

## CHAPTER 11

### Reporting and Analyzing Stockholders' Equity

#### Study Objectives

- Identify and discuss the major characteristics of a corporation.
- Understand the Components of Stockholders' Equity.
- Record the issuance of common stock.
- Explain the accounting for the purchase of treasury stock.
- Differentiate preferred stock from common stock.
- Prepare the entries for cash dividends and understand the effect of stock dividends and stock splits.
- Identify the items that affect retained earnings.
- Prepare a comprehensive stockholders' equity section.
- Evaluate a corporation's dividend and earnings performance from a stockholder's perspective.

#### Chapter Outline

#### Study Objective 1 - Identify and Discuss the Major Characteristics of a Corporation

1. A corporation is
  - a. a legal entity created by law
  - b. **a corporation** has most of the rights and privileges of a person.
  - c. Corporations may be classified in a variety of ways. Two common classifications are
    - i. **by purpose**
    - ii. **by ownership.**
      1. Classification by ownership differentiates publicly held or privately held:
        - a. A **publicly held corporation** is regularly traded on a national securities market and may have thousands of stockholders.
        - b. A **privately held corporation**, often referred to as a closely held corporation, does not offer its stock for sale to the general public and may have only a few stockholders.
2. Distinguishing Corporations from proprietorships and partnerships.
  - a. **Separate legal existence:**
    - i. An entity separate and distinct from owners.
    - ii. Acts under its own name rather than name of stockholders.
    - iii. May buy, own, and sell property; borrow money; and enter into legally binding contracts; may sue or be sued; and pays its own taxes.
    - iv. The acts of owners (stockholders) cannot bind the corporation unless owners are agents of the corporation.
  - b. **Limited liability of stockholders:**

- i. Creditors have recourse only to corporate assets to satisfy their claims.
  - ii. Liability of stockholders is limited to investment in corporation.
  - iii. Creditors have no legal claim on personal assets of owners unless fraud has occurred.
- c. **Transferable ownership rights:**
  - i. Ownership evidenced by shares of stock, which are transferable units.
  - ii. The transfer of stock is at the discretion of the stockholder; it does not require the approval of either the corporation or other stockholders.
  - iii. Transfer of ownership rights among stockholders has no effect on operating activities of the corporation.
  - iv. Transfer of ownership rights among stockholders has no effect on a corporation's assets, liabilities and total stockholders' equity.
  - v. Corporation does not participate in transfer of ownership rights after original sale of capital stock.
- d. **Ability to acquire capital:**
  - i. It is relatively easy for a corporation to obtain capital through the issuance of stock.
  - ii. Buuying stock in a corporation is often attractive to an investor because a stockholder has limited liability and shares of stock are readily transferable.
  - iii. Numerous individuals can become stockholders by investing small amounts of money.
- e. **Continuous life:**
  - i. The life of a corporation is stated in its charter. It may be perpetual or limited to a specific number of years.
  - ii. If limited, its period of existence can be extended through renewal of charter.
  - iii. Since a corporation is a separate legal entity, continuance as a going concern is not affected by withdrawal, death, or incapacity of a stockholder, employee, or officer.
- f. **Professional management:**
  - i. Stockholders manage the corporation indirectly through a board of directors, which they elect.
  - ii. The board of directors formulates operating policies and selects officers to execute policy and to perform daily management functions.
  - iii. The president is the chief executive officer (CEO) and has direct responsibility for managing the business.
  - iv. The controller is the chief accounting officer. The controller's responsibilities include
    1. maintaining the accounting records and an adequate system of internal control and
    2. preparing financial statements, tax returns, and internal reports.
  - v. The treasurer has custody of the corporation's funds and is responsible for maintaining the company's cash position.
- g. **Government Regulations:**
  - i. A corporation is subject to state and federal regulations.
  - ii. State laws prescribe the requirements for issuing stock, the distribution of earnings permitted to stockholders, and acceptable methods of retiring stock.
  - iii. Federal securities laws govern the sale of capital stock to the general public; disclosure of financial affairs to the Securities and Exchange Commission through quarterly and annual reports; and, if publicly traded, the reporting requirements of the various securities markets.
- h. **Additional Taxes:**

- i. Corporations, as separate legal entities, must pay federal and state income taxes.
- ii. Stockholders must pay taxes on cash dividends.
  1. Thus, it may be argued that corporate income is taxed twice, once at the corporate level and again at the individual level.

#### Advantages and disadvantages of the Corporate form of Business Organization

▪ **Advantages of a corporation:**

- Separate legal existence.
- Limited liability of stockholders.
- Transferable ownership rights.
- Ability to acquire capital.
- Continuous life.
- Corporation management—professional managers.

▪ **Disadvantages of a corporation:**

- Corporation management—separation of ownership and management.
- Government regulations.
- Additional taxes.

### 3. Forming a corporation:

- a. A corporation is formed by grant of a state **charter**.
  - i. Although a corporation may have operating divisions in a number of states, it is incorporated in only one state.
  - ii. Some states have laws favorable to the corporate form of business organization. (i.e. In the state of Delaware defense tactics against takeovers can be approved by the board of directors without a vote by shareholders.)
- b. Upon receipt of its charter, the corporation establishes **by-laws**.
  - i. The by-laws establish the internal rules and procedures for conducting the affairs of the corporation.
- c. A corporation must obtain from each state in which it does business a **license** that subjects the corporation's operating activities to the general corporation laws of the state.

### 4. Stockholder rights:

- a. Once it is chartered, the corporation sells ownership rights in the form of shares of stock.
  - i. When a corporation has only one class of stock it is **common stock**.
  - ii. Ownership rights are specified in the articles of incorporation or in the by-laws.
    1. Proof of stock ownership is evidenced by a printed or engraved form known as a **stock certificate**.
    2. The stock certificate shows
      - a. the name of the corporation,
      - b. the stockholder's name,
      - c. the class and special features of the stock,
      - d. the number of shares owned, and
      - e. the signatures of duly authorized corporate officials.
    3. Stock certificates are pre-numbered to facilitate accountability.
- b. Stock issue considerations:
  - i. When a corporation decides to issue stock it must answer the following questions:
    1. How many shares should be authorized for sale?
    2. How should the stock be issued?
    3. What value should be assigned to the shares?

