

ACCOUNTING FOR DIVIDENDS

Key Terms and Concepts to Know

Dividends vs. Interest

- Dividends and interest differ in a number of ways:
 - Dividends are income to the recipient in the period received; however they are not an expense to the corporation that pays them.
 - Dividends are declared at the discretion of the company whereas interest is required to be paid under the terms of the debt agreement.
 - Dividends relate to ownership of the corporation whereas interest relates to debt used to finance operations.
 - Dividends are not an expense and do not appear on the income statement whereas interest paid is an expense and does appear on the income statement.
 - Interest is typically paid in cash whereas dividends are most often paid in cash but may also be distributed to owners in the form of stock.
 - Dividends are paid out of after-tax earnings of the corporation
 - In a sense, dividends are a “gift” from the corporation to its shareholders whereas interest is an obligation of the debtor.

Dividends on Common Stock

- Dividends on common stock are declared and paid at the discretion of the corporation’s board of directors. If the board does not declare a dividend for accounting period, the common shareholders do not have the right to ask for that dividend to be declared and paid in a subsequent accounting period.
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Dividends on Preferred Stock

- Dividends on preferred stock can be much more complex than dividends on common stock:
 - Preferred stock dividends may be non-cumulative, meaning that the rights to receive undeclared dividends do not accumulate “in arrears” until the next time the board declares a dividend.

- Preferred stock dividends may be cumulative, meaning that the rights to receive undeclared dividends accumulate “in arrears” until the next time the board declares a dividend. Then the preferred shareholders receive up to the total of the dividends in arrears plus the current period’s dividends before the common shareholder receive any dividends.
- Preferred stock dividends may be participating, meaning that the preferred shareholders receive their current period dividends first and then share any remaining dividends declared with the common shareholders. That is, they “double dip” on dividends. This is very rare.

Distributing Dividends to Stockholders

- There are four basic steps to distribute dividends and calculate dividends per share:
 - If there is outstanding cumulative preferred stock, distribute dividends in arrears followed by the current year’s dividend to preferred shareholders.
 - If there is outstanding non-cumulative preferred stock, distribute the current year’s dividend to preferred shareholders.
 - Distribute the remaining dividends, if any, to common stockholders.
 - May have to divide by the respective number of shares to obtain dividends per share

Cash vs. Stock Dividends

- As noted above, dividends may be paid in cash or distributed in common stock.
- Stock dividends may be categorized as small or large and are accounted for differently.
 - Small stock dividends are 25% or less of the outstanding shares. Accounting is similar to a cash dividend.
 - Large stock dividends are more than 25% of the outstanding shares. Accounting is similar to issuing common stock at par or stated value.

Key Topics to Know

Dividends

Dividends are payments by the corporation to its shareholders.

- Dividends are declared and paid at the discretion of the corporation.
- Dividends are declared and paid based on the number of outstanding shares of stock. The number of shares outstanding changes with each stock issuance and each purchase or sale of treasury stock.
- Dividends are never paid or distributed to treasury stock since this would amount to the corporation paying or distributing shares to itself.
- There are three important dates for dividends:
 - Date of Declaration – Journalize the entry to record cash dividends payable or shares distributable.
 - Date of Record – All stockholders on this date will receive the dividend (no entry).
 - Date of Payment – Journalize the entry to pay cash dividends to shareholders or distribute the shares of stock.

Cash Dividends

- Most dividends are declared and paid in cash on a per share basis.
- Declared and unpaid dividends represent a current liability to the corporation.

The general form of the journal entries for cash dividends is:

Date of Declaration:

Cash Dividends	xxx	
Cash Dividends Payable		xxx
<i>Outstanding shares x dividend per share</i>		

Date of Payment:

Cash Dividends Payable	xxx	
Cash		xxx

Example #1

During February, X Company had the following common stock transactions:

1. Issued 5,000 shares of \$100 par common stock at par
2. Issued 5,000 shares of \$100 par common stock at a market price of \$110 per share.
3. Issued 5,000 shares of no par common stock with \$100 stated value at a market price of \$115 per share
4. Issued 5,000 shares of no par common stock at a market price of \$120 per share

On March 1, X Company declared a dividend of \$.50 per share to be paid on March 31 to shareholders of record on March 15.

