighted average shares		57,218

Note to Instructor: Students may mistakenly add the 10% stock dividend to the 200% stock split and multiply the initial issuance by 210% (instead of the correct 220%).

E17-2

1. 2010 annual report:

2010 basic earnings per share: $0.50

2010 computations: $\frac{\$5,125}{10,250*} = \$0.50$

* 9,000 x 7/12 = 5,250
12,000 x 5/12 = 5,000
10,250

2. 2011 annual report:

2011 basic earnings per share: $0.60

2010 basic earnings per share: $0.25

2011 computations: $\frac{\$16,400}{27,333*} = \$0.60$

*12,000 x 2.00 x 2/12 = 4,000
14,000 x 2.00 x 10/12 = 23,333
27,333

E17-2 (continued)
2. (continued)

2010 computations: $\frac{\$5,125}{20,500*} = \underline{\underline{\$0.25}}$

*9,000 x 2.00 x 7/12 = 10,500
12,000 x 2.00 x 5/12 = 10,000 or 10,250 (from requirement 1) x 2.00 = 20,500
20,500

3. 2012 annual report:

2012 basic earnings per share: $0.70

2011 basic earnings per share: $0.50

2010 basic earnings per share: $0.21

2012 computations: $\frac{\$23,520}{33,600*} = \underline{\underline{0.70}}$

*28,000 x 1.20 x 12/12 = 33,600

2011 computations: $\frac{\$16,400}{32,800*} = \underline{\underline{0.50}}$

*12,000 x 2.00 x 1.20 x 2/12 = 4,800 or 27,333 (from requirement 2)
14,000 x 2.00 x 1.20 x 10/12 = 28,000 x 1.2 = 32,800
32,800

2010 computations: $\frac{\$5,125}{24,600*} = \underline{\underline{\$0.21}}$

* 9,000 x 2.00 x 1.20 x 7/12 = 12,600 or 20,500 (from requirement 2)
12,000 x 2.00 x 1.20 x 5/12 = 12,000 x 1.2 = 24,600
24,600

E17-3

1. $\frac{\$29,975 - \$10,000^{*}}{8,500^{\#}} = \$2.35$

*10% x ($100 x 1,000)

#7,000 x 3/12 = 1,750
9,000 x 9/12 = 6,750
8,500

2. Price / earnings ratio = $\frac{\text{Market price per common share}}{\text{Earnings per share}}$

$\text{7.4 times} = \frac{\$17.50}{\$2.35}$

E17-4

1. $\frac{\$27,760 - \$6,000}{13,600^{*}}$ = $1.60 Basic earnings per share

$\frac{\$29,936 - \$6,000}{13,600^{*}}$ = $1.76 Basic earnings per share related to income before extraordinaary items

*10,000 x 1.20 = 12,000 x 4/12 = 4,000
12,000 x 1.20 = 14,400 x 8/12 = 9,600
13,600

2.

Income before extraordinary items	$1.76
Extraordinary loss	(0.16)
Net income (see Note A)	$1.60

3. Note A: Preferred dividends of $6,000 were deducted from income before extraordinary items and net income to determine earnings available to common stockholders. Each earnings per share figure is based upon 13,600 weighted average common shares outstanding.

E17-5

1. 9.5% preferred stock: $\frac{0.095 \times \$200{,}000}{2{,}000 \times 4.2} = \frac{\$19{,}000}{8{,}400} = \underline{\underline{\$2.26}}$

11.0% bonds: $\frac{(0.11 \times \$220{,}000) \times (1-0.3)}{220 \times 44} = \frac{\$16{,}940}{9{,}680} = \underline{\underline{\$1.75}}$

8.0% preferred stock: $\frac{0.08 \times \$150{,}000}{1{,}500 \times 3.8} = \frac{\$12{,}000}{5{,}700} = \underline{\underline{\$2.11}}$

10.0% bonds: $\frac{[(0.10 \times \$100{,}000) + \$6{,}000/20] \times (1-0.3)}{100 \times 55} = \frac{\$7{,}210}{5{,}500} = \underline{\underline{\$1.31}}$

9.0% bonds: $\frac{[(0.09 \times \$200{,}000) - \$16{,}000/25] \times (1-0.3)}{200 \times 48} = \frac{\$12{,}152}{9{,}600} = \underline{\underline{\$1.27}}$

2.

Security		Impact	Ranking
9.5%	preferred	$2.26	5
11.0%	bonds	$1.75	3
8.0%	preferred	$2.11	4
10.0%	bonds	$1.31	2
9.0%	bonds	$1.27	1

E17-6

1. Diluted EPS: $\frac{\$36{,}000}{30{,}000 + 889^*} = \underline{\underline{\$1.17}}$

*Issued 4,000

Reacquired $\frac{4{,}000 \times (\$32 + \$3)}{\$45} = \underline{(3{,}111)}$

Increment $\underline{\underline{889}}$

2. Under IFRS, Butler Company would not include the unrecognized compensation cost in the assumed proceeds from issuing the shares under the treasury stock method. Therefore, the earnings per share would be $1.16 (instead of $1.17) as shown below:

Diluted EPS: $\frac{\$36{,}000}{30{,}000 + 1{,}156^*} = \underline{\underline{\$1.16}}$

*Issued 4,000

Reacquired: $\frac{4{,}000 \times \$32}{45} = \underline{(2{,}844)}$

Increment $\underline{\underline{1{,}156}}$

E17-7

Explanation	Earnings (Adjustments)	÷	Shares (Adjustments)	=	Earnings Per Share
Basic earnings and shares	$39,000[a]	÷	12,000[b]	=	$3.25 Basic
Preferred dividend savings	4,800[c]				
Increment in common shares			3,000[d]		
Diluted earnings and shares	$43,800	÷	15,000	=	$2.92 Diluted

[a]$39,000 = $43,800 - $4,800 (600 x 0.08 x $100) preferred dividends

[b]10,000 x 6/12 = 5,000
14,000 x 6/12 = 7,000
12,000

[c]$4,800 ÷ (600 x 5) = $1.60 < $3.25; individually dilutive
[d]600 x 5

E17-8

Explanation	Earnings (Adjustments)	÷	Shares (Adjustments)	=	Earnings Per Share
Basic earnings and shares	$79,200	÷	18,000[a]	=	$4.40 Basic
Bond interest expense savings[b]	3,920[c]				
Increment in common shares			2,000[d]		
Diluted earnings per share	$83,120	÷	20,000	=	$4.16 Diluted

[a]15,000 x 4/12 = 5,000
19,500 x 8/12 = 13,000
18,000

[b][($80,000 x 0.07) x (1 - 0.30)] ÷ (80 x 25) = $1.96 < $4.40; individually dilutive

[c]($80,000 x 0.07) x (1 - 0.30)

[d]80 x 25

E17-9

Explanation	Earnings (Adjustments)	÷	Shares (Adjustments)	=	Earnings Per Share
Basic earnings and shares	$45,000[a]	÷	15,000[b]	=	$3.00 Basic
Bond interest expense savings (1/2 year)[d]	3,500[c]				
Increment in common shares (1/2 year)			1,750[c]		
Tentative diluted EPS	$48,500	÷	16,750	=	$2.90 $DEPS_1$
Preferred dividend savings[e]	9,000[c]				
Increment in common shares			3,500[c]		
Diluted earnings and shares	$57,500	÷	20,250	=	$2.84 Diluted

E17-9 (continued)

[a]$45,000 = $54,000 net income - $9,000 preferred dividends

[b]15,000 = 15,000 x 12/12

[c]Impact on diluted earnings per share and ranking:

	Impact	Ranking
Preferred:	$\frac{\$9,000}{1,000 \times 3.5} = \frac{\$9,000}{3,500} = \$2.57$	2
Bonds:	$\frac{\$10,000 \times (1 - 0.3) \times 1/2 \text{ year}}{100 \times 35 \times 1/2 \text{ year}} = \frac{\$3,500}{1,750} = \$2.00$	1

[d]Convertible bonds are included in diluted earnings per share because $2.00 < $3.00, so individually dilutive.

[e]Convertible preferred stock is included in diluted earnings per share because $2.57 < $2.90, so individually dilutive.

Walker would report basic earnings per share of $3.00 and diluted earnings per share of $2.84 on its 2010 income statement.

E17-10

Explanation	Earnings (Adjustments)	÷	Shares (Adjustments)	=	Earnings Per Share
Basic earnings and shares	$52,000[a]	÷	20,000[b]	=	$2.60 Basic
Preferred dividend savings[d]	9,500[c]				
Increment in common shares			6,000[c]		
Tentative diluted EPS	$61,500	÷	26,000	=	$2.37 $DEPS_1$
Bond interest expense savings[e]	7,980[c]				
Increment in common shares			4,400[c]		
Diluted earnings and shares	$69,480	÷	30,400	=	$2.29 Diluted

[a]$52,000 = $61,500 net income - $9,500 preferred dividends

[b]20,000 = 20,000 x 12/12

[c]Impact on diluted earnings per share and ranking:

	Impact	Ranking
Bonds:	$\frac{\$11,400 \times (1 - 0.3)}{200 \times 22} = \frac{\$7,980}{4,400} = \$1.81$	2
Preferred:	$\frac{\$9,500}{2,000 \times 3} = \frac{\$9,500}{6,000} = \$1.58$	1

E17-10 (continued)

[d]Convertible preferred stock is included in diluted earnings per share because $1.58 < $2.60, so individually dilutive.

[e]Convertible bonds are included in diluted earnings per share because $1.81 < $2.37, so individually dilutive.

Caldwell would report basic earnings per share of $2.60 and diluted earnings per share of $2.29 on its 2010 income statement.

E17-11

1.		Preferred	Common
a.	Preferred dividend (2,000 x 0.10 x $100)	$20,000	
	Remainder to common ($80,000 - $20,000)		$60,000
	Total	$20,000	$60,000
b.	Dividends in arrears (2 x 2,000 x 0.10 x $100)	$40,000	
	Current preferred dividend (2,000 x 0.10 x $100)	20,000	
	Remainder to common ($80,000 - $60,000)		$20,000
	Total	$60,000	$20,000
c.	Dividends in arrears (1 x 2,000 x 0.10 x $100)	$20,000	
	Current preferred dividends	20,000	
	Common proportional share (0.10 x 30,000 x $10)		$30,000
	Remainder shared* ($80,000 - $70,000)	4,000	6,000
	Total	$44,000	$36,000

*Preferred: $10,000 extra dividend x $\frac{2{,}000 \times \$100}{(2{,}000 \times \$100)+(30{,}000 \times \$10)} = \$4{,}000$

Conmmon: $10,000 extra dividend x $\frac{\$300{,}000}{\$500{,}000} = \$6{,}000$

		Preferred	Common
d.	Preferred dividend	$20,000	
	Common proportional share (0.10 x 30,000 x $10)		$30,000
	Preferred extra (0.05 x $200,000)	10,000	
	Common extra (0.05 x $300,000)		15,000
	Remainder to common ($80,000 - $75,000)		5,000
		$30,000	$50,000

E17-11 (continued)

2. Dividend yield = $\frac{\text{Dividends per share}}{\text{Market price per share}}$

Preferred stock: $\frac{\$20{,}000 / 2{,}000}{\$125} = \frac{\$10}{\$125} = \underline{\underline{8\%}}$

Common stock: $\frac{\$60{,}000/30{,}000}{\$20} = \frac{\$\ 2}{\$20} = \underline{\underline{10\%}}$