## 5. Stock Terminology

### a. Authorized stock:

- i. The amount of stock a corporation is authorized to sell is indicated in the corporate charter.
  1. If all **authorized stock** is sold, a corporation must obtain consent of the state to amend its charter before issuing additional shares.
  2. The authorization of common stock does not result in a formal accounting entry because the event has no immediate effect on either corporate assets or stockholders' equity.
  3. Disclosure of the number of shares authorized is required in the stockholders' equity section of the balance sheet.

### b. Issued stock:

- i. Once the corporation has a number of shares authorized by the state of incorporation, some or all of the shares can be issued to the public
  1. A corporation has the option of issuing common stock **directly** to investors or **indirectly** through an investment banking firm that specializes in bringing securities to the attention of prospective investors.
    - a. Direct issue is typical in closely held companies.
    - b. Indirect issue is customary for publicly held companies.
  2. New issues of stock may be offered for sale to the public through various organized U.S. securities exchanges: the New York Stock Exchange, the American Stock Exchange, and 13 regional exchanges.
    - a. Stock may also be traded on the NASDAQ national market.

### c. Par and no-par value stocks:

- i. **Par value stock** is capital stock that has been assigned a value per share in the corporate charter.
  1. Par value is used to compute the value of common stock on the balance sheet
    - a. (Value of common stock = Number of shares issued x par value)
  2. Par value is used to determine the **legal capital** per share that must be retained in the business for the protection of corporate creditors.
    - a. It is the amount that is not available for withdrawal by stockholders.
  3. Because par value has no relationship with market value and in most cases is an immaterial amount, today many states do not require a par value.
    - a. If a state does not require a par value, the stock is referred to as a **no par value stock**:
      - i. **No par stock** is capital stock that has not been assigned a value per share in the corporate charter.
      - ii. In many states the board of directors is permitted to assign a **stated value** to the no-par shares, which then becomes the legal capital per share.

The concept of legal capital is illustrated by the accounting equation below:

- Legal capital requires a minimum value under Stockholders' Equity. (# shares issued x par or stated value)
- This in turn results in a minimum value on the asset side of the equation. This minimum value is intended to protect both the stockholders and creditors.

Assets = Liabilities + Stockholders Equity

The existence of a "legal capital" requirement means that an equalizing value of assets must exist.

#shares issued x par (or stated) value  
(This is known as "legal capital")

Paid-in-Capital is referred to as PIC.

- Note that total PIC includes common stock (PIC from Common Stock) and
- PIC in excess of par

### Study Objective 2 - Understand the Components of Stockholders' Equity

- The stockholders' equity section of a corporation's balance sheet consists of
  - paid-in (contributed) capital** and
    - Paid-in capital consists of
      - The value of stock (#shares issued x par value) and
      - Paid in capital in excess of par (# shares issued x (Issue price - par value))
    - retained earnings (earned capital).**
      - Retained earnings represents the net earnings (revenues - expenses) of the business from the first day of operations to the beginning of the current year.
        - If the nominal accounts have been closed, the balance of retained earnings is as of the end of the current year.
  - The distinction between paid-in capital and retained earnings is important from a legal and an economic point of view.
    - Paid-in capital** is the amount paid in to the corporation by stockholders in exchange for shares of ownership.
    - Retained earnings** is earned capital held for future use in the business.
      - Note that there is no relationship between retained earnings and cash.

### Study Objective 3 - Record the Issuance of Common Stock

- The primary objectives in accounting for the issuance of common stock are to
  - identify the specific sources of paid-in capital
    - Common Stock
    - Preferred Stock
    - Paid-in-Capital in excess of par
  - maintain the distinction between paid-in capital and retained earnings.
- The issuance of common stock affects only paid-in capital accounts.
  - When the issuance of common stock for cash is recorded, the par value of the shares is credited to Common Stock, and the portion of the proceeds that is above or below par value is recorded in a separate paid-in capital in excess of par account.

Assume Hydro-Slide, Inc., issues 1,000 shares of \$1 par value common stock at par for cash. The entry to record the transaction is:

Cash		1,000	
Common Stock	(1,000 x \$1)		1,000

(To record issuance of 1,000 shares of \$1 par common stock at par)

If Hydro-Slide, Inc., issues an additional 1,000 shares of the \$1 par value common stock for cash at \$5 per share, the entry is:

Cash		5,000	
Common Stock	(1,000 x \$1)		1,000
Paid-in Capital in Excess of Par Value		4,000	

(To record issuance of 1,000 shares of common stock in excess of par)

Note that PIC in excess of par is computed as follows:

(Issue \$ - Par) x # shares issued  
 $(\$5 - \$1) \times 5,000 = \$4,000$

- b. The total paid-in capital from these two transactions is \$6,000. Assuming Hydro-Slide, Inc., has retained earnings of \$27,000, the stockholders' equity section of the balance sheet would be:

<b>HYDRO-SLIDE, INC.</b>	
<b>Balance Sheet (partial)</b>	
Stockholders' equity	
<u>Paid-in capital</u>	
Common stock	\$ 2,000
<b>Paid-in capital in excess of par value</b>	<b><u>4,000</u></b>
Total paid-in capital	6,000
<u>Retained earnings</u>	<u>27,000</u>
Total stockholders' equity	<b><u>\$ 33,000</u></b>

- i. If, in the previous example, the stock had been no-par stock with a stated value of \$1, the entries would be the same as those for the par stock except the term "Par Value" would be replaced with "Stated Value."
- ii. If the company issues no-par stock that does not have a stated value, the full amount received is credited to the Common Stock account and there is no need for the Paid-in Capital in Excess of Stated Value account.

#### **Study Objective 4 - Explain the Accounting for the Purchase of Treasury Stock**

1. **Treasury stock** is a corporation's own stock that
  - a. has been issued,
  - b. fully paid for,
  - c. reacquired by the corporation and
  - d. held in its treasury for future use.
2. A corporation may acquire treasury stock to:
  - a. reissue the shares to officers and employees under bonus and stock compensation plans.
  - b. increase trading of the company's stock in the securities market in the hopes of enhancing its market value by signaling that management believes the stock is underpriced.
  - c. have additional shares available for use in the acquisition of other companies.
  - d. reduce the number of shares outstanding and thereby increase earnings per share.
  - e. Reduce the number of shares outstanding if management is trying to eliminate hostile shareholders by buying them out.
3. Accounting for treasury stock may be accomplished by using either the cost or par methods but the purchase of treasury stock is generally accounted for by **the cost method**.
  - a. Cost Method of Accounting for Treasury Stock
    1. Under the cost method treasury stock is increased (debited) by the price paid (cost) to reacquire the shares.
      1. Treasury Stock decreases by the same amount when the shares are later sold.
  - b. Par Method of Accounting for Treasury Stock
    1. Under the par method the treasury stock is increased (debited) by the number of shares acquired x par value.
    2. The difference between the cost of the acquisition and the par value of the acquisition is credited to PIC-Treasury stock account.
      1. If a debit is required to balance, the charge is to PIC-Treasury stock if it exists in sufficient quantity to cover the charge
      2. If there is insufficient PIC-Treasury stock, the charge (debit) is to retained earnings.
    3. Use of the par method is preferred because it maintains the relationship between the stock accounts and PIC in excess of par.