Required: Journalize the transactions for the cash dividend.

Solution #1

March 1 - Date of Declaration:

Cash Dividends	10,000	
Cash Dividends Payable		10,000

March 31 - Date of Payment:

Cash Dividends Payable	10,000	
Cash		10,000

Stock Dividends

- Some dividends are declared and distributed i.e., "paid", in common stock so as to conserve the company's cash.
- Stock dividends distribute common stock rather than cash to the shareholders.
- Stock dividends do not affect total assets, total liabilities or total stockholders' equity.
- Stock dividends redistribute equity from retained earnings to paid-in capital (common stock and perhaps paid-in capital in excess of par)

- Declared and unpaid stock dividends are not a liability. They represent common stock to be distributed and are part of owners' equity.
- All of the accounts used to record stock dividends are equity accounts.
- Stock dividends capitalize a portion of retained earnings transferring it to paid-in capital. Therefore retained earnings decreases by the same amount as the total increase in common stock and paid-in capital in excess of par.
- Accounting for stock dividends differs depending on the size of the stock dividend, i.e., the percentage of outstanding shares to be distributed.
- Small stock dividends, up to 25% of the outstanding shares, are recorded by capitalizing an amount equal to the number of shares in the dividend times the current market price.
- Large stock dividends are recorded by capitalizing an amount equal to the number of shares in the dividend times the par value.

Small Stock Dividends

Small stock dividends are less than 20% - 25% of the outstanding shares.

Example #2

After paying the cash dividend in Example #1, X Company declared a 10% stock dividend on April 1 to be paid April 30 to shareholders of record on April 15. The stock price on April 1 was \$113.

Required: Journalize the transactions for the stock dividend.

Solution #2

Date of Declaration:

Stock Dividends	226,000	
<i>shares x market price</i>		
Stock Dividends Distributable		200,000
<i>shares x par</i>		
Paid-in capital in excess of par-common		26,000
<i>difference</i>		

Date of Payment:

Stock Dividends Distributable	200,000	
Common Stock		200,000

Large Stock Dividends

Large stock dividends are more than 20% - 25% of the outstanding shares.

Example #3

After the small stock dividend, X Company declared a 40% stock dividend on May 1 to be paid May 31 to shareholders of record on May 15. The stock price on May 1 was \$118.

Required: Journalize the transactions for the stock dividend.

Solution #3Date of Declaration:

Stock Dividends <i>shares x par</i>	880,000	
Stock Dividends Distributable		880,000

Date of Payment:

Stock Dividends Distributable	880,000	
Common Stock		880,000

Preferred Stock Dividends

As explained above, preferred stock dividends can be cumulative, participating, cumulative and participating or none of the above.

Determining the proper amount of dividends for each class of stock means that preferred shareholders receive their first and then the common shareholders receive the remaining amount of dividends declared.

Example #4

M Company has stock outstanding as follows: 20,000 shares of \$4.00 cumulative, nonparticipating preferred stock of \$100 par, and 60,000 shares of \$20 par common stock. During its first five years of operations, the following amounts were distributed as dividends: first year, none; second year, \$30,000; third year, \$150,000; fourth year, \$260,000; fifth year, \$140,000.

Required: Calculate the dividends paid and dividends per share on each class of stock.

Solution #4

Preferred shareholders are entitled to receive \$80,000 (20,000 shares * 4.00/share) per year in dividends.

Year 1

Dividends per share are \$0 for both preferred and common stock. Preferred Stock has \$80,000 dividends in arrears.