E17-12

2010				
Feb.	2	Dividends Payable: Preferred	4,000	
		Dividends Payable: Common	40,000	
		Cash		44,000
Mar.	5	Investment in Xurk Company Bonds	6,000	
		Gain on Disposal of Investments		6,000
		Retained Earnings	31,000	
		Property Dividend Payable		31,000
Apr.	5	Property Dividend Payable	31,000	
		Investment in Xurk Company Bonds		31,000
July	6	Retained Earnings*	48,000	
		Dividends Payable: Preferred		4,000
		Dividends Payable: Common		44,000
		*Preferred: 1,000 shares x $4.00 = $ 4,000		
		Common: 40,000 shares x $1.10 = $44,000		
Aug.	17	Dividends Payable: Preferred	4,000	
		Dividends Payable: Common	44,000	
		Cash		48,000
Oct.	15	Retained Earnings*	17,600	
		Common Stock To Be Distributed		8,000
		Additional Paid-in Capital From Stock Dividend		9,600
		*40,000 shares x 2% x $22 per share		

E17-12 (continued)

			Debit	Credit
Dec.	3	Common Stock To Be Distributed	8,000	
		Common Stock, $10 Par		8,000
	28	Retained Earnings*	52,960	
		Dividends Payable: Preferred		4,000
		Dividends Payable: Common		48,960

*Preferred: 1,000 shares x $4.00 = $ 4,000
Common: 40,800 shares x $1.20 = $48,960

E17-13

			Debit	Credit
1.	(1)	Retained Earnings	10,000	
		Dividends Payable		10,000
		Dividends Payable	10,000	
		Cash		10,000
	(2)	Retained Earnings (10,000 x 0.05 x $17)	8,500	
		Common Stock To Be Distributed		8,500
		Common Stock To Be Distributed	8,500	
		Common Stock, No Par		8,500
	(3)	Investment in M Bonds ($13,000 - $9,000)	4,000	
		Gain on Disposal of Investment		4,000
		Retained Earnings	13,000	
		Property Dividends Payable		13,000
		Property Dividends Payable	13,000	
		Investment in M Stock		13,000
	(4)	Retained Earnings	8,000	
		Dividends Payable: Scrip		8,000
		Interest Expense ($8,000 x 0.12 x 11/12)	880	
		Dividends Payable: Scrip	8,000	
		Cash		8,880

E17-13 (continued)

1. (continued)

		Debit	Credit
(5)	Retained Earnings (10,000 x $0.70)	7,000	
	Contributed Capital Distributed as a Liquidating Dividend (10,000 x $0.30)	3,000	
	Dividends Payable		10,000
	Dividends Payable	10,000	
	Cash		10,000

2.

(1)	Current assets	$ 50,000	Current liabilities	$ 30,000
	Investment in M bonds	9,000	Common stock, no par	150,000
	Fixed assets (net)	200,000	Retained earnings	79,000
		$259,000		$259,000

(2)	Current assets	$ 60,000	Current liabilities	$ 30,000
	Investment in M bonds	9,000	Common stock, no par	158,500
	Fixed assets (net)	200,000	Retained earnings	80,500
		$269,000		$269,000

(3)	Current assets	$ 60,000	Current liabilities	$ 30,000
	Fixed assets (net)	200,000	Common stock, no par	150,000
		$260,000	Retained earnings ($89,000 - $13,000 + $4,000 gain)	80,000
				$260,000

(4)	Current assets	$ 51,120	Current liabilities	$ 30,000
	Investment in M bonds	9,000	Common stock, no par	150,000
	Fixed assets (net)	200,000	Retained earnings ($89,000 - $8,000 - $880 interest)	80,120
		$260,120		$260,120

(5)	Current assets	$ 50,000	Current liabilities	$ 30,000
	Investment in M bonds	9,000	Common stock, no par	150,000
	Fixed assets (net)	200,000	Contributed capital distributed as a	(3,000)
		$259,000	liquidating dividend	82,000
			Retained earnings	$259,000

E17-14

1. 6% stock dividend

(a)	Retained Earnings (25,000 x 0.06 x $30)		45,000	
	Common Stock To Be Distributed			15,000
	Additional Paid-in Capital From Stock Dividend			30,000
(b)	Common Stock To Be Distributed		15,000	
	Common Stock, $10 Par			15,000
(c)	Common stock, $10 par	$265,000		
	Additional paid-in capital on common stock	150,000		
	Additional paid-in capital from stock dividend	30,000		
	Retained earnings	155,000		
		$600,000		

2. 40% stock dividend

(a)	Retained Earnings (25,000 x 0.40 x $10)		100,000	
	Common Stock To Be Distributed			100,000
(b)	Common Stock To Be Distributed		100,000	
	Common Stock, $10 Par			100,000
(c)	Common stock, $10 par	$350,000		
	Additional paid-in capital on common stock	150,000		
	Retained earnings	100,000		
		$600,000		

E17-15

1. and 2.

Stockholders' Equity	(1)	(2)
Common stock, $10 par	$ 460,000	$ 520,000
Premium on common stock	944,000	800,000
Total contributed capital	$1,404,000	$1,320,000
Retained earnings	1,096,000[a]	1,180,000[b]
Total stockholders' equity	$2,500,000	$2,500,000

[a]$1,096,000 = $1,300,000 - ($34 x 40,000 shares x 0.15)

[b]$1,180,000 = $1,300,000 - ($10 x 40,000 shares x 0.30)

E17-15 (continued)

3. Retained earnings are reduced more by a small stock dividend than by a large stock dividend. From a theoretical standpoint, this might have been avoided by (1) using the adjusted market price after the dividends had been declared for both sizes of dividends, or (2) recording the dividends like a stock split.

E17-16

			Debit	Credit
1.	(1)	Accumulated Depreciation	15,000	
		Retained Earnings		15,000
		Retained Earnings ($15,000 x 0.30)	4,500	
		Income Taxes Payable on Prior Earnings		4,500
	(2)	Retained Earnings	4,000	
		Interest Payable		4,000
		Income Taxes Payable on Prior Earnings	1,200	
		Retained Earnings ($4,000 x 0.30)		1,200

2. MILES COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2010

Retained earnings, as previously reported, January 1, 2010	$142,400
Prior Period Adjustments:	
Correction of overstatement in 2009 depreciation (net of $4,500 income taxes)	10,500
Correction of understatement in 2009 interest (net of $1,200 income tax credit)	(2,800)
Adjusted retained earnings, January 1, 2010	$150,100
Add: Net income	60,000
	$210,100
Less: Cash dividends	(13,000)
Retained earnings, December 31, 2010	$197,100

E17-17

Stockholders' Equity (in part)

Retained earnings (see Note 1) $400,000

Notes to 2010 Financial Statements

Note 1: Retained earnings are restricted in the amount of $20,000 as a result of a contractual agreement in connection with the issuance of 12%, 5-year, $100,000 bonds. This restriction will increase by $20,000 each year until the maturity date. Additionally, retained earnings has been restricted in the amount of $15,000, the cost of the treasury stock that it currently holds.

E17-18

HERNANDEZ COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2010

Retained earnings, as previously reported, January 1, 2010		$120,000
Add: Correction due to understatement of previous income (net of $4,200 income taxes)		9,800
Adjusted retained earnings, January 1, 2010		$129,800
Add: Net income		80,000
		$209,800
Less: Cash dividends	$13,000	
Stock dividends	17,000	
Reduction due to retirement of preferred stock	10,000	(40,000)
Retained earnings, December 31, 2010 (see Note A)		$169,800

2. Note A: Retained earnings are restricted in the amount of $20,000, the cost of the common shares being held as treasury stock.

E17-19

1.

FRANKLIN COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2010

Retained earnings, as previously reported, January 1, 2010		$206,000
Less: Correction of overstatement of previous net income (net of $5,400 income tax credit)		(12,600)
Adjusted retained earnings, January 1, 2010		$193,400
Add: Net income		58,000
		$251,400
Less: Cash dividends	$ 9,000	
Stock dividends	6,000	
Reduction due to retirement of preferred stock	40,000	(55,000)
Retained earnings, December 31, 2010 (see Note A)		$196,400

2. Note A: Retained earnings are restricted in the amount of $14,000, the cost of the common shares being held as treasury stock.

E17-20

WILK MANUFACTURING CORPORATION
Stockholders' Equity
December 31, 2010

Contributed Capital	
Preferred stock, $50 par (6,000 shares authorized, issued, and outstanding)	$300,000
Common stock, $5 par (30,000 shares authorized, 15,000 shares issued of which 500 shares are being held as treasury stock)	75,000
Additional paid-in capital:	
On preferred stock	120,000[a]
On common stock	255,000[b]
From treasury stock	2,500[c]
Total contributed capital	$752,500
Retained earnings (see Note A)	16,000
Accumulated other comprehensive income (loss)	
Unrealized decrease in value of available-for-sale securities	(2,500)
Total contributed capital, retained earnings, and accumulated other comprehensive income	$766,000
Less: Treasury stock at cost (500 common shares at $18)	(9,000)
Total stockholders' equity	$757,000

Notes to Financial Statements

Note A: Retained earnings are restricted in the amount of $9,000, the cost of the treasury stock.

[a]($70 - $50) x 6,000

[b]($22 - $5) x 15,000

[c]($23 - $18) x 500

1.

WINSLOW DESIGN COMPANY
Statement of Changes in Stockholders' Equity
For Year Ended December 31, 2010

	Preferred Stock		Common Stock		Additional Paid-In Capital				Treasury
	Shares Issued	Par Value	Shares Issued	Par Value	Preferred Stock	Common Stock	Treasury Stock	Retained Earnings	Stock (cost)
Balances, 1/1/2010	1,250	$125,000	15,000	$150,000	$55,000	$105,000	$ 0	$78,000	$(4,200)
Issued preferred stock	250	25,000			16,000[a]				
Issued common stock			3,000	30,000		21,000[b]			
Reacquired treasury stock									(3,000)
Reissued treasury stock							750[c]		3,500
Net income								46,500	
Dividends					$71,000			(25,000)	
Balances, 12/31/2010	1,500	$150,000	18,000	$180,000		$126,000	$750	$99,500	$(3,700)

[a]($164 - $100) x 250

[b]($17 - $10) x 3,000

c($17 - $14) x 250

2.

$$\text{Return on stockholders' equity} = \frac{\text{Net income}}{\text{Average stockholders' equity}}$$

$$= \frac{\$46,500}{(\$623,550^* + \$508,800)/2} = \frac{\$46,500}{\$566,175} = \underline{\underline{8.2\%}}$$

*$150,000 + $180,000 + $71,000 + $126,000 + $750 + $99,500 - $3,700 = $623,550

SOLUTIONS TO PROBLEMS

P17-1

MANTY COMPANY
Income Statement
For Year Ended December 31, 2010

Sales		$206,000
Cost of goods sold		(131,000)
Gross profit		$ 75,000
Operating expenses		(19,250)
Pretax income from continuing operations		$ 55,750
Income tax expense		(16,725)
Income from continuing operations		$ 39,025
Results of discontinued operations		
Gain on disposal of discontinued Division B (net of $2,400 income taxes)	$ 5,600	
Loss from operations of discontinued Division B (net of $6,000 income tax credit)	(14,000)	(8,400)
Income before extraordinary gain		$ 30,625
Extraordinary gain from bond retirement (net of $4,500 income tax expense)		10,500
Net income		$ 41,125
Basic earnings per share (see Note A):		
Income from continuing operations		$2.85
Results of discontinued operations		(0.70)
Extraordinary gain		0.88
Net income		$3.03

Notes to Financial Statements

Note A: Preferred dividends of $4,800 were deducted from income from continuing operations and net income to determine earnings available to common stock. The resulting amounts of $34,225 and $36,325 divided by the 12,000* weighted average number of common shares yielded $2.85 and $3.03 basic earnings per share, respectively.