## Study Objective 5 - Differentiate Preferred Stock from Common Stock

1. **Preferred stock (PS)** has contractual provisions that give it preference or priority over common stock.
  - a. **What are the characteristics of PS?**
    - i. PS stockholders have a priority in relation to Receiving dividends and Access to assets in the event of liquidation.
      1. **Preferred stockholders have the right to share in the distribution of corporate income before common stockholders.**
        - a. If the dividend rate of preferred stock is \$5 per share, common shareholders will not receive any dividends in the current year until preferred stockholders have received \$5 per share.
          - i. The first claim to dividends does not **guarantee** dividends.
          - ii. Dividends depend on factors such as adequate retained earnings and availability of cash.
          - iii. Preferred stock dividends are stated as a percentage of the stock or as a specified amount.

For example, EarthLink specifies a 3% dividend, whereas Nike pays 10 cents per share on its \$1 par preferred stock.

- ii. Preferred stockholders normally do not have voting rights.
  1. This makes PS more like debt than equity but it is still considered equity (ownership).
- iii. When a corporation has more than one class of stock, each paid-in capital account title should identify the stock to which it relates.

For example, assume Stine Corporation issues 10,000 shares of \$10 par value preferred stock for \$12 cash per share. The entry to record the issuance is:

Cash	120,000	
Preferred Stock		100,000
Paid-in Capital in Excess of Par Value—Preferred Stock		20,000

(To record issuance of 10,000 shares of \$10 par value preferred stock)

- iv. Preferred stock may have either a par value or no-par value.
- b. **Preferred Stock "Sweeteners":** PS is often given two important additional features to make it more attractive to investors.
    - i. **cumulative dividend** feature.
      1. If preferred stock is cumulative, preferred stockholders must be paid both current-year dividends and any unpaid prior-year dividends before common stockholders receive dividends.
      2. When preferred stock is cumulative, preferred dividends not declared in a given period are called **dividends in arrears**.

To illustrate dividends in arrears, assume that Scientific Leasing has 5,000 shares of 7%, \$100 par value cumulative preferred stock outstanding. The annual dividend is \$35,000 (5,000 × \$7 per share). If dividends are two years in arrears, preferred stockholders are entitled to receive dividends of \$105,000 shown below before any distribution may be made to common stockholders.

Dividends in arrears (\$35,000 × 2 years)	\$ 70,000
Current-year dividends	<u>35,000</u>
<b>Total preferred dividends</b>	<b><u>\$ 105,000</u></b>

- **Dividends in arrears are not a liability because no obligation exists until the board of directors declares a dividend.**
- The amount of dividends in arrears should be disclosed in the notes to the financial statements.



ii. **Liquidation preference in excess of par feature**

1. Many preferred stocks have a preference on corporate assets if the corporation fails. The norm would be for the par value of the stock.
  - a. To make that preference more attractive, a liquidating preference in excess of par may be established to give the PS an even greater claim on assets in the event of liquidation (bankruptcy).

**Study Objective 6 - Prepare the Entries for Cash Dividends and Understand the Effect of Stock Dividends and Stock Splits**

1. Dividends are a distribution of retained earnings.

- a. dividends are a distribution by a corporation to its stockholders on a pro rata basis.
  - i. Pro rata means that if you own 10% of the common shares, you will receive 10% of the dividend.
- b. Dividends can take four forms: cash, property, script (promissory note to pay cash), or stock but all dividends are a distribution of Retained Earnings and cannot be made unless there is a sufficient balance in RE to support them.
  - i. Cash dividends and stock dividends are declared with some frequency are discussed in this chapter. Property and script dividends are not discussed until intermediate accounting.
- c. Requirements to pay a dividend (of any type):
  - i. Sufficient RE to cover the amount of the dividend
    1. Exceptions:
      - a. In most states, payment of dividends from legal capital is illegal.
      - b. Payment of dividends from paid-in capital in excess of par is legal in some states.
    - ii. In addition to retained earnings, a corporation must have adequate cash to pay a dividend.

2. The Dividend Process

- a. Dividends must be declared by the Board of Directors (BOD).
  - i. The BOD has full authority to determine the amount of income to be distributed in the form of dividends and the amount to be retained in the business.
  - ii. Dividends do not accrue, and they are not a liability until they are declared.
    1. The amount and timing of a dividend are important issues for management to consider;
      - a. The payment of a large cash dividend could lead to liquidity problems.
      - b. A small dividend or a missed dividend may cause unhappiness among stockholders who expect to receive a reasonable cash payment from the company on a periodic basis.
      - c. In order to remain in business, companies must honor their interest payments to creditors. But the payment of dividends to stockholders is another matter.

3. **Recording Cash dividends** - Three dates are important in connection with dividends:

- a. The declaration date:
  - i. The **declaration date** is the date the board of directors formally declares the cash dividend and announces it to stockholders.
    1. The declaration of a cash dividend **commits the corporation to a binding legal obligation**.
      - a. e.g. the declaration date is the date upon which the dividend becomes a legal liability.

- b. An entry is required to recognize the decrease in retained earnings and the increase in the liability  
To record declaration of cash dividend

Assume that on December 1, 2004, the directors of Media General declare a \$.50 per share cash dividend on 100,000 shares of \$10 par value common stock. The dividend is \$50,000 (100,000 × \$.50), and the entry to record the declaration is:

**Declaration Date**

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

ii. **The date of record:**

- 1. The **record date** marks the time when ownership of the outstanding shares is determined for dividend purposes.
  - a. The record date is important in determining the dividend to be paid to each stockholder but not the total dividend.
  - b. No entry is required on the record date.

iii. **The payment date:**

- 1. On the **payment date**, dividend checks are mailed to the stockholders and the payment of the dividend is recorded.

