
PROBLEM 1

1. An auditor usually obtains evidence of stockholders equity transactions by reviewing the entity's
 - a. Minutes of board of directors meetings.
 - b. Transfer agents' records.
 - c. Canceled stock certificates
 - d. Treasury stock certificates.
2. In performing tests concerning the granting of stock options, an auditor should:
 - a. Confirm the transaction with the Secretary.
 - b. Verify 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.
3. During an audit of an entity's stockholders' equity accounts, the auditor determines whether there are restrictions on retained earnings resulting from loans, agreements or laws. This audit procedure most likely is intended to verify management assertion of:
 - a. Existence
 - b. Completeness
 - c. Valuation
 - d. Presentation and disclosure
4. When the client-company does not maintain its own stock records, the auditor should obtain written confirmation form the transfer agent and registrar concerning:
 - a. Restrictions on the payments of dividends.
 - b. The number of shares issued and outstanding.
 - c. Guarantees of preference shares liquidation value.
 - d. The number of shares subject to agreements to repurchase
5. An audit program for the examination of the retained earnings account should include a step that requires verification of the:
 - a. Market value used to charge retained earnings to account for a two-for-one split.
 - b. Approval of the adjustment to the beginning balance as a result of a write-down of an accounts receivable.
 - c. Authorization for both cash and stock dividends.
 - d. Gain or loss resulting from disposition of treasury shares.
6. A feature common to both stock splits and share dividends is:
 - a. A transfer to earned capital of a corporation.
 - b. That there is no effect on total stockholders' equity.
 - c. An increase in total liabilities of a corporation.
 - d. A reduction in the contributed capital of a corporation.

PROBLEM 2:

You were assigned to audit the shareholders' equity of SB Corp. for the year ended December 31, 2018. SB Corp. was incorporated in early 2017 when it was authorized by SEC to issue 100,000 ordinary shares (P100 par) and 50,000 preference shares (P50 par). The following schedule reflects the company's capital balances as of December 31, 2017:

Ordinary shares, 50,000 shares issued during the company's incorporation at P150 per share.	P7,500,000
Preference shares, 20,000 shares issued in June 30, 2017 in exchange of a building with a fair market value of P1,200,000	1,200,000

Retained earnings, which is the company's net income in 2017	<u>5,540,000</u>
Total shareholders' equity	<u>P14,240,000</u>

Your inquiries and investigation revealed the following transactions which occurred in 2018:

- a. In early 2018, the company reacquired 20,000 from its previously issued ordinary shares at P160 per share and reverted them to treasury since it has an intent of reissuing the same.
- b. On March 10, the company issued 10,000 ordinary shares (from previously unissued shares) and 10,000 preference shares for a total lump sum of P2,800,000. On this date, ordinary shares are quoted in the market at P175 per share while preference shares are quoted at P75 per share.
- c. On June 19, the company issued, through a broker, additional 5,000 preference shares at P85 per share. The company incurred P25,000 in broker's fees and commission.
- d. On July 1, the company issued 15,000 ordinary shares with a 3 year- P2,000,000, 12% face value bonds for a total consideration of P5,000,000. The bonds which pay semi-annual interest every January 1 and July 1, are currently quoted at 110 while the ordinary shares are quoted in the market at P180 per share.
- e. On October 11, the company reissued 8,000 treasury shares at P185 per share.
- f. On December 1, the company retired 7,000 treasury shares and reverted them to unissued basis.
- g. The company registered an adjusted net income in 2018 at P4,530,000.

Based on the information above, answer the following:

1. What is the balance of ordinary shares account as of December 31, 2018?
2. What is the balance of the preference shares account as of December 31, 2018?
3. What is the balance of the share premium in excess of par from ordinary shares as of December 31, 2018?
4. What is the balance of the share premium in excess of par from preference shares as of December 31, 2018?
5. What is the total additional paid-in capital as of December 31, 2018?
6. What is the total contributed capital as of December 31, 2018?
7. What is the correct balance of the retained earnings - unappropriated account as of December 31, 2018?
8. What is the total stockholders' equity as of December 31, 2018?

