

Question 1 of 5

On April 1, Year 1, Hyde Corp., a newly formed company, had the following stock issued and outstanding:

- Common stock, no par, \$1 stated value, 20,000 shares originally issued for \$30 per share.
- Preferred stock, \$10 par value, 6,000 shares originally issued for \$50 per share.

Hyde's April 1, Year 1, statements of stockholders' equity should report

	<u>Common stock</u>	<u>Preferred stock</u>	<u>Additional paid-in capital</u>
A.	\$20,000	\$60,000	\$820,000
✓			
B.	\$20,000	\$300,000	\$580,000
C.	\$600,000	\$300,000	\$0
D.	\$600,000	\$60,000	\$240,000

Explanation:

Stockholders' equity: stock issuance

Issue 20,000 shares common stock: \$30 per share

Cash (\$30 × 20,000 shares)	600,000	
Common stock (\$1 stated value)		20,000
APIC		580,000

Stock is recorded at par or stated value

APIC is recorded as the excess amount received over par or stated value

Issue 6,000 shares preferred stock: \$50 per share

Cash (\$50 × 6,000 shares)	300,000	
Preferred stock (\$10 par value)		60,000
APIC		240,000

Stockholders' equity balances after issuance:

Common stock (\$1 stated value)	20,000
Preferred stock (\$10 par value)	60,000
APIC (580,000 + 240,000)	820,000

©UWorld

A corporation can finance its operations by issuing stock to raise funds. **Stock** represents an **investor's** ownership or **equity** in a firm. Equity can be issued as **common** or **preferred** stock.

- Common stockholders have voting rights for the corporation's board of directors and corporate policies
- Preferred stockholders have priority over common stockholders for dividends and liquidation, but typically do not have voting rights

Equity balances are reported on the statement of stockholders' equity. **Stock** is **reported at par or stated value**. The **issue price** of stock is typically **greater** than the **par or stated value**. The **excess** amount received **over par or stated value** is reported as **APIC**.

In this scenario, Hyde Corp. issued 20,000 shares of common stock for \$30 per share and 6,000 shares of preferred stock for \$50 per share. As shown in the image, Hyde's equity balances reported on the statement of stockholders' equity are **common stock \$20,000** (\$1 stated value × 20,000 shares), **preferred stock \$60,000** (\$10 par value × 6,000 shares), and **APIC \$820,000** ([\$30 – \$1] × 20,000 common shares + [\$50 – \$10] × 6,000 preferred shares).

Things to remember:

Equity in a corporation can be issued as common or preferred stock. Stock is typically issued at a price greater than par or stated value and is reported at par on the

statement of stockholders' equity. The excess amount received over par is reported as additional paid-in capital.

Question 2 of 5

The following changes in Vel Corp.'s account balances occurred during Year 1:

	<u>Increase</u>
Assets	\$89,000
Liabilities	27,000
Capital stock	60,000
Additional paid-in capital	6,000

Except for a \$13,000 dividend payment and the year's earnings, there were no changes in retained earnings for Year 1. What was Vel's net income for Year 1?

A. \$4,000

B. \$9,000 ✓

C. \$13,000

D. \$17,000

Explanation:

Stockholders' equity

Contributed (paid-in) capital	
Preferred stock	\$XXX
Common stock	XXX
Additional paid-in capital (from various sources)	<u>XXX</u>
Total paid-in capital	XXX
Noncontrolling interest in consolidated subsidiaries (if consolidated financial statements)	XXX
Retained earnings (appropriated and unappropriated)	XXX
Accumulated other comprehensive income (loss)	XXX
Less: Treasury stock (cost method)	<u>(XXX)</u>
Total stockholders' equity	<u><u>\$XXX</u></u>

Retained earnings

Dividends declared XXX	XXX Beg. bal.
Net loss XXX	XXX Net income
Treasury stock XXX	
	XXX End. bal.

The balance sheet reports the cumulative effect of financial transactions at a specific point in time. It consists of assets, liabilities, and equity. After every financial transaction, an entity's assets must equal its liabilities plus the owners' equity.

A company's **equity** (ie, contributed capital and retained earnings (RE)) is **increased** by contributions from the stockholders and **net income** for the period and **decreased** by dividends declared and **net loss** for the period.

