AUDIT OF STOCKHOLDERS’ EQUITY

PROBLEM NO. 1

The following data were compiled prior to preparing the balance sheet of the Conviction Corporation as of December 31, 2005:

- Authorized common stock, P100 par value: P4,000,000
- Cash dividends payable: 160,000
- Donated capital: 800,000
- Gain on sale of treasury stock: 80,000
- Net unrealized loss on available for sale securities: 96,000
- Premium on capital stock: 320,000
- Premium on bonds payable: 240,000
- Reserve for bond sinking fund: 400,000
- Reserve for depreciation: 600,000
- Revaluation increment on property: 800,000
- Retained earnings, unappropriated: 720,000
- Stock subscriptions receivables: 120,000
- Stock warrants outstanding: 200,000
- Treasury stock, at cost: 144,000
- Unissued common stock: 800,000

REQUIRED:

Compute for the following:

\[
\begin{array}{llll}
\text{A} & \text{B} & \text{C} & \text{D} \\
\hline
1. \text{Common stock issued} & 4,000,000 & 3,200,000 & 3,056,000 & 3,680,000 \\
2. \text{Additional paid-in capital (APIC)} & 320,000 & 1,400,000 & 1,320,000 & 1,200,000 \\
3. \text{Appropriated retained earnings} & 400,000 & 544,000 & 1,000,000 & - \\
4. \text{Total stockholders’ equity} & 6,760,000 & 6,640,000 & 6,480,000 & 6,240,000 \\
5. \text{Legal capital} & 3,200,000 & 3,680,000 & 3,560,000 & 4,000,000 \\
\end{array}
\]

PROBLEM NO. 2

Following is the stockholders’ equity section of Tenacity Corporation’s balance sheet at December 31, 2004:

- Common stock, P10 par value; authorized 1,500,000 shares; issued and outstanding 900,000 shares: P9,000,000
- Additional paid-in capital: 750,000
- Retained earnings: 2,700,000
- Total stockholders’ equity: P12,450,000

Transactions during 2005 and other information relating to the stockholders’ equity accounts were as follows:

- On January 26, Tenacity reacquired 75,000 shares of its common stock for P11 per share.
- On April 4, Tenacity sold 45,000 shares of its treasury stock for P14 per share.
- On June 1, Tenacity declared a cash dividend of P1 per share, payable on July 15, 2005 to stockholders of record on July 1, 2005.
On August 15, each stockholder was issued one stock right for each share held to purchase two additional shares of stock for P12 per share. The rights expire on October 31, 2005.

On September 30, 150,000 stock rights were exercised when the market value of the stock was P12.50 per share.

On November 2, Tenacity declared a two for one stock split-up and charged the par value of the stock from P10 to P5 per share. On November 20, shares were issued for the stock split.

On December 5, 60,000 shares were issued in exchange for a secondhand equipment. It originally cost P600,000, was carried by the previous owner at a book value of P300,000, and was recently appraised at P390,000.

Net income for 2005 was P720,000.

QUESTIONS:

Based on the above and the result of your audit, determine the following as of December 31, 2005:

1. Common stock
   a. P12,600,000   b. P10,800,000   c. P10,050,000   d. P12,300,000

2. Additional paid-in capital
   a. P1,485,000   b. P1,575,000   c. P3,825,000   d. P1,275,000

3. Unappropriated retained earnings
   a. P2,550,000   b. P2,422,500   c. P2,220,000   d. P2,190,000

4. Total stockholders’ equity
   a. P16,425,000   b. P14,295,000   c. P16,095,000   d. P16,065,000

PROBLEM NO. 3

The stockholders’ equity section of the Determination Inc. showed the following data on December 31, 2004: Common stock, P3 par, 450,000 shares authorized, 375,000 shares issued and outstanding, P1,125,000; Paid-in capital in excess of par, P10,575,000; Additional paid-in capital from stock options, P225,000; Retained earnings, P720,000. The stock options were granted to key executives and provided them the right to acquire 45,000 shares of common stock at P35 per share. Each option has a fair value of P5 at the time the options were granted.

The following transactions occurred during 2005:

Feb. 1 Key executives exercised 6,750 options outstanding at December 31, 2004. The market price per share was P44 at this time.

Apr. 1 The company issued bonds of P3,000,000 at par, giving each P1,000 bond a detachable warrant enabling the holder to purchase two shares of stock at P40 each for a 1-year period. The bonds would sell at P996 per P1,000 bond without the warrant.

July 1 The company issued rights to stockholders (one right on each share, exercisable within a 30-day period) permitting holders to acquire one share at P40 with every 10 rights submitted. All but 9,000 rights were exercised on July 31, and the additional stock was issued.

Oct. 1 All warrants issued in connection with the bonds on April 1 were exercised.
Dec.  1  The market price per share dropped to P33 and options came due. Because the market price was below the option price, no remaining options were exercised.

Dec.  31  Net income for 2005 was P375,750.