PROBLEM 3:

You were assigned to audit the shareholders' equity of Glorieta Inc. for the year ended December 31, 2018. Glorieta Corp. was incorporated in early 2017 when it was authorized by SEC to issue 500,000 ordinary shares (P10 par) and 100,000 convertible preference shares (P20 par). The following schedule reflects the company's capital balances as of December 31, 2017:

Ordinary shares, 100,000 shares issued during the company's incorporation in exchange of a land with a fair value of P1.4M.	P1,400,000
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Preference shares, 50,000 share issued during the company's incorporation at P50 per share. Each preference share is convertible to four ordinary shares.	2,500,000
Retained earnings, which is the company's net income in 2017	<u>540,000</u>
Total shareholders' equity	<u><u>P3,440,000</u></u>

Your inquiries and investigation revealed the following transactions, which occurred in 2018:

- a. On February 12, 20,000 preference shares were converted to ordinary shares.
- b. On March 15, 25,000 ordinary shares and 20,000 preference shares were issued in exchange of a building with a fair market value of P1,200,000. The fair value of the ordinary shares was considerably stable at P25 per share while the fair value of the preference shares was volatile and highly speculative and that it ranges from a low of P21 per share to high of P55 per share within a trading week.
- c. On June 19, the company issued, through a broker, additional 5,000 preference shares at P52 per share. The company incurred P12,000 in broker's fees and commission.
- d. On August 15, the company reacquired 10,000 ordinary shares (from the 2017 issue) at P22 per share and reverted them to treasury since it intends to reissue the same.
- e. On October 11, the company reissued 2,000 treasury shares at P20 per share.
- f. On December 1, the company retired 5,000 treasury shares and reverted them to unissued basis.
- g. The company registered an adjusted net income in 2018 at P830,000.

Based on the information above, answer the following:

1. What is the balance of ordinary shares account as of December 31, 2018?
2. What is the balance of the preference shares account as of December 31, 2018?
3. What is the balance of the share premium in excess of par from ordinary shares as of December 31, 2018?
4. What is the balance of the share premium in excess of par from preference shares as of December 31, 2018?
5. What is the total additional paid-in capital as of December 31, 2018?
6. What is the total contributed capital as of December 31, 2018?
7. What is the correct balance of the retained earnings - unappropriated account as of December 31, 2018?
8. What is the total stockholders' equity as of December 31, 2018?

PROBLEM 4:

Bulacan Co. had the following selected information in its December 31, 2017 Stockholders' Equity portion of its balance sheet:

10% Preference shares, P100 par value, 50,000 shares authorized, 10,000 shares issued and outstanding	P1,000,000
Ordinary shares, P50 par value, 100,000 shares authorized, 50,000 shares issued, 5,000 shares reacquired at P75 per share	2,500,000

Share premium on preference shares	250,000
Share premium on ordinary shares	250,000
Accumulated profits	2,350,000

Transactions in 2018 are as follows:

- a. On January 2, the company issued 5,000, P1,000 12% bonds payable with detachable warrants. One warrant is attached to each P1,000 bond. The bonds which pay semi-annual interest every June 30 and December 31 were issued at total lump sum of P5,700,000. On the date of issuance, the bonds were quoted at 105 without the warrants while each warrant can be sold in the market at P25. Five warrants surrendered together with P60 exercise price entitle the holder to acquire one ordinary share. Warrants can be exercised 2 years from the date of the issuance.
- b. On March 1, 4,000 treasury shares were reissued at P70 per share. The remaining treasury shares were retired and reverted to unissued basis.
- c. On April 15, stock rights were issued to ordinary shareholders. Ten stock rights plus P55 per share entitle the holder to acquire one additional ordinary share.
- d. On June 1, 60% of the warrants issued with the bonds were exercised.
- e. On August 15, all but 9,000 stock rights were exercised by the ordinary shareholders.
- f. Adjusted net income for the year amounted to P1,250,000.