<u>Year 2</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	20,000	60,000	
Dividends Distributed			\$30,000
Dividends Paid	\$30,000	0	30,000
Dividends per Share	\$1.50		

Dividends in Arrears:	From year 1	\$50,000	80,000 owed – 30,000 paid
	From year 2	<u>80,000</u>	
	Total	\$130,000	

<u>Year 3</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	20,000	60,000	
Dividends Distributed			\$150,000
Dividends Paid	\$150,000	0	150,000
Dividends per Share	\$7.50		

Dividends in Arrears:	From year 1	\$0	50,000 in arrears – 50,000 paid
	From year 2	0	80,000 in arrears – 80,000 paid
	From Year 3	<u>60,000</u>	80,000 owed – 20,000 paid
	Total	\$60,000	

<u>Year 4</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	20,000	60,000	
Dividends Distributed			\$260,000
Dividends Paid	\$140,000	120,00	260,000
Dividends per Share	\$7.00	\$2.00	

Dividends in Arrears:	From year 3	\$0	60,000 in arrears – 60,000 paid
	From year 4	<u>0</u>	80,000 owed – 80,000 paid
	Total	\$0	

<u>Year 5</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	20,000	60,000	
Dividends Distributed			\$140,000
Dividends Paid	\$80,000	60,000	140,000
Dividends per Share	\$4.00	\$1.00	

Practice Problems

Practice Problem #1

O Company has completed the following transactions.

March 4	Purchased 5,000 shares of its own common stock at \$32, recording the stock at cost.
June 3	Declared a semiannual dividend of \$1 on the 8,000 shares of preferred stock and a \$.40 dividend on the common stock to stockholders of record on June 30, payable July 15.
July 15	Paid the cash dividends.
Oct. 14	Sold 2,000 shares of treasury stock at \$35, receiving cash.
Nov. 5	Declared semiannual dividends of \$1 on the preferred stock and \$.40 on the common stock (before the stock dividend). In addition, a 5% common stock dividend was declared on the common stock outstanding, to be capitalized at the fair market value of the common stock, which is estimated at
Dec. 10	Paid the cash dividends and issued the certificates for the common stock dividend.

Required: Journalize the entries to record the transactions.

Practice Problem #2

C Company has stock outstanding as follows: 25,000 shares of \$2.00 cumulative, non-participating preferred stock of \$50 par, and 100,000 shares of \$25 par common. During its first five years of operations, the following amounts were distributed as dividends: first year, none; second year, \$20,000; third year, \$90,000; fourth year, \$180,000; fifth year, \$250,000.

Required: Calculate the dividends per share on each class of stock for each of the five years.

Practice Problem #3

Selected transactions completed by Z Company appear below.

Note that this problem includes entries from the Capital Stock review packet.

Jan. 5	Split the common stock 4 for 1 and reduced the par from \$100 to
Feb. 20	Purchased 10,000 shares of treasury stock for \$300,000.
Mar. 12	Declared the semiannual dividends of \$4 on 20,000 shares of preferred stock and \$.50 on the outstanding common stock.
April 12	Paid the cash dividends.
June 5	Sold 5,000 shares of treasury stock at \$33, receiving cash.
Sept. 2	Declared semiannual dividends of \$4 on preferred stock, and \$.50 on common stock (before the stock dividend). In addition, a 4% common stock dividend was declared when the fair market value of the common stock was estimated at \$40.
Oct. 5	Paid the cash dividends and issued the certificates for the common stock dividend.
Dec. 12	Declared a 40% common stock dividend. The fair market value of the common stock was estimated at \$50.

Required: Journalize the entries to record only the dividend transactions.

Practice Problem #4

P Company had the following transactions during the year:

- In January, declared a \$0.40 per share cash dividend on 300,000 shares of preferred stock outstanding.
- In March, declared and distributed an 8% stock dividend on 800,000 shares of \$1 par value Class A common stock outstanding. Market price per common share on this date was \$9.
- In May, declared and distributed a 2-for-1 stock split on 400,000 shares of \$4 par value Class B common stock outstanding.
- In July, declared and distributed a 35% stock dividend on the \$4 par value Class B common stock outstanding. Market price per common share on this date was \$8.

Required: Journalize the entries to record the transactions.