*10,000 x 6/12 =	5,000	(Jan. - June)
12,000 x 4/12 =	4,000	(July - Oct.)
18,000 x 2/12 =	3,000	(Nov. - Dec.)
	12,000	

Note to Instructor: 18,000 common shares ($90,000 ÷ $5 par) were outstanding on December 31. Therefore, 10,000 (18,000 - 6,000 - 2,000) shares were outstanding on January 1.

P17-2

1. AGOCHA COMPANY
Comparative Income Statements
For Years Ended December 31, 2010 and 2011

	2010	2011
Sales	$124,300	$140,000
Cost of goods sold	(75,000)	(80,000)
Gross profit	$ 49,300	$ 60,000
Operating expenses	(18,000)	(20,000)
Pretax income before extraordinary item	$ 31,300	$ 40,000
Income tax expense	(9,390)	(12,000)
Income before extraordinary item	$ 21,910	$ 28,000
Extraordinary gain (net of $1,800 income tax expense)	4,200	
Extraordinary loss (net of $2,700 income tax credit)		(6,300)
Net income	$ 26,110	$ 21,700
Basic earnings per share (see Note A):		
Income before extraordinary item	$2.79	$2.92
Extraordinary gain	0.64	
Extraordinary loss		(0.75)
Net income	$3.43	$2.17

Notes to Financial Statements

Note A: For comparative purposes, retroactive recognition back to 2010 was given to a 20% stock dividend issued in 2011. Preferred dividends of $3,500 were deducted from income before extraordinary item and net income to determine earnings available to common stock. The resulting amounts of $18,410 and $22,610 divided by the 6,600* weighted average number of common shares yielded $2.79 and $3.43 earnings per share in 2010, respectively. The resulting amounts of $24,500 and $18,200 divided by the 8,400* weighted average common shares yielded $2.92 and $2.17 basic earnings per share in 2011, respectively.

*2010
5,000 X 1.20 X 9/12 = 4,500
7,000 X 1.20 X 3/12 = 2,100
6,600

2011
7,000 X 1.20 X 12/12 = 8,400

P17-2 (continued)

2. Price / earnings ratio = $\frac{\text{Market price per common share}}{\text{Earnings per share from continuing operations}}$

2011	2010
$\frac{\$32.20}{\$2.92}$ = 11 times	$\frac{\$25.75}{\$2.79}$ = 9.2 times

The price/earnings ratio for 2011 was higher than for 2010 because the ending market price increased at a rate faster than the increase in earnings per share from continuing operations.

P17-3

1.a. & b.

Explanation	Earnings	÷	Shares	=	Earnings Per Share
Basic earnings and shares	$ 91,000[a]	÷	30,000[b]	=	$3.03 Basic
Increment in shares (options)		÷	500[c]		
Tentative $DEPS_1$ amounts	$ 91,000	÷	30,500	=	$2.98 $DEPS_1$
Preferred dividend savings	18,800[d]				
Increment in shares (P/S)			8,000[d]		
Diluted earnings and shares	$109,800	÷	38,500	=	$2.85 Diluted

[a]$91,000 = $109,800 (net income) - $18,800 (9.4% preferred dividends)

[b]Weighted average shares:

10,000 x 2.00 x 3/12 =	5,000
12,000 x 2.00 x 2/12 =	4,000
18,000 x 2.00 x 7/12 =	21,000
Weighted average	30,000

[c]Increment due to share options:

Issued	2,000
Reacquired $\left(\frac{2{,}000 \times (\$16 + \$2)}{\$24}\right) =$	(1,500)
Increment in shares	500

[d]Impact on diluted earnings per share:

Preferred: $\frac{0.094 \times \$200{,}000}{2{,}000 \times 4} = \frac{\$18{,}800}{8{,}000} = \$2.35$

$2.35 impact < $2.98 ($DEPS_1$), therefore dilutive

P17-3 (continued)

2. Earnings per Share (See Note 1)

Basic earnings per share	$3.03
Diluted earnings per share	$2.85

Notes to Financial Statements

Note 1: Basic earnings per share is based upon 30,000 average common shares outstanding. Preferred dividends of $18,800 have been deducted from net income to determine the basic earnings available to common stockholders. Diluted earnings per share include 500 shares from the assumed exercise of share options and 8,000 shares from the assumed conversion of preferred stock, for a total of 38,500 common shares. Diluted earnings available to common stockholders assume no payment of $18,800 dividends on the converted preferred stock.

3. IFRS do not require a company to include any unrecognized compensation cost in the application of the treasury stock method for share options. Therefore, the calculations in footnote (c) would differ as shown below.

Explanation	Earnings	÷	Shares	=	Per Share
Basic earnings and shares	$ 91,000[a]	÷	30,000	=	$3.03 Basic
Increment in shares (options)			667[c]		
Tentative $DEPS_1$ amounts	$ 91,000	÷	30,667	=	$2.97 $DEPS_1$
Preferred dividend savings	18,800[d]				
Increment in shares (P/S)			8,000[d]		
Diluted earnings and shares	$109,800	÷	38,667	=	$2.84 Diluted

[a]$91,000 = $109,800 (net income) - $18,800 (9.4% preferred dividends)

[b]Weighted average shares:

10,000 x 2.00 x 3/12	=	5,000
12,000 x 2.00 x 2/12	=	4,000
18,000 x 2.00 x 7/12	=	21,000
Weighted average		30,000

[c]Increment due to share options:

Issued	2,000
Reacquired: $\left(\frac{2,000 \times \$16}{\$24}\right)$ =	(1,333)
Increment in shares	667

[d]Impact on diluted earnings per share:

Preferred: $\frac{0.094 \times \$200,000}{2,000 \times 4} = \frac{\$18,800}{8,000} = \$2.35$

$2.35 impact < $2.97 ($DEPS_1$), therefore dilutive

P17-4

1. and 2.

		(1) Impact	(2) Ranking
10.2% bonds:	$\frac{\$20,400 \times 0.7}{200 \times 28} = \frac{\$14,280}{5,600}$	= $2.55	5
12.0% bonds:	$\frac{\left(\$19,200 - \frac{\$16,000}{20}\right) \times 0.7}{160 \times 47} = \frac{\$12,880}{7,520}$	= $1.71	3
9.0% bonds:	$\frac{\left(\$18,000 + \frac{\$10,000}{10}\right) \times 0.7}{200 \times 44} = \frac{\$13,300}{8,800}$	= $1.51	2
8.3% preferred stock:	$\frac{\$9,960}{1,200 \times 3.9} = \frac{\$9,960}{4,680}$	= $2.13	4
7.5% preferred stock:	$\frac{\$13,500}{1,800 \times 6} = \frac{\$13,500}{10,800}$	= $1.25	1

3. and 4.

Explanation	Earnings	÷	Shares	=	Earnings Per Share
Basic earnings and shares	$ 96,000[a]	÷	40,000	=	$2.40 Basic
7.5% preferred dividend savings	13,500[b]				
Increment in shares (P/S)			10,800		
Tentative $DEPS_1$	$109,500	÷	50,800	=	$2.16 $DEPS_1$
9% bond interest expense savings	13,300[b]				
Increment in shares (9% bonds)			8,800		
Tentative $DEPS_2$	$122,800	÷	59,600	=	$2.06 $DEPS_2$
12% bond interest expense savings	12,880[b]				
Increment in shares (12% bonds)			7,520		
Diluted earnings and shares	$135,680	÷	67,120	=	$2.02[c] Diluted

[a]$96,000 = $119,460 (net income) - $9,960 (8.3% preferred dividends) - $13,500 (7.5% preferred dividends)

[b]The 7.5% preferred stock, 9% bonds, and 12% bonds are included in diluted earnings per share because they are individually dilutive ($1.25 < $2.40, $1.51 < $2.16, $1.71 < $2.06).

[c]The 10.2% bonds and the 8.3% preferred stock are not included in diluted earnings per share because they are individually antidilutive.

5. Madsen Company would report basic earnings per share of $2.40 and diluted earnings per share of $2.02 on its 2010 income statement.

P17-5

Note to Instructor: This problem includes an extraordinary loss, so the impact of each convertible security is compared to earnings per share related to income from continuing operations (see footnote 11 in the chapter). The entire solution is formatted in that manner.

1. and 2.

Explanation	Earnings	÷	Shares	=	Earnings Per Share
Basic earnings and shares	\$117,000[a]	÷	25,300[b]	=	\$4.62 Basic[f]
Increment in shares (options)			600[c]		
Tentative $DEPS_1$ amounts	\$117,000	÷	25,900	=	\$4.52 $DEPS_1$
Bond interest expense savings	6,930[d]				
Increment in shares (bonds)			2,200[e]		
Diluted earnings and shares	\$123,930	÷	28,100	=	\$4.41[g] Diluted

*Related to income from continuing operations

[a]\$117,000 = \$130,400 (income from continuing operations) - \$7,000 (7% preferred dividends) - \$6,400 (8% preferred dividends)

[b]Weighted average shares:

20,000 x 1.10 x 6/12 =	11,000
24,000 x 1.10 x 2/12 =	4,400
27,000 x 1.10 x 4/12 =	9,900
Weighted average	25,300

[c]Increment due to share options:

Issued	3,000
Reacquired $\left(\frac{3{,}000 \times (\$20 + \$4)}{\$30}\right) =$	(2,400)
Increment in shares	600

[d]Impact on diluted earnings per share and ranking:

		Impact	Ranking
Preferred:	$\frac{0.08 \times \$80{,}000}{800 \times 1.7} = \frac{\$6{,}400}{1{,}360} =$	\$4.71	2
Bonds:	$\frac{[(0.096 \times \$100{,}000) + \$300] \times 0.7}{100 \times 22} = \frac{\$6{,}930}{2{,}200} =$	\$3.15	1

[e]Dilutive effect:

Bonds: \$3.15 impact <\$4.52 ($DEPS_1$), therefore individually dilutive

Preferred: \$4.71 impact >\$4.41, therefore antidilutive and excluded from EPS

[f]Basic earnings per share related to extraordinary loss is \$0.39 (\$10,000 extraordinary loss ÷ 25,300); rounded down to balance

[g]Diluted earnings per share related to extraordinary loss is \$0.36 (\$10,000 extraordinary loss ÷ 28,100)

P17-5 (continued)

3. Basic earnings per share (See Note 1)

Income before extraordinary items	$4.62
Extraordinary loss	(0.39)
Net income	$4.23

Diluted earnings per share (See Note 1)

Income before extraordinary items	$4.41
Extraordinary loss	(0.36)
Net income	$4.05

Notes to Financial Statements

Note 1: Basic earnings per share are based on 25,300 average common shares outstanding; 7% and 8% preferred dividends totaling $13,400 have been deducted from net income to determine the basic earnings available to common stockholders. Diluted earnings per share include 600 shares from the assumed exercise of stock options and 2,200 shares from the assumed conversion of bonds. Diluted earnings available to common stockholders assume no interest expense (net of tax) of $6,930 on the converted bonds.

P17-6

1. and 2.