Based on the information above, answer the following:

1. What is the correct amount to be allocated to the ordinary share warrants as a result of the transaction on January 2?
2. What is the credit to the share premium account as a result of the exercise of the stock warrants on June 1?
3. What is the credit to the share premium account as a result of the exercise of the stock rights on August 15?
4. What is the correct balance of the ordinary shares accounts as of December 31, 2018?
5. What is the total Additional paid in capital as of December 31, 2018?
6. What is the total stockholders' equity as of December 31, 2018?

PROBLEM 5:

On January 2018, the board of directors of Punk Inc. authorized the grant of 100 stock option per employee to supplement the salaries of 100 employees. Each stock option permits the purchase of one share of Punk Inc. ordinary share at a price of P25 per share (par value P20) The market price of the stock on January 1, 2018 is P40 per share.

The option, which has a market value of P25 per option vests, or become exercisable, beginning on January 1, 2021, if the employees stay with the company for the entire three-year vesting period. The options expire on December 31, 2022.

The company is estimating that none of the employees will leave until the vesting period ends.

Requirements:

1. What is the salaries expense in 2018?
2. Assuming that 5 employee left the company by the end of 2019, and it was estimated further that another 10 employee will leave by the end of 2020, what is the salaries expense in 2019?
3. Assuming that a total of 30 employees actually left by the end of 2020, what is the salaries expense in 2020?
4. Based on item 3, assuming that all employees exercised their options in 2021, how much is the credit to share premium account?

PROBLEM 6:

On January 2018, the board of directors of Punk Inc. authorized the grant of 100 stock options per employee to supplement the salaries of 100 of its key employees. Each stock option permits the purchase of one share of Punk ordinary share at a price of P25 per share (par value P20). The market price of the stock on January 1, 2018 is P40 per share.

The option which has a market value of P25 vests, or become exercisable, beginning on January 1, 2021, if the employees stay with the company for the entire three-year vesting period and provided further that market price of shares reaches P60 at the end of the vesting period. The options shall expire on December 31, 2022.

The following information were deemed relevant for the computation of the compensation expense for each year:

<u>Date</u>	<u>Estimated number of Employees who will leave the company</u>	<u>Share market price</u>
Dec. 31, 2018	20	P50
Dec. 31, 2019	25	P55
Dec. 31, 2020	30*	P61

*Actual number of employees who left the company.

Requirements:

1. What is the salaries expense in 2018?
2. What is the salaries expense in 2019?
3. What is the salaries expense in 2020?
4. Assuming that the fair market value of shares on December 31, 2020 was at P58, what is the salaries expense in 2020?
5. Assuming that the fair market value of shares on December 31, 2019 was at P60, what is the salaries expense in 2019?

PROBLEM 7:

On January 2018, the board of directors of Punk Inc. authorized the grant of stock options to supplement the salaries of 100 employees. Each stock option permits the purchase of one share of Punk common stock at a price of P25 per share (par value P20). The market price of the stock on January 1, 2018 is P40 per share.

The option which has a market value of P25 vests, or become exercisable, beginning on January 1, 2021, if the employees stay with the company for the entire three-year vesting period and provided further that sales at the end of the vesting period reaches P100M mark, option to vest is at 100 option per employee; if sales reach P125M mark, options to vest is at 150 options per employee; if sales reach P150M mark, options to vest is at 200 options per employee. The options expire on December 31, 2022.

The following information were deemed relevant for the computation of the compensation expense for each year:

<u>Date</u>	<u>Estimated number of Employees who will leave the company</u>	<u>Actual Sales as reported per year</u>
Dec. 31, 2018	25	P75M
Dec. 31, 2019	20	P110
Dec. 31, 2020	16*	P150

*Actual number of employees who left the company.

Based on historical performance, the company estimates that the average annual sales increase in the past years of 20% is expected to remain during the vesting period.

Requirements:

1. What is the salaries expense in 2018?
2. What is the salaries expense in 2019?
3. What is the salaries expense in 2020?
4. What is the credit to share premium account assuming that all employees receiving options by the end of 2020 exercises all options in 2021?

PROBLEM 8:

On January 2018, the board of directors of Punk Inc. authorized the grant of 10,000 stock options to supplement the salaries of 10 of its key employees (1,000 per employee). Each stock option permits the purchase of one share of Punk common stock at a price of P25 per share (par value P20). The market price of the stock on January 1, 2018 is P40 per share.