To Record the payment of the dividend

If January 20 is the payment date for Media General, the entry on that date is:

Jan. 20	Dividends Payable	50,000	
	Cash		50,000
	(To record payment of cash dividend)		

4. **Recording a stock dividend**

- a. A stock dividend is a pro rata distribution of the corporation's own stock to stockholders.
  - i. Whereas a cash dividend is paid in cash, a stock dividend is paid in stock.
- b. There are two types of Stock Dividend
  - i. Small Stock Dividends: Dividends less than 20% of a companies issued stock
    - 1. small stock dividends are charged against RE at the fair market value of the shares issued
  - ii. Large Stock Dividends: Dividends greater than 25% of the companies issued stock
    - 1. large stock dividends are charged against RE at the par value of the shares issued
- iii. Note that a **stock dividend (either type) results in a decrease in retained earnings and an increase in paid-in capital.**
  - 1. Unlike a cash dividend, a stock dividend does not decrease total stockholders' equity or total assets.
  - 2. Stock dividends are often issued by companies that do not have adequate cash to issue a cash dividend.

## Stock Dividends Illustrated:

Small Stock Dividend	Large Stock Dividend																																																												
<p>Assume Medland Corp. declares a 10% stock dividend on its \$10 par common stock when 50,000 shares were outstanding. The market price was \$15 per share.</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 30%;"></th> <th style="width: 15%; text-align: center;"><u>Before</u> <u>Dividend</u></th> <th style="width: 15%; text-align: center;"><u>After</u> <u>Dividend</u></th> </tr> </thead> <tbody> <tr> <td>Stockholders' equity</td> <td></td> <td></td> </tr> <tr> <td>  Paid-in capital</td> <td></td> <td></td> </tr> <tr> <td>    Common stock, \$10 par</td> <td style="text-align: right;">\$500,000</td> <td style="text-align: right;">\$550,000*</td> </tr> <tr> <td>    PIC in excess of par</td> <td style="text-align: right;">—</td> <td style="text-align: right;">25,000**</td> </tr> <tr> <td>    Total :PIC</td> <td style="text-align: right;">500,000</td> <td style="text-align: right;">575,000</td> </tr> <tr> <td>  Retained earnings</td> <td style="text-align: right;">300,000</td> <td style="text-align: right;">225,000***</td> </tr> <tr> <td><b>Total SHE</b></td> <td style="text-align: right;"><b>\$800,000</b></td> <td style="text-align: right;"><b>\$800,000</b></td> </tr> <tr> <td> </td> <td></td> <td></td> </tr> <tr> <td>  <b>Outstanding shares</b></td> <td style="text-align: right;"><b>50,000</b></td> <td style="text-align: right;"><b>55,000</b></td> </tr> </tbody> </table> <p style="font-size: small;">*10% x 50,000 sh x par ** 50,000 sh x (FMV-par) ***RE reduced by shares issued x FMV = 5,000 x \$15</p>		<u>Before</u> <u>Dividend</u>	<u>After</u> <u>Dividend</u>	Stockholders' equity			Paid-in capital			Common stock, \$10 par	\$500,000	\$550,000*	PIC in excess of par	—	25,000**	Total :PIC	500,000	575,000	Retained earnings	300,000	225,000***	<b>Total SHE</b>	<b>\$800,000</b>	<b>\$800,000</b>	 			<b>Outstanding shares</b>	<b>50,000</b>	<b>55,000</b>	<p>Assume Medland Corp. declares a 40% stock dividend on its \$10 par common stock when 50,000 shares were outstanding. The market price was \$15 per share.</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 30%;"></th> <th style="width: 15%; text-align: center;"><u>Before</u> <u>Dividend</u></th> <th style="width: 15%; text-align: center;"><u>After</u> <u>Dividend</u></th> </tr> </thead> <tbody> <tr> <td>Stockholders' equity</td> <td></td> <td></td> </tr> <tr> <td>  Paid-in capital</td> <td></td> <td></td> </tr> <tr> <td>    Common stock, \$10 par</td> <td style="text-align: right;">\$500,000</td> <td style="text-align: right;">\$700,000*</td> </tr> <tr> <td>    PIC in excess of par</td> <td style="text-align: right;">—</td> <td style="text-align: right;">— **</td> </tr> <tr> <td>    Total :PIC</td> <td style="text-align: right;">500,000</td> <td style="text-align: right;">500,000</td> </tr> <tr> <td>  Retained earnings</td> <td style="text-align: right;">300,000</td> <td style="text-align: right;">100,000</td> </tr> <tr> <td><b>Total SHE</b></td> <td style="text-align: right;"><b>\$800,000</b></td> <td style="text-align: right;"><b>\$800,000***</b></td> </tr> <tr> <td> </td> <td></td> <td></td> </tr> <tr> <td>  <b>Outstanding shares</b></td> <td style="text-align: right;"><b>50,000</b></td> <td style="text-align: right;"><b>70,000</b></td> </tr> </tbody> </table> <p style="font-size: small;">*140% x 50,000 x par</p>		<u>Before</u> <u>Dividend</u>	<u>After</u> <u>Dividend</u>	Stockholders' equity			Paid-in capital			Common stock, \$10 par	\$500,000	\$700,000*	PIC in excess of par	—	— **	Total :PIC	500,000	500,000	Retained earnings	300,000	100,000	<b>Total SHE</b>	<b>\$800,000</b>	<b>\$800,000***</b>	 			<b>Outstanding shares</b>	<b>50,000</b>	<b>70,000</b>
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<p>Note that a stock split simply rearranges the components of SHE;            Total SHE remains unchanged            RE is reduced by # shares issued x FMV (small dividend) or Par (large dividend)</p>																																																													

c. Corporations issue stock dividends for the following reasons:

- i. To satisfy stockholders' dividend expectations without spending cash.
- ii. To increase the marketability of its stock by increasing the number of shares outstanding and thereby decreasing the market price per share. Decreasing the market price of the stock makes it easier for smaller investors to purchase the shares.
- iii. To emphasize that a portion of stockholders' equity has been permanently reinvested in the business and therefore is unavailable for cash dividends.

### 5. Recording a stock split

- a. A stock split is similar to a stock dividend in that it involves the issuance of additional shares of stock to stockholders according to their percentage ownership.
  - i. However, a **stock split does nothing but reduce the par or stated value per share.**
  - ii. **Stock splits do not affect the dollar value of any component of SHE (other than par/stated value per share)**
- b. The purpose of stock split is to increase the marketability of the stock by lowering its market value per share, making it easier for the corporation to issue additional shares of stock.
  - i. In a stock split, the number of shares is increased in the same proportion that the par or stated value per share is decreased. (i.e. in a 2-for-1 split, one share of \$10 par value stock is exchanged for two shares of \$5 par value stock.)
  - ii. Remember: **A stock split does not have any effect on total paid-in capital, retained earnings, and total stockholders' equity.**
    1. With a stock split only the number of shares outstanding increases.