Explanation	Earnings	÷	Shares	=	Earnings Per Share
Basic earnings and shares	$122,000[a]	÷	33,333[b]	=	$3.66 Basic
Increment in shares (options)			293[c]		
Tentative $DEPS_1$ amounts	$122,000	÷	33,626	=	$3.63 $DEPS_1$
10% bond interest expense savings[e]	13,300[d]				
Increment in shares (10% bonds)			4,400[d]		
Tentative $DEPS_2$ amounts	$135,300	÷	38,026	=	$3.56 $DEPS_2$
7.5% preferred dividend savings[e]	28,500[d]				
Increment in shares (P/S)			9,310[d]		
Diluted earnings and shares	$163,800	÷	47,336	=	$3.46 Diluted

[a]$122,000 = $150,500 (net income) - $28,500 (preferred dividends)

[b]Weighted average shares:

25,000 x 1.20 = 30,000 x 7/12 =	17,500
32,000 x 1.20 = 38,400 x 4/12 =	12,800
38,400 - 2,000 = 36,400 x 1/12 =	3,033
Weighted average shares	33,333

[c]Increment due to share options:

Issued	4,000
Reacquired $\left(\frac{4{,}000 \times (\$33 + \$5)}{\$41}\right) =$	(3,707)
Increment in shares	293

P17-6 (continued)
1. and 2. (continued)

[d]Impact on diluted earnings per share and ranking:

		Impact	Ranking
10% bonds:	$\frac{[(0.10 \times \$200{,}000) - \$1{,}000] \times 0.7}{200 \times 22} = \frac{\$13{,}300}{4{,}400} =$	\$3.02	1
5.8% bonds:	$\frac{(0.058 \times \$540{,}000) \times 0.7}{540 \times 11.6} = \frac{\$21{,}924}{6{,}264} =$	\$3.50	3
7.5% preferred:	$\frac{0.075 \times \$380{,}000}{3{,}800 \times 2.45} = \frac{\$28{,}500}{9{,}310} =$	\$3.06	2

[e]Dilutive effect on diluted earnings per share:
10% bonds: \$3.02 impact < \$3.63 ($DEPS_1$), therefore dilutive
7.5% preferred: \$3.06 impact < \$3.56 ($DEPS_2$), therefore dilutive
5.8% bonds: \$3.50 impact > \$3.46 ($DEPS_3$), therefore antidilutive and excluded from EPS

3. Frost Company would report basic earnings per share of \$3.66 and diluted earnings per share of \$3.46 on its 2010 income statement.

P17-7 (AICPA adapted solution)

LAFAYETTE CORPORATION
Schedule to Compute Basic Earnings Per Share
and Diluted Earnings Per Share
For Year Ended September 30, 2011

	Earnings Adjusted for Assumed Conversions	Number of Shares	Earnings Per Share (Income Statement)
Basic earnings per share	\$540,000	350,000	\$1.54
Diluted earnings per common share	\$657,600*	456,000	\$1.44

*Includes interest, net of tax effect, on convertible debentures for the year ended September 30, 2011:

Interest (7% x \$2,400,000)	\$168,000
Less income taxes (30% x \$168,000)	(50,400)
Interest, net of tax effect	\$117,600

P17-7 (continued)

Computation of Number of Shares
To Be Used in Earnings Per Share Computations

Weighted average shares outstanding during year:		
October 1 - November 30, 2010 (giving retroactive effect to stock split)	120,000 x 1/6	20,000
December 1, 2010 - March 2, 2011	400,000 x 1/4	100,000
March 3 - March 31, 2011	360,000 x 1/12	30,000
April 1 - September 30, 2011	400,000 x 1/2	200,000
Number of shares to be used in basic earnings per share computations		350,000
Add excess of number of shares to be issued on the exercise of Series A warrants (50,000) over number of treasury shares that could be purchased with the funds obtained from the exercise of the warrants ($30 x 50,000 ÷ $37.50 = 40,000)		10,000
Add shares resulting from conversion of convertible debentures (40 x 2,400)		96,000
Number of shares to be used in computation of diluted earnings per share		456,000

P17-8 (AICPA adapted solution)

1.

MASON CORPORATION
Weighted Average Number of Common Shares for
Computation of Basic Earnings per Share
For Year Ended December 31, 2010

Dates	Shares		Months Outstanding		Weighted Shares
January 1 - August 31	300,000	x	8	=	2,400,000
September 1, sold additional shares	36,000				
September 1 - December 31	336,000	x	4	=	1,344,000
					3,744,000
Total shares-months					÷ 12
Weighted average number of shares outstanding					312,000

P17-8 (continued)

2. MASON CORPORATION
Computation of Basic Earnings Per Share
For Year Ended December 31, 2010

Income:	
Net income	$750,000
Deduct dividends paid on preferred stock (10,000 shares x $3)	(30,000)
Net income, adjusted	$720,000
Number of shares (Requirement 1)	312,000
Basic earnings per share ($720,000 ÷ 312,000)	$2.31

3. MASON CORPORATION
Number of Shares for Computation of
Diluted Earnings per Share
For Year Ended December 31, 2010

Weighted average number of shares outstanding (Requirement 1)	312,000
Stock options and warrants:	
From share options-dilutive (Schedule 1)	11,250
From warrants-antidilutive (Schedule 2)	0
Shares assumed to be issued upon conversion of convertible bonds ($1,000,000 ÷ $1,000 = 1,000 bonds x 40)	40,000
Total number of shares for diluted EPS computation	363,250

Schedule 1:

Assumed Shares Increase From Share Options-
Treasury Stock Method

	Shares
Shares that would be issued upon exercise of options	30,000
Cash proceeds that would be realized upon exercise [30,000 shares x $22.50 ($20.50 option price + $2 unrecognized compensation cost) = $675,000]	
Treasury shares that could be purchased [$675,000 ÷ $36 (average market price)]	(18,750)
Dilutive share options	11,250

P17-8 (continued)
3. (continued)

Schedule 2:

Assumed Shares Increase (Decrease) From
Warrants-Treasury Stock Method

Shares that would be issued upon exercise of warrants	20,000
Cash proceeds that would be realized upon exercise [20,000 shares x $38 (exercise price) = $760,000]	
Treasury shares that could be purchased [$760,000 ÷ $36 (average market price)]	(21,111)
Antidilutive warrants (not included in EPS computations)	(1,111)

4.

MASON CORPORATION
Computation of Diluted Earnings Per Share
For Year Ended December 31, 2010

Income:	
Net income	$750,000
Deduct dividends paid on preferred stock (10,000 shares x $3)	(30,000)
	$720,000
Add interest expense (net of income tax effect) on convertible bonds [$1,000,000 x 8% = $80,000 x 0.70 (1.00 - 0.30 tax rate)]	56,000
Net income, adjusted	$776,000
Number of shares (Requirement 3)	363,250
Diluted earnings per share ($776,000 ÷ 363,250)	$2.14

P17-9

			Preferred	Common	Total
1.	Year 1	Preferred	$ 6,000	$ 0	$ 6,000
	Year 2	Current preferred dividend ($100 x 0.07 x 1,000)	$ 7,000	---	
		Remainder to common	---	$21,000	
		Totals	$ 7,000	$21,000	$28,000
	Year 3	Current preferred dividend	$ 7,000	---	
		Remainder to common	---	$23,000	
		Totals	$ 7,000	$23,000	$30,000

P17-9 (continued)

			Preferred	Common	Total
2.	Year 1	Preferred (and $1,000 is in arrears)	$ 6,000	$ 0	$ 6,000
	Year 2	Dividends in arrears	$ 1,000	---	
		Current preferred dividend	7,000	---	
		Remainder to common	---	$20,000	
		Totals	$ 8,000	$20,000	$28,000
	Year 3	Current preferred dividend	$ 7,000	---	
		Remainder to common	---	$23,000	
		Totals	$ 7,000	$23,000	$30,000
3.	Year 1	Preferred (and $1,000 is in arrears)	$ 6,000	$ 0	$ 6,000
	Year 2	Dividends in arrears	$ 1,000	---	
		Current preferred dividend	7,000	---	
		Common proportional share (0.07 x $5 x 40,000)	---	$14,000	
		Remainder ($28,000 - $22,000)*	2,000	4,000	
		Totals	$10,000	$18,000	$28,000

$$\text{*Preferred: } \frac{\$100{,}000}{\$100{,}000 + \$200{,}000} \times \$6{,}000 \text{ extra dividend} = \$2{,}000$$

$$\text{Common: } \frac{\$200{,}000}{\$100{,}000 + \$200{,}000} \times \$6{,}000 \text{ extra dividend} = \$4{,}000$$

	Preferred	Common	Total
Year 3 Current preferred dividend	$ 7,000	---	
Common proportional share	---	$14,000	
Remainder ($30,000 - $21,000)*	3,000	6,000	
Totals	$10,000	$20,000	$30,000

$$\text{*Preferred: } \frac{\$100{,}000}{\$100{,}000 + \$200{,}000} \times \$9{,}000 = \$3{,}000$$

$$\text{Common: } \frac{\$200{,}000}{\$100{,}000 + \$200{,}000} \times \$9{,}000 = \$6{,}000$$

P17-9 (continued)

4\.

		Preferred	Common	Total
Year 1	Preferred (and $1,000 is in arrears)	$ 6,000	$ 0	$ 6,000
Year 2	Preferred in arrears	$ 1,000	---	
	Preferred current	7,000	---	
	Common proportional share	---	$14,000	
	Remainder (2% of par value)	2,000	4,000	
	Totals	$10,000	$18,000	$28,000
Year 3	Preferred current	$ 7,000	---	
	Common proportional share	---	$14,000	
	Extra (2% of par value)	2,000	4,000	
	Remainder to common	---	3,000	
	Totals	$ 9,000	$21,000	$30,000

P17-10 (AICPA adapted solution)

TOMASCO, INC.
Maximum Cash Dividend Distribution
December 31, 2010

	Common stock	4% Preferred stock	8% Preferred stock	Total
8% preferred stock, dividends in arrears for 2006-2009 ($1,000,000 x 8% x 4 years)			$320,000	$320,000
4% preferred stock dividends for 2010 ($100,000 x 4%)		$4,000		4,000
8% preferred stock dividends for 2010 ($1,000,000 x 8%)			80,000	80,000
Distribution of remaining retained earnings (Schedule 1)	$175,333		270,667	446,000
	$175,333	$4,000	$670,667	$850,000

P17-10 (continued)

Schedule 1: Distribution of Remaining Retained Earnings

	Common stock	8% Preferred stock	Total
Dividends on common stock at preferred rate ($500,000 x 8%)	$ 40,000		$ 40,000
Distribution of remaining retained earnings of $406,000* based on the ratio of par values:			
Common stock $\frac{\$500,000}{\$1,500,000}$ x $406,000	135,333		406,000
8% preferred stock $\frac{\$1,000,000}{\$1,500,000}$ x $406,000		$270,667	
	$175,333	$270,667	$446,000

*$850,000 - $320,000 - $4,000 - $80,000 - $40,000

P17-11

1. 2010

Date		Account	Debit	Credit
Jan.	4	Cash (3,000 x $25)	75,000	
		Common Stock, $10 par		30,000
		Additional Paid-in Capital on Common Stock		45,000
	30	Dividends Payable: Preferred [($100 x 0.08) x 1,200]	9,600	
		Dividends Payable: Common*	32,000	
		Cash		41,600

*18,000 - 2,000 in treasury = 16,000 x $2 = $32,000

Date		Account	Debit	Credit
Mar.	2	Cash (400 x $125)	50,000	
		Preferred Stock, $100 par		40,000
		Additional Paid-in Capital on Preferred Stock		10,000
May	7	Cash (600 x $24)	14,400	
		Treasury Stock (600 x $21)		12,600
		Additional Paid-in Capital from Treasury Stock		1,800

P17-11 (continued)
1. (continued)

Date		Account	Debit	Credit
June	15	Common Stock, $10 par (21,000 x $10)	210,000	
		Additional Paid-in Capital on Common Stock	42,000	
		Common Stock, $6 par (42,000 x $6)		252,000

15 Memorandum entry: The treasury stock participates in the stock split on this date. There are now 2,800 treasury shares at a $6 par value per share and a cost of $10.50 per share.