True / False Questions

1. Dividends are paid on all shares issued by the company including treasury stock.
True False
2. Small stock dividends are recorded by debiting Retained Earnings for the par value per share.
True False
3. Cumulative preferred stock means that dividends accumulate interest during the year.
True False
4. Total assets, total liabilities, and total stockholders' equity do not change as a result of a stock dividend.
True False
5. Large stock dividends are recorded by debiting Retained Earnings for the par value per share.
True False
6. No journal entry is made to record a stock split.
True False
7. The date of record is the date that directors vote to pay a cash dividend to shareholders.
True False
8. The journal entry to record the declaration of a stock dividend on common stock includes a debit to Retained Earnings and a credit to Common Dividend Payable.
True False
9. A stock dividend does not reduce a corporation's assets but does reduce stockholders' equity.
True False
10. A stock split increases total stockholders' equity. True
True False

11. Both cash dividends and stock dividends decrease the total stockholders' equity
True False
12. Non-cumulative preferred stock dividends always result in the preferred stockholders receiving their full dividend when a dividend is declared.
True False
13. Cash dividends are based on the market value of the stock on the date of declaration.
True False
14. Cash dividends are not paid on treasury shares.
True False
15. Stock dividends may be declared on the number of shares common stock issued.
True False

Multiple Choice Questions

1. The charter of a corporation provides for the issuance of 100,000 shares of common stock. Assume that 60,000 shares were originally issued and 10,000 were subsequently reacquired. What is the amount of cash dividends to be paid if a \$1 per share dividend is declared?
 - a) \$50,000
 - b) \$100,000
 - c) \$70,000
 - d) \$60,000

2. A company with 100,000 authorized shares of \$5 par common stock issued 80,000 shares at \$7. Subsequently, the company declared a 2% stock dividend on a date when the market price was \$10 a share. The effect of the declaration and issuance of the stock dividend is to:
 - a) Decrease retained earnings, increase common stock, and decrease paid-in capital
 - b) Increase retained earnings, decrease common stock, and decrease paid-in capital
 - c) Increase retained earnings, decrease common stock, and increase paid-in capital
 - d) Decrease retained earnings, increase common stock, and increase paid-in capital

3. Dividends in arrears are:
 - a) Reported as a current liability on the balance sheet.
 - b) Reported as a contra-equity account
 - c) Not recorded until dividends are declared.
 - d) Debited to retained earnings.

4. On the date of record:
 - a) Cash dividends is debited for the amount of dividends to be paid.
 - b) Dividends payable is debited for the amount of dividends to be paid.
 - c) Dividends distributable is credited for the value of the common shares to be distributed
 - d) No entry is required.

5. B Company has 8,000 shares of 5%, \$50 par, cumulative preferred stock and 50,000 shares of \$3 par common stock outstanding. No dividends were declared last year; however, a dividend of \$50,000 was declared and paid this year. What amount of the total dividend was paid to common stockholders?
- a) \$10,000
 - b) \$30,000
 - c) \$15,000
 - d) \$50,000
6. S Company has 2,000 shares of 5%, \$100 par, cumulative preferred stock and 80,000 shares of \$4 par common stock outstanding. Last year the board of directors declared and paid an \$8,000 dividend. This year the dividend declared and paid was \$15,000. What amount of this year's total dividend was paid to preferred stockholders?
- a) \$15,000
 - b) \$10,000
 - c) \$0
 - d) \$12,000

The next 2 questions refer to the following information.

V Company had 300,000 shares of \$20 par common stock outstanding when a 3% stock dividend was declared. The market price of the stock at the time of the declaration was \$22 per share.

7. How many shares were outstanding after the stock dividend?
- a) \$390,000
 - b) \$330,000
 - c) \$300,000
 - d) \$309,000
8. The journal entry to record the dividend declaration would include a credit to
- a) Common Stock for \$180,000
 - b) PIC-excess of par-CS for \$198,000
 - c) Stock Dividends for \$198,000
 - d) Stock Dividends Distributable for \$180,000