### Stock Split Illustrated

Assume that instead of issuing a 10% stock dividend Medland splits its 50,000 shares of common stock on a 2-for-1 basis. The effects of Medland's stock dividend are shown as follows:

	<u>Before Stock Split</u>	<u>After Stock Split</u>	
Stockholders' equity			
Paid-in capital			
Common stock	\$ 500,000	\$ 500,000	
Paid-in capital in excess of par value	<u>0</u>	<u>0</u>	
Total paid-in capital	(50,000 × \$10) → <u>500,000</u>	500,000 ← (100,000 × \$5)	
Retained earnings	<u>300,000</u>	<u>300,000</u>	
<b>Total stockholders' equity</b>	<b>\$ <u>800,000</u></b>	<b>\$ <u>800,000</u></b>	
<b>Outstanding shares</b>	<b><u>50,000</u></b>	<b><u>100,000</u></b>	
<b># Shares Issued &amp; Outstanding</b>	<b>50,000</b>	<b>100,000</b>	
<b>Par value per share</b>	<b>\$ 10</b>	<b>\$ 5</b>	

### Stock Split/Stock Dividend Comparison Table

<u>Item</u>	<u>Stock Dividend</u>	<u>Stock Split</u>
Total paid-in capital	Increase	No change
Total retained earnings	Decrease	No change
Total par value (common stock)	Increase	No change
Par value per share	No change	Decrease
Number of shares	Increase	Increase

### Study Objective 7 - Identify the Items that Affect Retained Earnings

Retained Earnings	
Deduct:	Beginning Balance Add: Net Income  Net Loss Dividends Prior Period Adj. Quasi Reorganization  Prior Period Adj.
	Ending Balance

#### 1. Characteristics of Retained earnings

- a. RE is the net income that is retained in the business from the start of operations to the beginning of the current year.
  - i. If the accounts have been closed, the ending balance in RE is as of the end of the year.
- b. RE has no relationship to cash.
- c. The balance in retained earnings is part of the stockholders' claim on the total assets of the corporation.
- d. Retained earnings does not represent a claim on any specific asset (such as cash!).
- e. A debit balance in retained earnings is identified as a **deficit** and is reported as a deduction in the stockholders' equity section of the balance sheet as shown below:

**AMAZON.COM**  
**Balance Sheet (partial)**  
**December 31, 2000**  
**(in thousands)**

Stockholders' equity			
Paid-in capital			
Common stock	\$	3,571	
Paid-in capital in excess of par value		<u>1,322,479</u>	
Total paid-in capital		1,326,050	
		<b><u>(2,293,301)</u></b>	
	<b>Accumulated deficit</b>		
Total stockholders' equity (deficit)	\$	<u><u>(967,251)**</u></u>	

\*\* This would result in a "quasi reorganization whereby PIC would be reduced and RE would be increased (it is not permissible for RE to remain in deficit balance)

- f. Although the balance in retained earnings is generally available for dividend declarations, there may be **retained earnings restrictions** that make a portion of the balance currently unavailable for dividends.
  - i. Restrictions may result from one or more of the following causes: legal, contractual, or voluntary.
  - ii. Retained earnings restrictions are generally disclosed in the notes to the financial statements.

**Study Objective 8 - Prepare a Comprehensive Stockholders' Equity (SHE) Section**

1. In SHE, paid-in capital and retained earnings are reported, and the specific sources of paid-in capital are identified.
  - a. Within paid-in capital, two classifications are recognized:
    - i. **Capital stock** consists of preferred and common stock.
      1. Preferred stock is shown before common because of its preferential rights.
      2. Information about the par value, shares authorized, shares issued, and shares outstanding is reported for each class of stock are also disclosed.
    - ii. **Additional paid-in capital** includes the excess of amounts paid in over par or stated value and paid-in capital from treasury stock.
      1. Subclassifications within the stockholders equity sections are seldom presented in published annual reports.
      2. Individual sources of additional paid-in capital are often combined and reported as a single amount as shown in the following illustration:

<b>KMART INC.</b>		
<b>Balance Sheet (partial)</b>		
<b>January 30, 2002</b>		
<b>(in millions)</b>		
Stockholders' equity		
Common stock, \$1 par value; 1,500,000,000 shares authorized; 503,294,515 shares issued	\$	503
Capital in excess of par value		1,695
Retained earnings		<u>1,261</u>
Total stockholders' equity	\$	<u><u>3,459</u></u>

**Study Objective 9 - Evaluate a Corporation's Dividend and Earnings Performance from a Stockholder's Perspective**

1. The **payout ratio** measures the percentage of earnings distributed in the form of cash dividends to common stockholders and is computed by dividing total cash dividends declared to common shareholders by net income.

a. The payout ratios for Nike in 2001 and 2000 are shown below:

	<u>2001</u>	<u>2000</u>
Dividends (in millions)	\$129.6	\$131.5
Net income (in millions)	589.7	579.1

$$\text{Payout Ratio} = \frac{\text{Cash Dividends Declared on Common Stock}}{\text{Net Income}}$$

	<u>2001</u>	<u>2000</u>
Payout Ratio	$\frac{\$129.6}{\$589.7} = 22\%$	$\frac{\$131.5}{\$579.1} = 23\%$

- b. Companies that have high growth rates are characterized by low payout ratios because they reinvest most of their net income in the business. Thus, a low payout ratio is not necessarily bad news.

2. The **return on common stockholders' equity** is a widely used ratio that measures profitability from the common stockholders' viewpoint.
  - a. This ratio shows how many dollars of net income were earned for each dollar invested by common stockholders.
  - b. Return on common stockholders' equity is computed by dividing net income available to common stockholders (Net income - Preferred stock dividends) by average common stockholders' equity.
    1. The return on common stockholders' equity for Nike in 2001 and 2000 are shown below:

<u>(in thousands)</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Net Income	\$ 589,700	\$ 579,100	\$ 451,400
Preferred stock dividends	30	30	30
Common stockholders' equity	3,494,500	3,136,000	3,334,600

Return on common stockholders' equity ratio	<u>2001</u>	= 17.8%	<u>2000</u>	= 17.9%
	$\frac{\$589,700 - \$30}{(\$3,494,500 + \$3,136,000)/2}$		$\frac{\$579,100 - \$30}{(\$3,136,000 + \$3,334,600)/2}$	

3. **Debt versus equity decisions** - To obtain large amounts of long-term capital, corporate managers must decide whether to issue bonds or to sell common stock.
  - a. Bonds have three primary advantages relative to common stock:
    1. Stockholders' control is not affected. Bondholders do not have voting rights, so current owners (stockholders) retain full control of the company.
    2. Tax savings result: Bond interest is deductible for tax purposes; dividends on stock are not.
    3. Return on Common Stockholders' Equity may be higher: although bond interest expense reduces net income, return on common stockholders' equity often is higher under bond financing because no additional shares of common stock are issued.