Date		Account	Debit	Credit
July	2	Retained Earnings*	27,440	
		Common Stock To Be Distributed (1,960 x $6)		11,760
		Additional Paid-in Capital from Stock Dividend		15,680

*42,000 shares issued
- 2,800 treasury shares (1,400 split two for one)
39,200 shares outstanding
x 0.05 stock dividend %
1,960 shares in stock dividend
x $14 current market price
$27,440 reduction in retained earnings

Date		Account	Debit	Credit
Aug.	3	Common Stock To Be Distributed	11,760	
		Common Stock, $6 Par		11,760
Oct.	1	Allowance for Change in Value of Investment [2,000 x ($16 - $15)]	2,000	
		Unrealized Increase in Value of Available-for-Sale Securities [2,000 x ($15 - $12)]	6,000	
		Gain on Disposal of Investment [2,000 x ($16 - $12)]		8,000
		Retained Earnings (2,000 x $16)	32,000	
		Property Dividend Payable		32,000
Nov.	1	Property Dividend Payable	32,000	
		Investment in Lamb Company Stock		24,000
		Allowance for Change in Value of Investment [2,000 x ($16 - $12)]		8,000

P17-11 (continued)
1. (continued)

Dec.	31	Retained Earnings	53,960	
		Dividends Payable: Preferred*		12,800
		Dividends Payable: Common*		41,160

*Preferred: 1,200 + 400 = 1,600 x $8 = $12,800
Common: 42,000 - 2,800 + 1,960 = 41,160 x $1 = $41,160

2.

GRAY COMPANY
Stockholders' Equity
December 31, 2010

Preferred stock (8%, $100 par, 1,600 shares issued and outstanding)	$160,000
Common stock ($6 par, 43,960 shares issued of which 41,160 are outstanding and 2,800 shares are being held as treasury stock)	263,760
Additional paid-in capital on preferred stock	31,600[a]
Additional paid-in capital on common stock	93,000[b]
Additional paid-in capital from treasury stock	1,800
Additional paid-in capital from stock dividend	15,680
Total contributed capital	$565,840
Retained earnings (restricted in the amount of $29,400, the cost of the treasury shares)	341,600[c]
Contributed capital and retained earnings	$907,440
Less: Treasury stock (2,800 shares of common at $10.50 per share)	(29,400)
Total stockholders' equity	$878,040

[a]$31,600 = $21,600 + $10,000

[b]$93,000 = $90,000 + $45,000 - $42,000

[c]$341,600 = $230,000 + $225,000 - $27,440 - $32,000 - $53,960

P17-12

1. 2010

Jan.	4	Dividends Payable: Preferred ($6 x ½ x 2,000)	6,000	
		Dividends Payable: Common*	46,400	
		Cash		52,400

*30,000 - 1,000 in treasury = 29,000 x $1.60 = $46,400

P17-12 (continued)

1. (continued)

Jan.	5	Cash (500 x $110)	55,000	
		Preferred Stock, $100 Par		50,000
		Premium on Preferred Stock		5,000
	23	Cash (4,000 x $23)	92,000	
		Common Stock, $5 Par		20,000
		Premium on Common Stock		72,000
Apr.	2	Cash (700 x $24)	16,800	
		Treasury Stock (700 x $20 per share cost)		14,000
		Additional Paid-in Capital from Treasury Stock		2,800
May	14	Retained Earnings*	84,250	
		Common Stock To Be Distributed (3,370 x $5)		16,850
		Additional Paid-in Capital from Stock Dividend		67,400

*34,000 shares issued
- 300 treasury shares
33,700 shares outstanding
x 0.10 stock dividend %
3,370 shares in stock dividend
x $25 current market price
$84,250 reduction in retained earnings

June	4	Retained Earnings [(2,000 + 500) x $6 x ½ year]	7,500	
		Dividends Payable: Preferred		7,500
	29	Common Stock To Be Distributed	16,850	
		Common Stock, $5 Par		16,850
July	5	Dividends Payable: Preferred	7,500	
		Cash		7,500

20 Memorandum entry: On this date the common stock was split two for one and the par value was reduced from $5 to $2.50 per share. The number of issued common shares increased from 37,370* to 74,740. The number of treasury shares increased from 300 to 600 and the cost decreased to $10 per share.

*37,370 = 34,000 issued + 3,370 stock dividend

P17-12 (continued)
1. (continued)

Date		Account	Debit	Credit
Aug.	3	Loss on Disposal of Investment [5,000 x ($9 - 4)]	25,000	
		Unrealized Decrease in Value of Securities Available-for-Sale [5,000 x ($9 - 6)]		15,000
		Allowance for Change in Value of Investment [5,000 x ($6 - 4)]		10,000
		Retained Earnings (5,000 x $4)	20,000	
		Property Dividend Payable		20,000
Sept.	14	Property Dividend Payable	20,000	
		Allowance for Change in Value of Investment	25,000	
		Investment in Drot Company Stock		45,000
Dec .	3	Retained Earnings*	74,226	
		Dividends Payable: Preferred		7,500
		Dividends Payable: Common		66,726

*Preferred: 2,500 x $6 x ½ year = $7,500
Common: (74,740 - 600 in treasury) x $0.90 = $66,726

2.

JACOBI COMPANY
Stockholders' Equity
December 31, 2010

Preferred stock (6%, $100 par, 2,500 shares issued and outstanding)	$250,000	
Premium on preferred stock	17,000[a]	$ 267,000
Common stock ($2.50 par, 74,740 shares issued of which 600 are in the corporate treasury)	$186,850	
Premium on common stock	312,000[b]	498,850
Additional paid-in capital from treasury stock		2,800
Additional paid-in capital from stock dividend		67,400
Total contributed capital		$ 836,050
Retained earnings (restricted in the amount of $6,000, the cost of the treasury shares)		711,024[d]
Accumulated other comprehensive income (loss)		
Unrealized decrease in value of available-for-sale securities		(26,000)[c]
Contributed capital, retained earnings, and accumulated other comprehensive income		$1,521,074
Less: Treasury stock (600 common shares at $10 per share)		(6,000)
Total stockholders' equity		$1,515,074

P17-12 (continued)
2. (continued)

[a]$17,000 = $12,000 + $5,000

[b]$312,000 = $240,000 + $72,000

[c]$26,000 = $41,000 - $15,000

[d]$711,024 = $627,000 + $270,000 - $84,250 - $7,500 - $20,000 - $74,226

P17-13

				Debit	Credit
1.	(1)	(a)	Retained Earnings (1,200 x $30)	36,000	
			Common Stock To Be Distributed		12,000
			Additional Paid-in Capital From Stock Dividend		24,000
		(b)	Common Stock To Be Distributed	12,000	
			Common Stock, $10 Par		12,000
	(2)	(a)	Retained Earnings (4,500 x $10)	45,000	
			Common Stock To Be Distributed		45,000
		(b)	Common Stock To Be Distributed	45,000	
			Common Stock, $10 Par		45,000
	(3)	(a)	Retained Earnings (150 preferred shares x $123)	18,450	
			Preferred Stock To Be Distributed		15,000
			Additional Paid-in Capital From Stock Dividend		3,450
		(b)	Preferred Stock To Be Distributed	15,000	
			Preferred Stock, $100 Par		15,000
	(4)		Common Stock, $10 Par	150,000	
			Premium on Common Stock		30,000
			Common Stock, $4 Par (30,000 shares)		120,000
	(5)	(a)	Investment in West Company Stock [1,000 x ($54 - $48)]	6,000	
			Gain on Disposal of Investment		6,000
			Retained Earnings	54,000	
			Property Dividend Payable		54,000

P17-13 (continued)
1. (5) (continued)

			Debit	Credit
	(b)	Property Dividend Payable	54,000	
		Investment in West Company Stock		54,000
(6)	(a)	Retained Earnings [(1,000 x $8) + (15,000 x $2.00)]	38,000	
		Contributed Capital Distributed as a Liquidating Dividend on Preferred Stock (1,000 x $2)	2,000	
		Contributed Capital Distributed as a Liquidating Dividend on Common Stock (15,000 x $0.30)	4,500	
		Dividend Payable: Preferred Stock		10,000
		Dividend Payable: Common Stock (15,000 x $2.30)		34,500
	(b)	Dividend Payable: Preferred Stock	10,000	
		Dividend Payable: Common Stock	34,500	
		Cash		44,500

2.

	(1)	(2)	(3)	(4)	(5)	(6)
Preferred stock	$100,000	$100,000	$115,000	$100,000	$100,000	$100,000
Common stock	162,000	195,000	150,000	120,000	150,000	150,000
Premium on preferred stock	16,000	16,000	16,000	16,000	16,000	16,000
Premium on common stock	220,000	220,000	220,000	250,000	220,000	220,000
Additional paid-in capital from stock dividend	24,000	—	3,450	—	—	—
Contributed capital distributed as a liquidating dividend on preferred stock	—	—	—	—	—	(2,000)
Contributed capital distributed as a liquidating dividend on common stock	—	—	—	—	—	(4,500)
Retained earnings	228,000	219,000	245,550	264,000	216,000*	226,000
Total stockholders' equity	$750,000	$750,000	$750,000	$750,000	$702,000	$705,500

*$216,000 = $264,000 - $54,000 + $6,000 gain

P17-14

TATE COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2010

Retained earnings, as previously reported, January 1, 2010		$180,000
Add: Correction of overstatement in 2009 depreciation (net of $3,900 income taxes)		9,100
Less: Correction of omission of 2009 loss on sale of land (net of $3,000 income tax credit)		(7,000)
Adjusted retained earnings, January 1, 2010		$182,100
Add: Net income		72,000
		$254,100
Less: Stock dividends	$39,000[1]	
Cash dividends	29,900[2]	
Reduction of retained earnings due to a retirement of preferred stock at a call price higher than the original issue price	9,600[3]	(78,500)
Retained earnings, December 31, 2010 (see Note A)		$175,600

Notes to Financial Statements

Note A: Retained earnings are restricted in the amount of $50,000 in accordance with the provisions of a bond issue that matures on January 1, 2020. The restriction applies during the period the bonds are outstanding.

[1](10,000 x 2 x 0.15) x $13

[2][(10,000 x 2) + (10,000 x 2 x 0.15)] x $1.30

[3]($120 - $108) x 800

P17-15

1. (1) Retained Earnings (4,000 x $3)	12,000	
Dividends Payable		12,000
Dividends Payable	12,000	
Cash		12,000

P17-15 (continued)

1. (continued)

		Debit	Credit
(2)	Retained Earnings (600 x $36)	21,600	
	Common Stock To Be Distributed		6,000
	Additional Paid-in Capital From Stock Dividend		15,600
	Common Stock To Be Distributed	6,000	
	Common Stock, $10 Par		6,000
(3)	Preferred Stock, $100 Par	50,000	
	Additional Paid-in Capital on Preferred Stock	5,000	
	Retained Earnings [500 x ($125 - $110)]	7,500	
	Cash		62,500
(4)	Accumulated Depreciation ($45,000 - $20,000)	25,000	
	Retained Earnings		25,000
	Retained Earnings ($25,000 x 0.30)	7,500	
	Income Taxes Payable on Prior Earnings		7,500

2.