9. H Company declared a \$0.50 per share cash dividend on its common shares. The company has 20,000 shares authorized, 9,000 shares issued, and 8,000 shares of common stock outstanding. The journal entry to record the dividend payment is:
- Debit Retained Earnings \$4,000; credit Common Dividends Payable \$4,000.
 - Debit Common Dividends Payable \$4,000; credit Cash \$4,000
 - Debit Common Dividends Payable \$4,500; credit Cash \$4,500
 - Debit Retained Earnings \$10,000; credit Common Dividends Payable
10. F Company declared a \$0.55 per share cash dividend. The company has 200,000 shares authorized, 190,000 shares issued, and 8,000 shares in treasury stock. The journal entry to record the dividend declaration is:
- Debit Retained Earnings \$104,500; credit Common Dividends Payable \$104,500.
 - Debit Common Dividends Payable \$104,500; credit Cash \$104,500.
 - Debit Dividends \$100,100; credit Common Dividends Payable \$100,100.
11. A stock dividend is recorded with a transfer from:
- Contributed capital to retained earnings.
 - Retained earnings to contributed capital.
 - Retained earnings to assets.
 - Contributed capital to assets
12. All of the following statements regarding stock dividends are true except:
- Directors can use stock dividends to keep the market price of the stock affordable.
 - Stock dividends provide evidence of management's confidence that the company is doing well.
 - Stock dividends do not reduce assets or equity.
 - Stock dividends decrease the number of shares outstanding.
13. Which of the following is true of a stock dividend?
- Does not affect total equity, but transfer amounts between the components of equity.
 - Transfers a portion of equity from retained earnings to a cash reserve account.
 - Reduces a corporation's assets and stockholders' equity.
 - It is a liability on the balance sheet.

14. The board of directors votes to declare a cash dividend of \$.75 per share of common stock. The company has 15,000 shares authorized, 10,000 issued, and 9,500 shares outstanding. The total amount of the cash dividend is:
- a) \$7,125
 - b) \$10,250
 - c) \$14,625
 - d) \$11,250.
15. On September 1, Z Corporation had 50,000 shares of \$5 par value common stock, and \$1,500,000 of retained earnings. On that date, when the market price of the stock is \$15 per share, the corporation issues a 2-for-1 stock split. The general journal entry to record this transaction is:
- a) Debit Retained Earnings \$750,000; credit Common Stock Split Distributable
 - b) \$750,000.
 - c) No entry is made for this transaction.
 - d) Debit Retained Earnings \$250,000; credit Common Stock \$250,000.

Solutions to Practice Problems

Practice Problem #1

March 4	Treasury Stock	160,000	
	Cash		160,000
	<i>Outstanding shares:</i>		
	<i>50,000 – 5,000 = 45,000</i>		
June 3	Cash dividends	26,000	
	Dividends payable		26,000
	<i>preferred: 8,000 * 1 = \$8,000</i>		
	<i>common: 45,000 * .40 = \$18,000</i>		
July 15	Cash Dividends Payable	26,000	
	Cash		26,000
October 14	Cash	70,000	
	Treasury Stock		64,000
	Paid-in capital-Treasury Stock		6,000
	<i>Outstanding Shares:</i>		
	<i>45,000 + 2,000 = 47,000</i>		
Nov. 5	Cash Dividends	26,800	
	Cash Dividends Payable		26,800
	<i>preferred: 8,000 * 1 = \$8,000;</i>		
	<i>common: 47,000 * .40 = 18,800</i>		
	Stock dividends	70,500	
	Stock dividends distributable		47,000
	Paid-in capital-excess of par-common		23,500
	<i>Stock Dividend:</i>		
	<i>Shares issued = 47,000 * 5% =</i>		
Dec. 10	Cash Dividends Payable	26,800	
	Cash		26,800
	Stock Dividends Distributable	47,000	
	Common stock		47,000

Practice Problem #2

Preferred shareholders are entitled to receive \$50,000 = 25,000 shares * \$2.00/share per year in dividends.

Year 1

Dividends per share are \$0 for both preferred and common stock.
Preferred Stock has \$50,000 dividends in arrears.