Changes in account balances can be used in the equation (**Assets = Liabilities + Stockholders' equity**) to solve for any of the equation's three components. In this scenario, Vel Corp. should calculate the total change in stockholders' equity to determine the change in RE.

$$\textit{Change in assets} = \textit{Change in liabilities} + \textit{Change in stockholders' equity}$$

$$\$89,000 = \$27,000 + \textit{Change in stockholders' equity}$$

$$\$62,000 = \textit{Change in stockholders' equity}$$

The change in stockholders' equity is then used to calculate the change in RE:

$$\textit{Change in stockholders' equity} = \textit{Change in capital stock} + \textit{Change in APIC} + \textit{Change in RE}$$

$$\$62,000 = \$60,000 + \$6,000 + \textit{Change in RE}$$

$$(\$4,000) = \textit{Change in RE}$$

Vel paid dividends of \$13,000 in Year 1, reducing RE. Because RE decreased by \$4,000 for the year, **net income equals \$9,000** [(\$4,000) change in RE = \$9,000 net income – \$13,000 dividends].

Things to remember:

After every financial transaction, an entity's assets must equal its liabilities plus the owners' equity. Equity (ie, contributed capital and retained earnings) is increased by contributions from owners and net income and decreased by dividends declared and net loss.

Question 3 of 5

At December 31, Year 2, Salo Corp.'s balance sheet accounts increased by the following amounts compared with those at the end of Year 1:

Assets	\$178,000
Liabilities	54,000
Capital stock	120,000
APIC	12,000

Except for a \$26,000 dividend payment and the year's earnings, there were no changes in retained earnings for Year 2. What was Salo's net income for Year 2?

A. \$8,000

B. \$18,000 ✓

C. \$26,000

D. \$34,000

Explanation:

Stockholders' equity

Contributed (paid-in) capital	
Preferred stock	\$XXX
Common stock	XXX
Additional paid-in capital (from various sources)	<u>XXX</u>
Total paid-in capital	XXX
Noncontrolling interest in consolidated subsidiaries (if consolidated financial statements)	XXX
Retained earnings (appropriated and unappropriated)	XXX
Accumulated other comprehensive income (loss)	XXX
Less: Treasury stock (cost method)	<u>(XXX)</u>
Total stockholders' equity	<u><u>\$XXX</u></u>

Retained earnings

Dividends declared XXX	XXX Beg. bal.
Net loss XXX	XXX Net income
Treasury stock XXX	
	<u>XXX End. bal.</u>

The balance sheet reports the cumulative effect of financial transactions at a specific point in time. It consists of assets, liabilities, and equity. After every financial transaction, an entity's assets must equal its liabilities plus the owners' equity.

The **equity** (ie, contributed capital and retained earnings (RE)) of a company is:

- **Increased** by contributions from the shareholders and **net income** (ie, increase to RE) for the period, and
- **Decreased** by dividends declared and **net loss** (ie, decrease to RE) for the period.

Changes in account balances can be used with the equation (**Assets = Liabilities + Shareholders' equity**) to solve for any of the three components. In this scenario, Salo Corp. must calculate the change in shareholders' equity to determine the change in RE.

Change in assets = Change in liabilities + Change in shareholders' equity

\$178,000 = \$54,000 + Change in shareholders' equity

\$124,000 = Change in shareholders' equity

Then, the next step is to use the change in shareholders' equity to calculate the change in RE:

Change in shareholders' equity = Change in capital stock + Change in APIC + Change in RE

\$124,000 = \$120,000 + \$12,000 + Change in RE

(\$8,000) = Change in RE

Salo paid dividends of \$26,000 in Year 2, reducing RE. Because RE decreased by \$8,000 for the year, **net income equals \$18,000** [(\$8,000) change in RE = \$18,000 net income – \$26,000 dividends].

Things to remember:

After every financial transaction, an entity's assets must equal its liabilities plus the owners' equity. Equity (ie, contributed capital and retained earnings) is increased by contributions from owners and net income and decreased by dividends declared and net loss.

Question 4 of 5

Under U.S. GAAP, all of the following would be included in accumulated other comprehensive income as a component of stockholders' equity **except**:

- A. **Unrealized fair value gains or losses on held-to-maturity investments.** ✓
- B. Foreign currency translation adjustments.
- C. Unrealized holding gains and losses (noncredit) on available-for-sale debt securities.
- D. Unrealized gains and losses on derivatives that are accounted for as cash flow hedges.