FASTOR COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2010

Retained earnings, as previously reported, January 1, 2010		$218,600
Add: Correction of overstatement in 2009 depreciation expense (net of $7,500 income taxes)		17,500
Adjusted retained earnings, January 1, 2010		$236,100
Add: Net income		67,000
		$303,100
Less: Cash dividends ($3 per share)	$12,000	
Stock dividend ($25 current market price on 600 common shares)	21,600	
Reduction of retained earnings due to retirement of 500 shares of preferred stock at a $125 call price in excess of the $110 original issuance price	7,500	(41,100)
Retained earnings, December 31, 2010		$262,000

P17-16

1. 2010

Date	Account	Debit	Credit
Jan.	Preferred Stock (8%), $100 par	100,000	
	Premium on Capital Stock [($105 - $100) x 1,000]	5,000	
	Retained Earnings	11,000	
	Cash		116,000
Apr.	Retained Earnings [($220,000 ÷ $10) x 0.10 x $16]	35,200	
	Common Stock To Be Distributed (2,200 x $10)		22,000
	Premium on Capital Stock		13,200
	Common Stock To Be Distributed	22,000	
	Common Stock, $10 par		22,000
Nov.	Treasury Stock ($18 x 1,000)	18,000	
	Cash		18,000
Dec.	Retained Earnings	10,500	
	Dividends Payable: Preferred [($100 x 0.07) x 1,500]		10,500
Dec.	Retained Earnings	23,200	
	Dividends Payable: Common [$1 x (22,000 + 2,200 - 1,000 treasury shares)]		23,200
Dec.	Dividends Payable: Preferred	10,500	
	Cash		10,500
Dec.	Dividends Payable: Common	23,200	
	Cash		23,200
Dec.	Income Summary (net income)	87,000	
	Retained Earnings		87,000
Dec.	Retained Earnings (depreciation error)	10,000	
	Accumulated Depreciation		10,000
	Income Tax Refund Receivable	3,000	
	Retained Earnings ($10,000 x 0.30)		3,000

P17-16 (continued)

1. (continued)

Dec.	Accumulated Depreciation	8,000	
	Retained Earnings (gain error)		8,000
	Retained Earnings ($8,000 x 0.30)	2,400	
	Income Taxes Payable*		2,400

*Or, credit to Income Tax Refund Receivable to reduce refund from previous journal entry.

2.

CORY COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2010

Retained earnings, as previously reported, January 1, 2010		$182,200
Add: Correction of error in 2009 gain on sale of equipment (net of $2,400 income taxes)		5,600
Less: Correction of omission of 2009 depreciation on certain machinery (net of $3,000 income tax credit)		(7,000)
Adjusted retained earnings, January 1, 2010		$180,800
Add: Net income		87,000
		$267,800
Less: Stock dividend ($16 current market price on 2,200 shares)	$35,200	
Cash dividends: preferred ($7 on 1,500 shares)	10,500	
Cash dividends: common ($1 on 23,200 shares)	23,200	
Reduction of retained earnings resulting from retirement of preferred stock at a call price in excess of the original issue price (1,000 shares at $11 excess)	11,000	(79,900)
Retained earnings, December 31, 2010 (see Note A)		$187,900

Notes to Financial Statements

Note A: Retained earnings are restricted in the amount of $18,000, the cost of the 1,000 common shares being held as treasury stock.

P17-17

1. Journal entries:

	Debit	Credit
Capital Surplus	30,100	
Premium on Common Stock		27,100
Premium on Preferred Stock		3,000
Capital Surplus	16,000	
Unrealized Capital from Donation of Land		16,000
Treasury Stock	7,500	
Capital Surplus		7,500
Retained Earnings*	80,000	
Capital Surplus		80,000

*Reductions in retained earnings due to:

Stock dividend	$20,000
Prior period adjustment	12,000
Loss from fire	18,000
Property dividend	6,000
Cash dividend	24,000
	$80,000

2.

MARBLE COMPANY
Stockholders' Equity
December 31, 2010

Preferred stock ($100 par, 300 shares issued and outstanding)	$ 30,000
Common stock ($10 par, 6,500 shares issued of which 6,000 shares are outstanding and 500 shares are in the treasury)	65,000
Premium on preferred stock	3,000
Premium on common stock	27,100
Contributed capital	$125,100
Retained earnings (see Note A):	70,000*
Unrealized capital from donation of land	16,000
Contributed capital, retained earnings, and unrealized capital	$211,100
Less: Treasury stock (500 shares at $15 per share cost)	(7,500)
Total stockholders' equity	$203,600

P17-17 (continued)
2. (continued)

Notes to Financial Statements

Note A: Retained earnings is restricted in the amount of $7,500, the cost of the treasury shares.

*$150,000 - $80,000

P17-18 (AICPA adapted solution)

1.

ASHWOOD, INC.
Statement of Retained Earnings
For the Year Ended December 31, 2010

Balance, December 31, 2009, as originally reported		$ 6,470,000
Add: Prior period adjustment from error understating inventories at December 31, 2009	$ 300,000	
Less: Income tax effect	(90,000)	210,000
As restated		$ 6,680,000
Net income		4,500,000
		$11,180,000
Deduct cash dividends:		
On preferred stock at required rate [$4.50 ($50 x 9%) x 100,000 shares]	$ 450,000	
On common stock, $1.00 per share [$1 x 2,480,000 shares (2,000,000 + 500,000 - 20,000)]	2,480,000	(2,930,000)
Balance, December 31, 2010		$ 8,250,000

P17-18 (continued)

2.

ASHWOOD, INC.
Stockholders' Equity Section of Balance Sheet
December 31, 2010

Preferred stock, $50 par value, 9% cumulative, convertible; 600,000 shares authorized; 100,000 shares issued and outstanding	$ 5,000,000
Common stock, $10 par value; 6,000,000 shares authorized; 2,500,000 shares issued (2,000,000 + 500,000), of which 10,000 shares are held in treasury	25,000,000
Additional paid-in capital from preferred stock [100,000 x $4 ($54 - $50)]	400,000
Additional paid-in capital from common stock (Schedule 1)	11,050,000
Retained earnings	8,250,000
	$49,700,000
Less: Common stock in treasury, 10,000 shares at cost [$16 x 10,000 (20,000 - 10,000)]	(160,000)
Total stockholders' equity	$49,540,000

Schedule 1: Additional Paid-In Capital From Common Stock

Balance, December 31, 2009	$ 7,500,000
From issuance of 500,000 shares on April 27, 2010 [500,000 x $7 ($17 - $10)]	3,500,000
From sale of 10,000 shares treasury stock on November 9, 2010 [10,000 x $5 ($21 - $16)]	50,000
Balance, December 31, 2010	$11,050,000

P17-19 (AICPA adapted solution)

1.

CARR CORPORATION
Statement of Retained Earnings
For the Year Ended December 31, 2010

Balance, December 31, 2009, as originally reported		$4,000,000
Deduct: Prior period adjustment from error overstating rent income for year ended December 31, 2009	$500,000	
Less: Income tax effect	(225,000)	275,000
As restated		$3,725,000
Net income		2,600,000
		$6,325,000
Deduct dividends:		
Cash dividend on preferred stock	$180,000[a]	
Dividend in kind on common stock	630,000[b]	(810,000)
Balance, December 31, 2010		$5,515,000

P17-19 (continued)

2.

CARR CORPORATION
Stockholders' Equity Section of Balance Sheet
December 31, 2010

Preferred stock, $100 par, 10% cumulative; 100,000 shares authorized; 18,000 shares issued and outstanding		$ 1,800,000
Common stock, $5 stated value; 3,000,000 shares authorized, 1,290,000 shares issued and outstanding		6,050,000[c]
Additional paid-in capital		
From preferred stock	$ 90,000	
From common stock	4,640,000[d]	
Total additional paid-in capital		4,730,000
Retained earnings		5,515,000
Accumulated other comprehensive income (loss)		
Unrealized decrease in value of marketable equity securities		(135,000)
Total stockholders' equity		$17,960,000

[a]Cash dividend on preferred stock for 2010

Shares outstanding	18,000
Dividends per share ($100 par x 10%)	x $10
Total dividend	$ 180,000

[b]Dividend in kind on common stock for 2010

Bush, Inc., common stock shares	10,000
Market price on 2/13/10 declaration date	x $63
Total dividend	$ 630,000

[c]Common stock	Date	Shares	Amount
Balance	12/31/09	1,030,000	$5,150,000
Deduct: Treasury stock retired	01/09/10	(30,000)	(150,000)
		1,000,000	$5,000,000
Stock rights exercised	04/23/10	210,000	1,050,000
Balance	12/31/10	1,210,000	$6,050,000

[d]Additional paid-in capital form common stock

12/31/09, balance	$3,500,000
1/09/10, deduct treasury stock retired ($270,000 - $150,000)	(120,000)
	$3,380,000
4/23/10, stock rights exercised [($11 - $5) x 210,000 shares]	1,260,000
12/31/10, balance	$4,640,000

DANA COMPANY
Statement of Changes in Stockholders' Equity
For Year Ended December 31, 2010

		Preferred Stock		Common Stock		Additional Paid-In Capital				Accumulated Other	
Explanation	Comprehensive Income	Shares Issued	Par Value	Shares Issued	Par Value	Preferred Stock	Common Stock	Treasury Stock	Retained Earnings	Comprehensive Income	Treasury Stock
Balances, January 1, 2010		1,000	$100,000	9,000	$90,000	$20,000	$99,000		$330,000		
Comprehensive income:											
Net income	$83,000								83,000		
Unrealized decrease in value of available-for-sale securities (net of taxes)	(10,000)									$(10,000)	
Comprehensive income	$73,000								(27,500)		
Dividends											
Reacquired treasury stock											$(16,500)
Reissued treasury stock								$2,500			11,000
Retired treasury stock				(200)	(2,000)		(2,200)[a]		(200)[b]		4,400
Issued preferred stock		100	10,000			2,500					
Balances, December 31, 2010		1,100	$110,000	8,800	$88,000	$22,500	$96,800	$2,500	$385,300	$(10,000)	$ (1,100)

[a]$99,000 ÷ 9,000 shares = $11 pro rata reduction x 200 shares

[b]$4,400 – ($2,000 + $2,200 from footnote a)

P17-20 (continued)

2.

DANA COMPANY
Stockholders' Equity
December 31, 2010

Contributed Capital	
Preferred stock, 9%, $100 par (10,000 shares authorized, 1,100 shares issued)	$110,000
Common stock, $10 par (20,000 shares authorized, 8,800 shares issued of which 100 shares are being held as treasury stock)	88,000
Additional paid-in capital on preferred stock	22,500
Additional paid-in capital on common stock	96,800
Additional paid-in capital from treasury stock	2,500
Total contributed capital	$319,800
Retained earnings (Note 1)	385,300
Accumulated other comprehensive income (loss)	
Unrealized decrease in value of available-for-sale securities (Note 2)	(10,000)
Total contributed capital, retained earnings, and accumulated other comprehensive income	$695,100
Less: Treasury stock (100 shares at cost of $22)	(1,100)
Total stockholders' equity	$694,000

Notes to Financial Statements

Note 1: Retained earnings are restricted in the amount of $1,100, the cost of the treasury stock.

Note 2: The aggregate market value of the company's long-term investments in available-for-sale equity securities dropped below the carrying value of these securities by $10,000 at the end of 2010.

P17-21

		Account	Debit	Credit
1.	(1)	Cash	40,000	
		Common Stock, $10 par		10,000
		Premium on Common Stock [1,000 x ($40 - $10)]		30,000
	(2)	Compensation Expense	3,000	
		Common Stock Option Warrants		3,000
	(3)	Cash (500 x $30)	15,000	
		Common Stock Option Warrants (500 x $3)	1,500	
		Common Stock, $10 par		5,000
		Premium on Common Stock ($16,500 - $5,000)		11,500
	(4)	Cash (200 x $41)	8,200	
		Treasury Stock (200 x $31)		6,200
		Premium on Common Stock		2,000
	(5)	Land	50,000	
		Donated Land for Factory Site from Columbus Development Association		50,000
	(6)	Legal Fees Expense (100 x $142)	14,200	
		Preferred Stock, $100 par		10,000
		Premium on Preferred Stock		4,200
	(7)	Income Summary	182,000	
		Retained Earnings		182,000
		Retained Earnings	67,800	
		Cash ($24,800 + $43,000)		67,800

P17-21 (continued)

2.