<u>Year 2</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	25,000	100,000	
Dividends Distributed			\$20,000
Dividends Paid	\$20,000	0	20,000
Dividends per Share	\$.80		
Dividends in Arrears:	From year 1	\$30,000	50,000 owed – 20,000 paid
	From year 2	<u>50,000</u>	
	Total	\$80,000	

<u>Year 3</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	25,000	100,000	
Dividends Distributed			\$90,000
Dividends Paid	\$90,000	0	90,000
Dividends per Share	\$3.60		
Dividends in Arrears:	From year 1	\$0	30,000 in arrears – 30,000 paid
	From year 2	0	50,000 in arrears – 50,000 paid
	From year 3	<u>40,000</u>	
	Total	\$40,000	

<u>Year 4</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	25,000	100,000	
Dividends Distributed			\$180,000
Dividends Paid	\$90,000	90,000	180,000
Dividends per Share	\$3.60	\$.90	
Dividends in Arrears:	From year 3	\$0	40,000 in arrears – 40,000 paid
	From year 4	<u>0</u>	50,000 owed – 50,000 paid
	Total	\$0	

<u>Year 5</u>	<u>Preferred</u>	<u>Common</u>	<u>Total</u>
Shares Outstanding	25,000	100,000	
Dividends Distributed			\$250,000
Dividends Paid	\$50,000	200,000	250,000
Dividends per Share	\$2.00	\$2.00	

Practice Problem #3

January 5	No entry required <i>Outstanding shares = 100,000</i>		
February 20	Treasury Stock Cash <i>Outstanding Shares: 100,000 – 10,000 = 90,000</i>	300,000	300,000
March 12	Cash Dividends Cash Dividends Payable <i>preferred: 20,000 * \$4 = 80,000 common: 90,000 * \$.50 = 45,000</i>	125,000	125,000
April 12	Cash Dividends Payable Cash	125,000	125,000
June 5	Cash Treasury Stock Paid-in capital-Treasury Stock <i>Outstanding Shares: 90,000 + 5,000 = 95,000</i>	165,000	150,000 15,000
September 2	Cash Dividends Payable Cash Dividends Payable <i>preferred: 20,000 * \$4 = 80,000 + common: 95,000 * \$.50 = 47,500</i> Stock dividend	127,500	127,500
	Stock dividends distributable Paid-in capital-excess of par- common <i>Shares issued = 4% * 95,000 = 3,800 * \$40.00 = \$152,000</i>		95,000 57,000
October 5	Cash Dividends Payable Cash Stock Dividends Distributable	127,500	127,500 95,000

	Common stock		95,000
December 12	Stock dividends	950,000	
	Stock dividends distributable		950,000
	<i>Stock Dividend: Shares issued = 40%</i>		
	<i>* 95,000 = 38,000</i>		
	<i>38,000 * \$25.00 = \$950,000</i>		

Practice Problem #4

Dividends	120,000	
Preferred Dividends Payable		120,000
Dividends	576,000	
Common stock dividends distributable		64,000
Paid-in capital in excess of par		512,000
No entry required		
Dividends	1,120,000	
Common stock dividends distributable		1,120,000

Solutions to True / False Problems

1. False - Dividends are not paid on treasury shares repurchased by the company.
2. False - Small stock dividends are recorded by debiting Retained Earnings for the market value, rather than the par value, per share.
3. False - Cumulative preferred stock means shares receive priority for future dividends, if dividends are not paid in a given year.
4. True
5. True
6. True
7. False – the date of record is the date on which ownership of stock is determined for purposes of paying the dividend on the subsequent date of payment.
8. False – the entry includes a debit to common stock dividends and a credit to common stock distributable.
9. False – a stock dividend does not change total stockholders' equity. However, it does redistribute equity from retained earnings to common stock accounts.
10. False – stock splits do not change owners' equity
11. False – Only cash dividends decrease total stockholders' equity.
12. False – non-cumulative dividends means that there are no dividends in arrears. The board of directors determines the amount of a preferred stock dividend declared.
13. False – cash dividends do not depend on the market value of the stock
14. True
15. False – dividends are declared only on outstanding shares

Solutions to Multiple Choice Questions

- | | |
|-----|---|
| 1. | D |
| 2. | C |
| 3. | C |
| 4. | D |
| 5. | A |
| 6. | D |
| 7. | D |
| 8. | D |
| 9. | B |
| 10. | C |
| 11. | B |
| 12. | D |
| 13. | A |
| 14. | A |
| 15. | B |