QUESTIONS:

Based on the above and the result of your audit, determine the following as of December 31, 2005:

1. Common stock
   a. P1,165,950  b. P1,250,775  c. P1,275,075  d. P1,273,050
2. Total additional paid-in capital
3. Retained earnings
   a. P870,750  b. P1,095,750  c. P1,287,000  d. P981,225
4. Total stockholders’ equity
   a. P13,545,000  b. P15,000,000  c. P14,676,000  d. P14,973,000

PROBLEM NO. 4

With your representation, as Managing Partner of the Sy Pee Ey & Co., your firm was engaged in the audit of the Fortitude Company at the close of the company’s first year of operations on December 31, 2005. The company closed its books prior to the time you began your year-end fieldwork.

Your audit and review showed the following stockholders’ equity accounts in the general ledger:

<table>
<thead>
<tr>
<th>Common Stock</th>
<th>08/30/05</th>
<th>CD</th>
<th>P550,000</th>
<th>01/02/05</th>
<th>CR</th>
<th>P6,000,000</th>
<th>12/29/05</th>
<th>J</th>
<th>P545,000</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Retained Earnings</th>
<th>12/29/05</th>
<th>J</th>
<th>P545,000</th>
<th>12/01/05</th>
<th>CR</th>
<th>P287,500</th>
<th>12/31/05</th>
<th>J</th>
<th>4,000,000</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Income Summary</th>
<th>12/31/05</th>
<th>J</th>
<th>P26,000,000</th>
<th>12/31/05</th>
<th>J</th>
<th>P30,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>12/31/05</td>
<td>J</td>
<td>4,000,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Based on the other working papers submitted by your audit staff, the following additional information was forwarded:

From the Articles of Incorporation of Fortitude Company:
- Authorized capital stock – 150,000 shares
- Par value per share – P100

From the board of directors’ minutes of meetings, the following resolutions were extracted:
- 01/02/05 – authorized the issuance of 50,000 shares at P120 per share.
- 08/30/05 – authorized the acquisition of 5,000 shares at P110 per share.
- 12/01/05 – authorized the re-issuance of 2,500 treasury shares at P115 per share.
PROBLEM NO. 5

The Retained Earnings account of **Endurance Company** shows the following debits and credits for the year 2005:

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 1 Balance</td>
<td>726,400</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>5,250</td>
<td>721,150</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td>52,500</td>
<td>668,650</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c)</td>
<td>140,000</td>
<td>528,650</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d)</td>
<td>48,300</td>
<td>480,350</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e)</td>
<td>325,500</td>
<td>154,850</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f)</td>
<td>70,000</td>
<td>84,850</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g)</td>
<td>129,500</td>
<td>214,350</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(h)</td>
<td>10,000</td>
<td>204,350</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i)</td>
<td>8,470</td>
<td>212,820</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(j)</td>
<td>25,900</td>
<td>238,720</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(k)</td>
<td>15,050</td>
<td>253,770</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(l)</td>
<td>10,500</td>
<td>264,270</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(m)</td>
<td>50,050</td>
<td>314,320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(n)</td>
<td>100,000</td>
<td>414,320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(o)</td>
<td>25,000</td>
<td>389,320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(p)</td>
<td>20,000</td>
<td>369,320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(q)</td>
<td>40,000</td>
<td>409,320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(r)</td>
<td>250,000</td>
<td>659,320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(s)</td>
<td>100,000</td>
<td>559,320</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

REQUIRED:
1. Prepare adjusting journal entries to correct the Retained Earnings account.
2. Determine the correct amount of Retained Earnings account.

PROBLEM NO. 6

In connection with your audit of the balance sheet of the **Guts Company** on December 31, 2005, the Liability side of the Balance Sheet shows following items:
Current liabilities
- P571,000

Bonds payable
- 600,000

Reserve for bond retirement
- 320,000

6% Cumulative preferred stock, P100 par value (liquidation value, P115 per share); Authorized, 6,000 shares; issued, 4,000 shares; in treasury, 600 shares
- 400,000

Common stock, P100 par value, authorized, 20,000 shares; issued and outstanding, 8,000 shares
- 800,000

Premium on preferred stock
- 150,000

Premium on common stock
- 165,000

Retained earnings
- 458,600

Treasury preferred stock, at cost
- 84,000

REQUIRED:
1. Compute for the total stockholders' equity as of December 31, 2005.
2. Compute for the book value per share of each class of stock as of December 31, 2005.
3. Assuming the preferred stock is participating, compute for the book value per share of each class of stock as of December 31, 2005.