1. The return on common stockholders' equity is affected by the return on assets ratio and the amount of leverage a company uses—that is, by the company' reliance on debt (often measured by the debt to total assets ratio).
2. If a company wants to increase its return on common stockholders' equity, it can either increase its return on assets or increase its reliance on debt financing.

To illustrate the potential effect of debt financing on the return on common stockholders' equity, assume that Microsystems, Inc. is considering two plans for financing the construction of a new \$5 million plant. Plan A involves issuing 200,000 shares of common stock at the current market price of \$25 per share. Plan B involves issuing \$5 million of 12% bonds at face value. Income before interest and taxes on the new plant will be \$1.5 million; income taxes are expected to be 30%. Microsystems currently has 100,000 shares of common stock outstanding issued at \$25 per share. The alternative effects on the return on common stockholders' equity are shown below:

	<u>Plan A</u> <u>Issue stock</u>	<u>Plan B</u> <u>Issue bonds</u>
Income before interest and taxes	\$ 1,500,000	\$ 1,500,000
Interest (12% x \$5,000,000)	—	<u>600,000</u>
Income before income taxes	1,500,000	900,000
Income tax expense (30%)	<u>450,000</u>	<u>270,000</u>
Net income	<u>\$ 1,050,000</u>	<u>\$ 630,000</u>
Common stockholders' equity	\$ 7,500,000	\$ 2,500,000
Return on common stockholders' equity	14%	25.2%

- b. In general, as long as the return on assets rate exceeds the rate paid on debt, the return on common stockholders' equity will be increased by the use of debt.
- c. Debt has one major disadvantage: The company locks in fixed payments that must be made in good times and bad. **Interest must be paid on a period basis, and the principal (face value) of the bonds must be paid at maturity.**

### Entries for Stock Dividends

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

Retained Earnings (or Stock Dividends Declared)	75,000
Common Stock Dividends Distributable	50,000
Paid-in Capital in Excess of Par Value	25,000
(To record declaration of 10% stock dividend)	

- a. Note that at the declaration date Retained Earnings is decreased for the fair market value of the stock issued: Common Stock Dividends Distributable is increased for the par value of the dividend shares; and the excess over par is credited to an additional paid-in capital account.
- b. Common Stock Dividends Distributable is a stockholders' equity account; it is not a liability account because assets will not be used to pay the dividend.
- c. If a balance sheet is prepared before the dividend shares are issued, the distributable account is reported in paid-in capital as an addition to common stock issued as shown below:

**MEDLAND CORPORATION**  
**Balance Sheet (partial)**

Paid-in capital

Common stock	\$	500,000	
<b>Common stock dividends distributable</b>		<u><b>50,000</b></u>	<b>\$550,000</b>

- d. When the dividend shares are issued, Common Stock Dividends Distributable is decreased and Common Stock is increased as follows:

Common Stock Dividends Distributable	50,000	
Common Stock		50,000

(To record issuance of 5,000 shares in a stock dividend)



## Chapter 11 Review

- ✓ Identify the major characteristics of a corporation and classify the characteristic as being advantageous or detrimental to a business.
  
- ✓ Describe the accounting treatment for the issuance of stock.
  
- ✓ Know what treasury stock is, know why corporations buy back their own stock, and explain the accounting for the purchase of treasury stock.
  
- ✓ Know how preferred stock is different from common stock.
  
- ✓ Understand what is to be done when declaring a dividend and be able to prepare the entries for cash dividends and stock dividends.
  
- ✓ How do net income, net loss, and dividends affect retained earnings?
  
- ✓ Have a thorough understanding of the items listed in the stockholders' equity section of the balance sheet.
  
- ✓ Use the ratios discussed in this chapter—dividend payout ratio and return on common stockholders' equity—to evaluate a corporation's dividend and earnings performance from a stockholder's perspective.

**Chapter 11**

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A corporation is created by \_\_\_\_\_. As a \_\_\_\_\_, a corporation has most of the rights and privileges of a \_\_\_\_\_. The major exceptions relate to privileges that can be exercised only by a living person, such as the right to \_\_\_\_\_ or \_\_\_\_\_. Similarly, a corporation is subject to the same \_\_\_\_\_ and \_\_\_\_\_ as a person; for example, it must abide by the \_\_\_\_\_ and it must \_\_\_\_\_.

Corporations may be classified in a variety of ways. Two common classifications are by \_\_\_\_\_ and by \_\_\_\_\_. A corporation may be organized for the purpose of \_\_\_\_\_ a \_\_\_\_\_ (such as Nike or General Motors), or it may be a \_\_\_\_\_, medical, or educational corporation (such as the Salvation Army or the American Cancer Society).

Classification by \_\_\_\_\_ differentiates publicly held and privately held corporations. A \_\_\_\_\_ may have thousands of \_\_\_\_\_ and its stock is regularly traded on a \_\_\_\_\_ such as the New York Stock Exchange. In contrast, a \_\_\_\_\_, often referred to as a \_\_\_\_\_ held corporation, usually has only a few \_\_\_\_\_, and it does not offer its stock for sale to the \_\_\_\_\_. \_\_\_\_\_ are generally much smaller than \_\_\_\_\_, although some notable exceptions exist.

## Solutions - Reading Comprehension Check I

### Chapter 11

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A corporation is created by law. As a legal entity, a corporation has most of the rights and privileges of a person. The major exceptions relate to privileges that can be exercised only by a living person, such as the right to vote or hold public office. Similarly, a corporation is subject to the same duties and responsibilities as a person; for example, it must abide by the laws and it must pay taxes.

Corporations may be classified in a variety of ways. Two common classifications are by purpose and by ownership. A corporation may be organized for the purpose of making a profit (such as Nike or General Motors), or it may be a nonprofit charitable, medical, or educational corporation (such as the Salvation Army or the American Cancer Society).