GAINES INDUSTRIES
Statement of Changes in Stockholders' Equity
For Year Ended December 31, 2010

Explanation	Preferred Stock		Common Stock		Premium		Common Stock Option Warrants	Retained Earnings	Donated Capital	Treasury Stock
	Shares Issued	Par Value	Shares Issued	Par Value	Preferred Stock	Common Stock				
Balances, January 1, 2010	3,000	$300,000	20,000	$200,000	$120,000	$280,000	$32,000	$260,000		$(15,500)
Issued common stock			1,000	10,000		30,000				
Compensation expense for share options							3,000			
Share options exercised			500	5,000		11,500	(1,500)			
Reissued treasury stock						2,000				6,200
Accepted donated land for factory site									$50,000	
Issued preferred stock	100	10,000			4,200					
Net income								182,000		
Dividends								(67,800)		
Balances, December 31, 2010	3,100	$310,000	21,500	$215,000	$124,200	$323,500	$33,500	$374,200	$50,000	$(9,300)

P17-21 (continued)

3.

GAINES INDUSTRIES
Stockholders' Equity
December 31, 2010

Contributed Capital	
Preferred stock, 8%, $100 par (5,000 shares authorized, 3,100 shares issued)	$ 310,000
Common stock, $10 par (25,000 shares authorized, 21,500 shares issued of which 300 shares are being held as treasury stock	215,000
Premium on preferred stock	124,200
Premium on common stock	323,500
Common stock option warrants (Note 1)	33,500
Total contributed capital	$1,006,200
Retained earnings (Note 2)	374,200
Donated land for factory site (Note 3)	50,000
Total contributed capital, retained earnings, and donated capital	$1,430,400
Less: Treasury stock (300 common shares at $31)	(9,300)
Total stockholders' equity	$1,421,100

Note 1: The company has a share option plan for its key executives. In accordance with the plan, the shares under option and the option price per share for each executive are known on the grant date. During 2010, no new options were granted, compensation expense of $3,000 was recorded, and 500 shares were issued.

Note 2: Retained earnings are restricted in the amount of $9,300, the cost of treasury stock.

Note 3: The Columbus Development Association donated a parcel of land valued at $50,000 in an industrial park for a factory building site.

4. Return on stockholders' equity for 2010 = Net income / Average stockholders' equity

= $182,000 / (($1,421,100 + $1,176,500)/2)

= $182,000 / $1,298,800

= 14.0%

P17-22 (AICPA adapted solution)

Note to Instructor: This problem appeared in the CPA Exam before GAAP was modified to require additional disclosures about fair values not specified in the problem.

RAUN COMPANY
Stockholders' Equity Section of Balance Sheet
December 31, 2010

9% cumulative convertible preferred stock,	
$100 par value, 2,000,000 shares authorized,	
1,000,000 shares issued (Note 1)	$ 100,000,000
Common stock, $1 stated value, 5,000,000 shares	
authorized, 3,580,000 shares issued (Note 2)	3,580,000
Paid-in Capital in Excess of Par or Stated Value	
On preferred stock	20,000,000
On common stock	XXXX
Total paid-in capital	$ XXXXXXXXXXXX
Retained earnings	XXXX
Total stockholders' equity	$ XXXXXXXXXXXX

Note 1: Convertible preferred stock. On December 31, 2010, all 1,000,000 shares of preferred stock outstanding of the company were convertible into common stock on a share-for-share basis. No shares of preferred stock were converted into common stock during 2010. Any preferred stock not converted into common stock by December 31, 2016 will lose its conversion right and becomes callable at par value at the discretion of the company.

Note 2: Employee share option plan and employee share purchase plan. The company has granted options to officers and certain key employees to purchase common stock of the company at the market price at the date of the grant. All options are exercisable in installments of one-third each year, commencing one year following date of the grant, and expire if not exercised within 4 years of the grant date. The following tabulation summarizes certain information relative to employee share options.

	Shares	Option Price
Outstanding at January 1, 2010	70,000	$47.00 to $83.00
Granted during 2010	15,000	86.00
Exercised in 2010	20,000	47.00 to 79.00
Expired in 2010	None	--
Outstanding at December 31, 2010	65,000	54.00 to 86.00
Exercisable at December 31, 2010	30,000	54.00 to 79.00

P17-22 (continued)

Pursuant to the terms of the employee share purchase plan, employees have subscribed to, paid for, and received 60,000 shares of common stock of the company during 2010. The company contributed one-half and the employees paid one-half of the stock price based on the market value of the common stock at the date of the subscription.

At December 31, 2010, a total of 355,000 shares of common stock were available for future grants under the share option plan and future purchases under the employee share purchase plan.

P17-23 (AICPA adapted solution)

1. FAY, INC.
Long-Term Liabilities Section of Balance Sheet
December 31, 2010

9% unsecured note payable to bank, due in annual principal installments of $800,000, less current portion	$ 3,200,000 [1]
11% debenture bonds payable due December 31, 2022, plus unamortized premium of $337,640	5,337,640 [2]
Total long-term liabilities	$ 8,537,640

2. FAY, INC.
Stockholders' Equity Section of Balance Sheet
December 31, 2010

Common stock, $10 par; 2,000,000 shares authorized; 840,000 shares issued; 829,500 shares outstanding	$ 8,400,000 [3]
Additional paid-in capital	2,485,000 [4]
Retained earnings	4,765,000 [5]
Accumulated other comprehensive income (loss)	
Unrealized decrease in value of noncurrent available-for-sale securities	(20,000) [6]
Treasury stock, at cost, 10,500 shares	(130,000) [7]
Total stockholders' equity	$15,500,000

P17-23 (continued)

3.

FAY, INC.
Interest Expense
For the Year Ended December 31, 2010

Note payable to bank	$ 60,000 [8]
Debenture bonds payable	535,240 [9]
Total interest expense	$595,240

Explanations of Amounts

[1] 9% note payable to bank

Note payable, 11/2/10	$4,000,000
Deduct installment due 11/2/11	(800,000)
Long-term portion, 12/31/10	$3,200,000

[2] Debenture bonds payable

Carrying amount, 12/31/09		$5,352,400
Deduct amortization of bond premium		
Interest paid 12/31/10 ($5,000,000 x 11%)	$550,000	
Less effective interest ($5,352,400 x 10%)	(535,240)	(14,760)
Carrying amount, 12/31/10		$5,337,640

[3] Common stock issued	Date	Shares	Amount
Balance	12/31/09	800,000	$8,000,000
5% stock dividend issued	03/02/10	40,000	400,000
Balance	12/31/10	840,000	$8,400,000

[4] Additional paid-in capital

Balance, 12/31/09	$2,295,000
Treasury stock reissued, 1/16/10	
[$225,000 - $195,000 ($325,000 x 60%)]	30,000
Stock dividend issued, 3/2/10	
[($14 - $10) x 40,000 shares]	160,000
Balance, 12/31/10	$2,485,000

[5] Retained earnings

Balance, 12/31/09	$2,465,000
Stock dividend issued, 3/2/10	
($14 x 40,000 shares)	(560,000)
Net income for 2010	2,860,000
Balance, 12/31/10	$4,765,000

P17-23 (continued)
3. (continued)

[6] Unrealized decrease in value of available-for-sale securities	
Balance, 12/31/10 [($20 - $18) x 10,000 shares]	$ 20,000
[7] Treasury stock at cost [(10,000 ÷ 25,000) x $325,000]	$130,000
[8] Interest expense on note payable to bank [11/2/10 to 12/31/10 ($4,000,000 x 9% x 2/12)]	$ 60,000
[9] Interest expense on debenture bonds payable	
Interest paid 12/31/10 for year ended 12/31/10	$550,000 [2]
Deduct amortization of bond premium for year	14,760 [2]
Interest expense year ended 12/31/10	$535,240

P17-24

1. $14,000[($320,000 ÷ 8 x 1/2) x (1-0.30)]
2. $12,000 ($200,000 x 0.06)
3. $165,000 [(100,000 + 13,000 - 5,000 + 2,000) x $1.50]
4. $720,000 (fair value on date of declaration)
5. 113,000 (100,000 + 13,000)
6. $113,000 (113,000 x $1)
7. $934,000 [$800,000 + {13,000 x ($11 - 1)} + {2,000 x ($16 - $14)}]
8. $42,000 (3,000 x $14)
9. $826,000 ($838,000 - $12,000)

ANSWERS TO CASES

C17-1 (AICPA adapted solution)

1. Dividends on outstanding preferred stock must be subtracted from net income or added to net loss for the period before computing EPS on the common shares. This generalization will be modified by the various features and different requirements preferred stock may have with respect to dividends. Thus, if preferred stock is cumulative, it is necessary to subtract its current dividend requirements from net income (or to add them to net loss) in order to arrive at the amount into which to divide outstanding common shares to compute basic EPS on the latter. This must be done regardless of whether or not the preferred dividends were actually declared. Where the preferred shares are noncumulative, only preferred dividends actually declared during the current period need be subtracted from net income (or added to net loss) to arrive at the amount to be used in basic EPS calculations.

   In case the preferred shares are convertible into common stock, when assuming conversion, dividend requirements on the preferred shares are not deducted from net income. This applies when testing for potential dilution to determine whether or not the diluted EPS figures for the period are lower than basic EPS figures.

2. When options and warrants to buy common stock are outstanding and their option price (that is, proceeds the corporation would derive from issuance of common stock pursuant to the warrants and options, including any unrecognized compensation cost) is less than the average price at which the company could acquire its outstanding shares as treasury stock, the treasury stock method is generally applicable. In these circumstances, existence of the options and warrants would be dilutive. However, if the option price exceeded the average price of the common stock, the cash proceeds from their assumed exercise would provide for repurchasing more common shares than were issued when the warrants were exercised, thereby reducing the number of shares outstanding. In these circumstances, assumed exercise of the warrants would be antidilutive, so exercise would not be presumed for purposes of computing diluted EPS.

3. In the case of convertible bonds that are assumed to be converted and are dilutive, their interest (less tax effect) is added back to net income as the numerator element of the diluted EPS calculation while the number of shares of common stock into which they would be convertible is added to the shares outstanding to arrive at the denominator element of the calculation.

C17-2 (AICPA adapted solution)

A capital structure is regarded as complex when it includes potentially dilutive convertible securities, options, warrants, or other rights that upon conversion or exercise could dilute earnings per common share.

When a corporation has a complex capital structure, there should be a dual presentation with equal prominence on the face of the earnings statement. This presentation is to include a basic earnings per share that is based on average outstanding common shares divided into net earnings. Also included in this presentation is the calculation of the diluted earnings per share. This is a pro forma presentation that reflects dilution of earnings per share that would have occurred if all potential common shares that would individually reduce earnings per share had taken place at the beginning of the year.

C17-2 (continued)

Additional disclosures when a complex structure exists include a schedule or note identifying and reconciling the numerators and denominators on which basic and diluted earnings per share are calculated. The schedule or note should also include the amount of preferred dividends deducted to determine the income available to common stockholders, the potential common shares that were not included in diluted earnings per share because they were antidilutive, and any material impact on common shares outstanding of subsequent transactions after the close of the accounting period but before issuance of the financial report.

C17-3 (AICPA adapted solution)

The general categories of a corporation's capital are contributed (invested) capital, earned capital (retained earnings), and accumulated other comprehensive income.