PROBLEM NO. 7

In connection with the audit of Courage Company's financial statements for the year ended December 31, 2005, your audit senior asked you to analyze the company's stockholders' equity section and provide him with certain figures. The stockholders' equity sections of the company's comparative balance sheets as of December 31, 2005 and 2004 are presented below:

<table>
<thead>
<tr>
<th></th>
<th>12.31.05</th>
<th>12.31.04</th>
</tr>
</thead>
<tbody>
<tr>
<td>12% Preferred stock, P100 par</td>
<td>330,000</td>
<td>270,000</td>
</tr>
<tr>
<td>Common stock, P10* par</td>
<td>1,642,400</td>
<td>1,598,400</td>
</tr>
<tr>
<td>Paid-in capital in excess of par - preferred</td>
<td>53,600</td>
<td>36,800</td>
</tr>
<tr>
<td>Paid-in capital in excess of par - common</td>
<td>257,200</td>
<td>235,200</td>
</tr>
<tr>
<td>Paid-in capital from treasury stock</td>
<td>7,200</td>
<td>3,200</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>1,884,800</td>
<td>1,585,840</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>P4,175,200</td>
<td>P3,729,440</td>
</tr>
</tbody>
</table>

*Par value after May 31, 2005 stock split.

Courage had 65,000 common stock outstanding as December 31, 2003.

The following stockholders' equity transactions were recorded in 2004 and 2005:

**2004**
- May 1 - Sold 9,000 common shares for P24, par value P20.
- July 1 - Sold 700 preferred shares for P124, par value P100.
- July 31 - Issued an 8% stock dividend on common stock. The market value of common stock was P30 per share.
- Aug. 30 - Declared cash dividends of 12% on preferred stock and P3 per share on common stock.
- Dec. 31 - Net income for the year amounted to P1,345,040

**2005**
- Feb. 1 - Sold 2,200 common shares for P30.
- May 1 - Sold 600 preferred shares for P128.
- May 31 - Issued a 2-for-1 split of common stock. The par value of the common stock was reduced to P10 per share.
- Sep. 1 - Purchased 1,000 common shares for P18 to be held as treasury stock.
- Oct. 1 - Declared cash dividends of 12% on preferred stock and P4 per share on common stock.
- Nov. 1 - Sold 1,000 shares of treasury stock for P22.
REQUIRED:

Compute for the basic earnings per share for the year 2004 and 2005.

PROBLEM NO. 8

Select the best answer for each of the following:

1. In an examination of shareholder’s equity, an auditor is most concerned that
   a. Capital stock transactions are properly authorized.
   b. Stock splits are capitalized at par or stated value on the dividend declaration date.
   c. Dividends during the year under audit were approved by the shareholders.
   d. Changes in the accounts are verified by a bank serving as a registrar and stock
      transfer agent.

2. In an audit of a medium-sized manufacturing concern, which one of the following areas
   can be expected to require the least amount of audit time?
   a. Owner’s equity
   b. Assets
   c. Revenue
   d. Liabilities

3. When a corporate client maintains its own stock records, the auditor primarily will rely
   upon
   a. Confirmation with the company secretary of shares outstanding at year-end.
   b. Review of the corporate minutes for data as to shares outstanding.
   c. Confirmation of the number of shares outstanding at year-end with the appropriate
      state official.
   d. Inspection of the stock book at year-end and accounting for all certificate
      numbers.

4. When a client company does not maintain its own stock records, the auditor should
   obtain written confirmation from the transfer agent and registrar concerning
   a. Restrictions on the payment of dividends.
   b. The number of shares issued and outstanding.
   c. Guarantees of preferred stock liquidation value.
   d. The number of shares subject to agreement to repurchase

5. The auditor is concerned with establishing that dividends are paid to client
   corporation shareholders owning stock as of the
   a. Issue date
   b. Declaration date
   c. Record date
   d. Payment date

6. An audit program for the retained earnings account should include a step that
   requires verification of the
   a. Fair value used to charge retained earnings to account for a two-for-one-stock
      split.
   b. Approval of the adjustment to the beginning balance as a result of a write-down of
      an account receivable.
   c. Authorization for both cash and stock dividends.
   d. Gain or loss resulting from disposition of treasury shares.

7. During an audit of an entity’s shareholders’ equity accounts, the auditor determines
   whether there are restrictions on retained earnings resulting from loans, agreements,
   or law. This audit procedure most likely is intended to verify management’s assertion of
   a. Existence
   b. Completeness
   c. Valuation
   d. Presentation and disclosure
8. If the auditee has a material amount of treasury stock on hand at year-end, the auditor should
   a. Count the certificates at the same time other securities are counted.
   b. Count the certificates only if the company had treasury stock transactions during the year.
   c. No count the certificates if treasury stock is a deduction from shareholders’ equity.
   d. Count the certificates only if the company classifies treasury stock with other assets.

9. In performing tests concerning the granting of stock options, an auditor should
   a. Confirm the transaction with the Securities and Exchange Commission.
   b. Verify the existence of option holders in the entity’s payroll records or stock ledgers.
   c. Determine that sufficient treasury stock is available to cover any new stock issued.
   d. Trace the authorization for the transaction to a vote of the board of directors.

10. The auditor would not expect the client to debit retained earnings for which of the following transactions?
    a. A 4-for 1 stock split.
    b. "Loss" resulting from disposition of treasury shares.
    d. Correction of error affecting prior year's earnings.

-- End of AP-5901 --