Classification by ownership differentiates publicly held and privately held corporations. A publicly held corporation may have thousands of stockholders and its stock is regularly traded on a national securities market such as the New York Stock Exchange. In contrast, a privately held corporation, often referred to as a closely held corporation, usually has only a few stockholders, and it does not offer its stock for sale to the general public. Privately held companies are generally much smaller than publicly held companies, although some notable exceptions exist.

**Chapter 11**

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To appeal to a larger segment of potential investors, a corporation may issue a class of stock in addition to common stock, called \_\_\_\_\_. Preferred stock has contractual provisions that give it preference or priority over \_\_\_\_\_ in certain areas. Typically, preferred stockholders have a priority in relation to (1) \_\_\_\_\_ and (2) \_\_\_\_\_ in the event of liquidation. However they generally do not have \_\_\_\_\_.

As indicated earlier, preferred stockholders have the right to share in the distribution of corporate income before \_\_\_\_\_. For example, if the dividend rate on preferred stock is \$5 per share, \_\_\_\_\_ will not receive any dividends in the current year until preferred \_\_\_\_\_ have received \$5 per share. The first claim to dividends does not, however, \_\_\_\_\_ dividends. Dividends depend on many factors, such as \_\_\_\_\_ and availability of \_\_\_\_\_.

Preferred stock contracts often contain a \_\_\_\_\_ feature. This right means that \_\_\_\_\_ must be paid both current-year dividends and any unpaid prior-year dividends before \_\_\_\_\_ receive dividends. When preferred stock is cumulative, preferred dividends not declared in a given period are called \_\_\_\_\_ in \_\_\_\_\_.

## Solutions - Reading Comprehension Check II

### Chapter 11

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To appeal to a larger segment of potential investors, a corporation may issue a class of stock in addition to common stock, called preferred stock. Preferred stock has contractual provisions that give it preference or priority over common stock in certain areas. Typically, preferred stockholders have a priority in relation to (1) dividends and (2) assets in the event of liquidation. However they generally do not have voting rights.

As indicated earlier, preferred stockholders have the right to share in the distribution of corporate income before common stockholders. For example, if the dividend rate on preferred stock is \$5 per share, common shareholders will not receive any dividends in the current year until preferred stockholders have received \$5 per share. The first claim to dividends does not, however, guarantee dividends. Dividends depend on many factors, such as retained earnings and availability of cash.

Preferred stock contracts often contain a cumulative dividend feature. This right means that preferred stockholders must be paid both current-year dividends and any unpaid prior-year dividends before common stockholders receive dividends. When preferred stock is cumulative, preferred dividends not declared in a given period are called dividends in arrears.

Chapter 11

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- \_\_\_\_\_ 1. Net income that is retained in the business.
  
- \_\_\_\_\_ 2. The amount per share of stock that must be retained in the business for the protection of corporate creditors.
  
- \_\_\_\_\_ 3. Capital stock that has contractual preferences over common stock in certain areas.
  
- \_\_\_\_\_ 4. A corporation that may have thousands of stockholders and whose stock is regularly traded on a national securities market.
  
- \_\_\_\_\_ 5. Capital stock that has been issued and is being held by stockholders.
  
- \_\_\_\_\_ 6. Capital stock that has been assigned a value per share in the corporate charter.
  
- \_\_\_\_\_ 7. A corporation's own stock that has been issued, fully paid for, and reacquired by the corporation but not retired.
  
- \_\_\_\_\_ 8. The issuance of additional shares of stock to stockholders accompanied by a reduction in the par or stated value per share.
  
- \_\_\_\_\_ 9. The date when ownership of outstanding shares is determined for dividend purposes.
  
- \_\_\_\_\_ 10. A feature of preferred stock entitling the stockholder to receive current and unpaid prior-year dividends before common stockholders receive any dividends.

## Solutions to Vocabulary Quiz

### Chapter 11

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1. Retained earnings
2. Legal capital
3. Preferred stock
4. Publicly held corporation
5. Outstanding stock
6. Par value stock
7. Treasury stock
8. Stock split
9. Record date
10. Cumulative dividend

**Chapter 11**

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1. All the following are true about a corporation **except**:
  - a. must abide by the laws.
  - b. is a legal entity.
  - c. has the right to vote.
  - d. must pay taxes.
  
2. Proof of stock ownership is evidenced by a printed or engraved form known as a:
  - a. stock dividend.
  - b. note.
  - c. debenture.
  - d. stock certificate.
  
3. All of the following statements are true concerning treasury stock **except**:
  - a. is accounted for by the cost method.
  - b. does not change the number of shares issued.
  - c. does not change the number of shares outstanding.
  - d. reduces stockholder claims on corporate assets.
  
4. In order to pay a cash dividend:
  - a. the corporation must have adequate retained earnings.
  - b. the board of directors must declare a dividend.
  - c. the corporation must have adequate cash.
  - d. all of the above.
  
5. Dividends can take the following forms:
  - a. cash
  - b. property
  - c. script
  - d. all of the above
  
6. When issuing cash dividends, the board of directors commits the corporation to a binding legal obligation on:
  - a. the declaration date.
  - b. the date of record.
  - c. the date of payment.
  - d. none of the above.
  
7. A stock dividend results in:
  - a. a decrease in retained earnings.
  - b. an increase in paid-in capital.
  - c. a decrease in stockholder's equity and total assets.
  - d. both a and b above.



8. Upon receiving a stock dividend:
- a stockholder owns more shares.
  - a stockholder's interest has increased.
  - a stockholder's interest has not changed.
  - both a and c above.
9. Corporations issue stock dividends
- to satisfy stockholders' dividend expectations without spending cash.
  - to increase the marketability of its stock by increasing the number of shares outstanding and thereby decreasing the market price per share.
  - to emphasize that a portion of stockholders' equity has been permanently reinvested in the business and therefore is unavailable for cash dividends.
  - all of the above.
10. A small stock dividend
- is less than 20%-25% of the corporation's issued stock.
  - is recorded at market value per share.
  - is recorded at par or stated value per share.
  - both a and b above.

## Solutions to Multiple Choice Quiz

### Chapter 11

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1. c

2. d

3. c

4. d

5. d

6. a

7. d

8. d

9. d

10. d

## Exercise 1 - Library or World Wide Web Research and Forming a Corporation Activity

### Chapter 11

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In chapter 11 of the text you will find a sentence that reads, "A corporation is formed by grant of a state charter." Conduct research in your school library or on the World Wide Web to find the "basic steps to incorporating a corporation." If researching the web, go to [www.bizfiling.com](http://www.bizfiling.com) and search for What are the costs. Click on Mississippi.