Contributed capital represents the amounts paid in for all classes of shares of stock and the amounts capitalized by order of the corporation's board of directors. Included in contributed capital is legal capital, which is usually the aggregate par value or stated value of the shares issued. Legal capital is usually not subject to withdrawal; it is intended to protect corporate creditors. Contributed capital also includes other amounts in addition to the legal capital. These amounts are generally referred to as additional paid-in capital and include the following:

- Premiums over the par (stated) value of the stock issued (including stock dividends).
- Donations of assets to the corporation by governmental units.
- Assessments on stockholders.
- Forfeitures of stock subscriptions.
- Excess of proceeds from reissuing treasury stock over its cost.
- Conversion of convertible bonds or preferred stock.
- Reacquisition of outstanding shares at an amount below par (stated) value.
- Tax benefits from certain share options.

Retained earnings are the accumulated net earnings of a corporation in excess of any net losses from operations and dividends (cash or stock). Total retained earnings should also include prior-period adjustments as direct increases or decreases and may include certain reserves. These reserves are restrictions of retained earnings as unavailable for dividends. These reserves and related restrictions may arise as a result of a restriction in a bond indenture or other formal agreement.

C17-3 (continued)

Accumulated other comprehensive income includes amounts accumulated to date for the following items:

1. Unrealized increases (gains) or decreases (losses) in the market (fair) value of investments in available-for-sale securities.

2. Translation adjustments from converting the financial statements of a company's foreign operations to U.S. dollars.

3. Certain gains and losses on "derivative" financial instruments.

4. Certain pension liability adjustments.

(Note to Instructor: This case appeared in the Uniform CPA Examination before GAAP required the reporting of accumulated other comprehensive income. The authors have updated the solution for the new GAAP.)

C17-4 (AICPA adapted solution)

1. The date of declaration is the date when the liability for dividends payable is recorded by a debit to retained earnings and a credit to dividends payable.

   The date of stockholders of record is the date that determines which stockholders will receive dividends on the payment date. No journal entry is made at this date.

   The date of payment is the date when the dividends are paid and is recorded by a debit to dividends payable and a credit to cash.

2. The effect of an ordinary 10 percent common stock dividend is that an amount equal to the fair value of the additional common stock issued is transferred from retained earnings to common stock and additional paid-in capital. There is no effect on total stockholders' equity.

C17-5 (AICPA adapted solution)

1. A stock split effected in the form of a dividend is a distribution of corporate stock to present stockholders in proportion to each stockholder's current holdings and can be expected to cause a material decrease in the fair value per share of the stock. GAAP specifies that a distribution in excess of 20% to 25% of the number of shares previously outstanding would cause a material decrease in the fair value. This is a characteristic of a stock split as opposed to a stock dividend, but, for legal reasons, the term "dividend" must be used for this distribution. From an accounting viewpoint, it should be disclosed as a stock split effected in the form of a dividend because it meets the accounting definition of a stock split as explained above.

2. The stock split effected in the form of a dividend differs from an ordinary stock dividend in the amount of other paid-in capital or retained earnings to be capitalized. An ordinary stock dividend involves capitalizing (charging) retained earnings equal to the fair value of the stock distributed. A stock split effected in the form of a dividend involves no charge to retained earnings or other paid-in capital if the par (stated) value of the stock is reduced in inverse proportion to the distribution. If the stock's par (stated) value is not reduced in inverse proportion to the distribution of stock, other paid-in capital or retained earnings

C17-5 (continued)
2. (continued)

would be charged for the par (stated) value of the additional shares issued. Another distinction between a stock dividend and a stock split is that a stock dividend usually involves distributing additional shares of the same class of stock with the same par or stated value. A stock split usually involves distributing additional shares of the same class of stock but with a proportionate reduction in par or stated value. The aggregate par or stated value would then be the same before and after the stock split.

3. A declared but unissued stock dividend should be classified as part of corporate capital rather than as a liability in a statement of financial position. A stock dividend affects only capital accounts; that is, retained earnings are decreased and contributed capital is increased. Thus, there is no debt to be paid, and, consequently, there is no severance of corporate assets when a stock dividend is issued. Furthermore, stock dividends declared can be revoked by a corporation's board of directors at any time prior to issuance. Finally, the corporation usually will formally announce its intent to issue a specific number of additional shares, and these shares must be reserved for this purpose.

C17-6 (AICPA adapted solution)

1. Convertible securities are included in the computation of the number of shares in the denominator for diluted earnings per share as long as they have a dilutive effect. Any related dividends or bond interest expense (net of taxes) are excluded from the numerator.

2. Antidilutive convertible securities are excluded from diluted earnings per share. They are, however, described in the notes to the financial statements.

C17-7 (AICPA adapted solution)

The diluted earnings per share computations are based on net earnings divided by the adjusted number of shares. The weighted average number of common shares is adjusted for the assumed increment in shares under the share option plan when the average market price is higher than the option price (plus any unrecognized compensation cost per share). The assumed increment is the difference between assumed shares issued under the plan and the assumed shares reacquired at the average market price with the proceeds.

C17-8 (AICPA adapted solution)

Note to Instructor: This case includes treasury stock, discussed in Chapter 16.

1. Brady should account for the cash dividend on December 21, 2010, the declaration date, by debiting retained earnings and crediting cash dividends payable for $1 per share multiplied by the number of shares outstanding. A cash dividend is a distribution to the corporation's stockholders. The liability for this distribution is incurred on the declaration date, and it is a current liability because it is payable within one year (January 11, 2011). The effect of the cash dividend on Brady's balance sheet at December 31, 2010 is an increase in current liabilities and a decrease in retained earnings.

C17-8 (continued)

2. Brady should account for the stock dividend by debiting retained earnings for $16 per share (the market value of the stock in October 2010, the date of the stock dividend) multiplied by the 2,000 shares distributed. Brady should then credit common stock for the par value of the common stock ($10 per share) multiplied by the 2,000 shares distributed, and credit additional paid-in capital for the excess of the market value ($16 per share) over the par value ($10 per share) multiplied by the 2,000 shares distributed. Total stockholders' equity does not change, but, because this is considered a small stock dividend, recognition has been made of a capitalization of retained earnings equivalent to the fair value of the additional shares resulting from the stock dividend.

3. Brady should account for the purchase of the treasury stock on August 13, 2010 by debiting treasury stock and crediting cash for the cost of the purchase (1,000 shares x $12 per share). Brady should account for the sale of the treasury stock on September 14, 2010 by debiting cash for the selling price (500 shares x $14 per share), crediting treasury stock for cost (500 shares x $12 per share), and crediting additional paid-in capital from treasury stock transactions for the excess of the selling price over the cost (500 shares x $2 per share). The remaining treasury stock (500 shares x $12 per share) should be presented separately in the stockholders' equity section of Brady's December 31, 2010 balance sheet as an unallocated reduction of stockholders' equity. These shares are considered issued but not part of common stock outstanding.

C17-9

1. The company uses the term "reinvested earnings"; the amount at the end of 2007 was $36,235 million (p. 67).
2. The balance of accumulated other comprehensive income on December 31, 2007 was $626 million. The $(1,291) beginning loss was decreased by $1,575 million of net foreign currency translation adjustment, increased by a $(64) million net loss on derivatives, decreased by a $14 million net change in unrealized gain on available-for-sale securities, and decreased by a $392 million net change in pension liability (p. 69).
3. The basic net income per share was $2.59 for 2007 (p. 66). No preferred dividends were subtracted because the company has no preferred stock outstanding (p. 67). The average number of common shares outstanding used in the computation of the basic net income per share was 2,313 million (p. 66). The diluted net income per share was $2.57 for 2007. This compares to $2.16 in 2006. Dilutive securities for 18 million shares were included because, if exercised, they would decrease net income per share. Approximately 71 million stock option awards were excluded because, if exercised, would be antidilutive (p. 66 and 73).
4. The dividends per share were $1.36 and the total dividends were $3,149 million for 2007 (p. 69).
5. The return on shareowners' equity for 2007 was 30.9%, computed as follows:

$$\frac{\text{Net Income}}{\text{Average Shareowners' Equity}} = \frac{\$5,981}{(\$21,744 + \$16,920)/2} = 30.9\%$$

The return on shareowners' equity for 2006 was 30.5%, computed as follows:

$$\frac{\$5,080}{(\$16,920 + \$16,355)/2} = 30.5\%$$

C17-10

Note to Instructor: This case does not have a definitive answer. From a financial reporting perspective, GAAP is identified and summarized. From an ethical perspective, various issues are raised for discussion purposes.

From a financial reporting perspective, in regard to bad debt expense, under the percentage of net sales method the bad debt expense is determined by multiplying the historical uncollectible percent of net credit sales times the net credit sales for the current year. The historical percentage may be adjusted as new evidence arises that shows that a change in the uncollectible percentage has occurred. This type of expense allocation is known as the association of cause and effect in the matching of revenues and expenses. In regard to depreciation, the straight line method is used when it is expected that the benefits to be derived from the asset will be constant each period of its life. An activity method is used when it is expected that the service life of an asset is affected primarily by the amount the asset is used. The estimated service life or residual value may be changed if new information arises that justifies the change in estimate. This type of expense allocation is known as systematic and rational allocation. For Ryan Company, a reduction in credit sales by itself does not warrant a change in the estimated uncollectible percent. On the other hand, if the decrease in credit sales occurred because customers must meet stricter credit policies before being allowed to make credit sales, then an adjustment of the uncollectible percent may be warranted. Ryan's depreciation method is not activity based. Hence, an increase in the estimated life because of decreased usage may not be appropriate. On the other hand, consideration might be given to switching to an activity based method, if, in fact, it can be justified that the service life is based on the amount the factory equipment is used. If this switch is made, this is a change in method and the cumulative effects would be reported on the income statement. However, because the activity method is more complex (and costly) than the straight-line method, many companies use the straight-line method even when the life of the asset is constrained by physical causes. In this case, an increase in the service life may be appropriate.

From an ethical perspective, the issue involves whether it is appropriate to adjust expenses downward to offset decreased revenues and increase income, thereby increasing earnings per share (EPS) to meet the company's goal. The primary stakeholders are you, the company's officers, and current and potential stockholders. An increase in earnings per share might get you a promotion, would make the officers appear to be managing the company well, and might continue the increase in the market value of the shares held by current stockholders. On the other hand, if this increase is not grounded in economic reality potential stockholders may be misled about the value of an investment in the company. An adjustment of expenses is only appropriate if, as a result, economic reality is better depicted in the income statement. An adjustment of expenses to "inflate" net income to achieve a targeted EPS goal may not be appropriate. More investigation is needed concerning the legitimacy of the adjustment of the bad debt percentage and the justification for a change in depreciation method or service life.

ANSWER TO RESEARCH SIMULATION

R17-1

Note to Instructor: Students are expected to cite references to GAAP in their research of this issue. They might use the FARS electronic database, pronouncements listed on the FASB web site, the FASB Original Pronouncements, the FASB Current text, or other primary sources of GAAP to obtain these references. They may also use the FASB Accounting Standards Codification which is cited in parentheses.

To: President of Tara Corporation

From: Student

I have researched the issue of how to report comparative earnings per share over a two-year period when a company reports basic earnings per share in one year and is required to report both basic and diluted earnings per share in the next year. According to FAS 128, par. 38 (FASB Cod. # 260-10-45-7), a dual presentation is required for all periods presented if it is required for any period presented. Since the Tara Corporation has a complex capital structure in the second year, the dual presentation is required for both the second and first years. Thus, I recommend the following earnings per share disclosures on the 2010 and 2011 comparative income statements in Tara Corporation's 2011 annual report:

	2010	2011
Basic earnings per share	$1.05	$1.12
Diluted earnings per share	$1.05	$0.98