Explanation:

Other comprehensive income (**DENT**)

- **D**erivative cash flow hedges
- **E**xcess adjustment of Pension PBO and FV of plan assets at year end
- **N**et unrealized holding gains and losses on available-for-sale debt securities
- **T**ranslation adjustments from foreign currency

©UWorld

Comprehensive income includes changes in an entity's equity from nonowner sources and is the sum of net income and **other comprehensive income** (OCI). Accumulated OCI (AOCI) is reported on the balance sheet as a component of stockholders' equity that includes the total of OCI for the current and previous periods.

OCI **includes certain changes** in **equity** that are **excluded** from **net income** because they are not effective indicators of business performance. OCI includes *DENT*:

- **Derivatives**: unrealized gains and losses (G/L) on derivatives accounted for as cash flow hedges (**Choice D**)
- **Excess** adjustment of pension projected benefit obligation and the FV of plan assets of a defined benefit pension plan
- **Net** unrealized holding G/L (noncredit related) on available-for-sale debt securities (**Choice C**)
- **Translation** adjustments for foreign currency (**Choice B**)

Held-to-maturity securities are initially recorded at cost and carried at amortized cost (ie, face amount, net of unamortized discount or premium). The difference between the cost and the face/maturity value is amortized over the life of the security. Because the investor intends to hold the security to maturity, noncredit-related fluctuations in FV are *disclosed but not recorded*.

Things to remember:

Other comprehensive income (OCI) includes certain changes in equity from nonowner sources. Items included in OCI are DENT: derivative cash flow hedges, excess adjustment of pension projected benefit obligation and FV of plan assets, net unrealized holding gains and losses on available-for-sale debt securities, and translation adjustments from foreign currency.

Question 5 of 5

United, Inc.'s unadjusted current assets section and stockholders' equity section of its December 31, Year 1, balance sheet are as follows:

Current Assets

Cash	\$60,000
Investments in trading securities (including \$300,000 of United, Inc. common stock)	400,000
Trade accounts receivable	340,000
Inventories	148,000
Total	\$948,000

Stockholders' Equity

Common stock	\$2,224,000
Retained earnings (deficit)	(224,000)
Total	\$2,000,000

The trading securities are reported at fair value and the inventories are reported at cost.

In its Year 1 statement of stockholders' equity, United's total amount of equity at December 31, Year 1, is

- A. \$2,224,000
- B. \$2,000,000
- C. \$1,924,000

D. \$1,700,000 ✓

Explanation:

Stockholders' equity

Contributed (paid-in) capital	\$XXX
Preferred stock	XXX
Common stock	<u>XXX</u>
Additional paid-in capital (from various sources)	XXX
Total paid-in capital	XXX
Noncontrolling interest in consolidated subsidiaries (if consolidated financial statements)	XXX
Retained earnings (appropriated and unappropriated)	XXX
Accumulated other comprehensive income (loss)	XXX
Less: Treasury stock (cost method)	<u>(XXX)</u>
Total stockholders' equity	\$XXX

©UWorld

The **stockholders' equity section** of the balance sheet consists of several components, including contributed capital (eg, preferred stock, common stock, APIC), retained earnings, accumulated other comprehensive income (AOCI), and **treasury stock** (repurchased by the company but not retired shares of stock). Treasury stock is a contra account and is therefore presented as a **reduction** to stockholders' equity.

The purchase of treasury stock is never considered an acquisition of an asset since a company may **not** carry its **own stock** as an **investment** (ie, trading securities, investment in equity securities). Accordingly, United will make a correcting journal entry to remove the treasury stock from investments and **deduct** the cost from its equity (**Choice B**). The correct total stockholders' equity is **\$1,700,000**, as shown below:

<i>Stockholders' equity:</i>	
Common stock	\$2,224,000
Retained earnings (deficit)	(224,000)
Less: treasury stock (at cost)	<u>(300,000)</u>
Total	<u><u>\$1,700,000</u></u>

©UWorld

(Choice A) Equity of \$2,224,000 incorrectly assumes that common stock is the only component of stockholders' equity.

(Choice C) Equity of \$1,924,000 incorrectly adds the deficit balance in retained earnings. A deficit (ie, debit balance) is deducted.

Things to remember:

Treasury stock is repurchased (but not retired) company stock. It is never considered an asset of the company, but is a component of equity. Because treasury stock is a contra account (ie, debit balance), it is presented as a reduction to stockholders' equity.