1. What are the corporate requirements relating to officer information, stock information, and corporate records?
2. When must annual reports be filed and what is the filing fee?
3. What are the income tax rates for corporations?
4. What is the franchise tax rate for corporations?

**Solutions:** Information available on website.

**Note:** The website is constantly being updated. Please check to see that the information requested in this exercise is available.

## Exercise 2 - World Wide Web Research and Forming a Corporation Activity

### Chapter 11

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For over a century, Delaware has been the home for America's premier corporations. More than half of the Fortune 500 companies are incorporated in Delaware. To learn more about incorporating, go to [www.accessincorp.com](http://www.accessincorp.com).

1. What are the advantages and disadvantages of incorporating your business?
2. What is a registered agent and why does your corporation need one?
3. Do you need an attorney to incorporate?
4. What are the advantages of incorporating your business in Delaware?
5. What are a C corporation, an S corporation, and a close corporation?

**Solutions:** Information available on website.

**Note:** The website is constantly being updated. Please check to see that the information requested in this exercise is available.

### Exercise 3 - Library or World Wide Web Research Activity

#### Chapter 11

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Listed below are 20 well-known Corporations. In the space provided, indicate the stock exchange on which each of the companies is listed--New York Stock Exchange, NASDAQ, or American Stock Exchange. In addition, show the current market value of the common stock of the company listed.

<u>Companies</u>	<u>Exchange</u>	<u>Current Price per Share</u>
American Vanguard	_____	_____
Applebee's	_____	_____
Bristol-Myers Squibb	_____	_____
Brookstone	_____	_____
Chiquita Brand	_____	_____
Community Banks	_____	_____
Daimler-Benz	_____	_____
Delta Airlines	_____	_____
Eastman Kodak	_____	_____
Gap, Inc.	_____	_____
Glacier Water Svcs	_____	_____
Harley-Davidson	_____	_____
Hollywood Casino	_____	_____
Papa John's	_____	_____
Pfizer	_____	_____
Piccadilly Cafeterias	_____	_____
Rawlings Sporting	_____	_____
Snap-On, Inc.	_____	_____
Tootsie Roll	_____	_____
Wyndham Intl.	_____	_____

## Solutions to Exercise 3 - Library or World Wide Web Research Activity

### Chapter 11

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<u>Companies</u>	<u>Exchange</u>
American Vanguard	American Stock Exchange
Applebee's	NASDAQ
Bristol-Myers Squibb	New York Stock Exchange
Brookstone	NASDAQ
Chiquita Brand	New York Stock Exchange
Community Banks, Inc.	NASDAQ
Daimler-Benz	New York Stock Exchange
Delta Airlines	New York Stock Exchange
Eastman Kodak	New York Stock Exchange
Gap, Inc.	New York Stock Exchange
Glacier Water Services	American Stock Exchange
Harley-Davidson	New York Stock Exchange
Hollywood Casino Corp	American Stock Exchange
Papa John's	NASDAQ
Pfizer	New York Stock Exchange
Piccadilly Cafeterias	American Stock Exchange
Rawlings Sporting Goods	NASDAQ
Snap-On, Inc.	New York Stock Exchange
Tootsie Roll	New York Stock Exchange
Wyndham International, Inc.	American Stock Exchange



## Exercise 5 - Library or World Wide Web Research and Stockholders' Equity Activity

### Chapter 11

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Obtain a copy of Colgate's Annual Report from your school library or research the World Wide Web to find information to answer the following questions. If researching the web, go to [www.colgate.com](http://www.colgate.com).

1. What accounting firm is responsible for Colgate's independent audit?
2. How much did Colgate pay out in dividends during the last fiscal year? Did the dividends go to preferred or common stockholders?
3. On which financial statement(s) did you find information concerning the amount of dividends paid?
4. Does Colgate own treasury stock? If so, how much did Colgate pay for the treasury stock?
5. On which financial statement(s) did you find information concerning Colgate's treasury stock?

**Solutions:** Information available on website.

**Note:** The website is constantly being updated. Please check to see that the information requested in this exercise is available.



## Exercise 6 - Library or World Wide Web Research, Stockholders' Equity Activity

### Chapter 11

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Research your school library or the World Wide Web for an Annual Report(s) of Pfizer, Inc. If researching the web, go to [www.pfizer.com](http://www.pfizer.com). Use the information in Pfizer's annual report to answer the following questions.

1. What was the last year in which Pfizer bought back its own stock?
2. What was the reason for buying the stock?
3. How much did Pfizer pay per share for the stock purchased?
4. Describe the provisions of Pfizer's preferred stock.

**Solutions:** Information available on website.

**Note:** The website is constantly being updated. Please check to see that the information requested in this exercise is available.

## Exercise 7 - World Wide Web Research and Stock Exchange Vocabulary Activity

### Chapter 11

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Stock ownership has grown dramatically in the 1990s. As a student and a potential investor you should be familiar with terms associated with corporate stocks and the exchanges on which they are traded. Go to [www.nyse.com](http://www.nyse.com), scroll down and click on **ABOUT THE NYSE** and **Glossary**. Find the definitions to the following terms:

1. American Stock Exchange
2. Blue Chip
3. Bull Market
4. Common Stock
5. Dividend
6. Dow Jones Industrial Average (DJIA)
7. Equity
8. Fiscal Year
9. Listed Stock
10. Market Value
11. Member
12. NASDAQ
13. New York Stock Exchange
14. Over-the-Counter
15. Record Date
16. Round Lot
17. SEC
18. Secondary Distribution
19. Stock Exchange
20. Stock Split
21. Ticker Symbol
22. Treasury Stock

**Solutions:** Information available on website.

**Note:** The website is constantly being updated. Please check to see that the information requested in this exercise is available.

## Exercise 8 - Library and/or World Wide Web Research and Initial Public Offering Activity

### Chapter 11

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A company may choose one of several ways to raise needed capital for growth and expansion. A popular alternative for raising capital is to sell stock to the public. Research your school library and/or the Internet to find an initial public offering (IPO) of common stock within the last three years. Answer the following questions for the company you select.

1. What is the name of the business?
2. What is the primary business of the company?
3. What was the initial selling price of the stock?
4. What was the number of shares originally offered for sale?
5. What is the current selling price of these shares?