The option which has a market value of P25 vests, or become exercisable, by the end of 2018, provided that the employees stay with the company by the end of 2018 and provided further that sales increase by 10%; or at the end of 2019, provided that the employees stay with the company for the entire vesting period and provided further that sales increase at average of 12% over the 2 year period; or by the end of 2020, provided that the employees stay with the company for the entire vesting period and provided further that sales increase at average of 14% over the 3 year period. The options expire on December 31, 2022.

The following information were deemed relevant for the computation of the compensation expense for each year:

<u>Date</u>	<u>Estimated number of Employees who will leave the company</u>	<u>Actual Sales as reported per year</u>	<u>Estimated increase in Sales for the next year</u>
Dec. 31, 2017		P75,000,000	
Dec. 31, 2018	2	81,000,000	16%
Dec. 31, 2019	2	92,340,000	20%
Dec. 31, 2020	3*	110,808,000	

*Actual number of employees who left the company.

Requirements:

1. What is the salaries expense in 2018?
2. What is the salaries expense in 2019?
3. What is the salaries expense in 2020?
4. What is the credit to share premium account assuming that all employees receiving options by the end of 2020 exercises all options in 2021?

PROBLEM 9:

MYX Co. issued stock appreciation rights to its Chief Operating Officer on January 1, 2018. The stock appreciation rights may be exercised beginning January 1, 2021 provided that the officer is still in the employ of the Company at the date of exercise. Each right provides for a cash payment equal to the prevailing fair market value of the stock appreciation rights. The equivalent number of shares for stock appreciation rights will be based on the level of sales of the company at the end of 2020, as follows:

Sales Level (in Millions)	Number of SAR to be granted
P250 to P400	10,000
P400+ to P750	15,000
Above P750	20,000

Sales actually achieved by the Company and the stock price at the end of each year are:

Year	Sales Level	FMV of SAR
2018	210 million	P74
2019	410 million	85
2020	760 million	95

There has been an average increase in annual sales of 25% in the past years and the company expects the same pattern over the vesting period.

Requirements:

1. What is the compensation expense to be recognized in 2019?
2. What is the compensation expense to be recognized in 2020?
3. The entry to record the payment to employees in 2021 assuming all of the rights are exercised in 2021 when the prevailing FMV of SAR is at P98?
4. Assuming the SARs are not yet exercised as at December 31, 2021 and that the fair value of the stock appreciation rights is at P90, what is the liability for the SAR to be recognized as of December 31, 2021?

PROBLEM 10:

Assume the stockholders' equity of Dark Company on January 1, 2018 to be as follows:

Ordinary Shares, P10 par, 100,000 shares issued	P1,000,000
Share premium - Ordinary shares	1,100,000
Retained earnings	750,000
Treasury shares, 10,000 shares at cost	(250,000)

On August 1, the company declared a 10% stock dividend issuable on September 30. The stock is selling on market on this date at P14.

Subsequently after the issuance of the above dividend, on October 10, the company declared a 25% stock dividend issuable in November 5. The stock is selling on the market on this date at P17.

The entries prepared by the accountant for the above transactions were:

At the date of declaration:			
Aug. 1	Retained earnings	100,000	
	Stock dividend distributable		100,000
Oct. 10	Retained earnings	425,000	
	Stock dividend distributable		250,000
	Paid in capital in excess of par		175,000

No entry has been made to record the issuance of the share dividends.

Requirements:

1. What is the correct debit to retained earnings as a result of the 10% stock dividend declaration on August 1?
2. What is the correct debit to retained earnings as a result of the 25% stock dividend declaration on October 10?
3. What is the correct balance of the ordinary shares account as of December 31, 2018?

PROBLEM 11:

Chris Company has 500,000 shares of P10 par value ordinary shares outstanding. In declaring and distributing 10% stock dividend, Chris Company issued only 46,000 new shares, the other share dividend were not issued because some investors did not own Chris Company's shares in even multiples of ten. To these stockholders, Chris Company issued fractional warrants. Chris Company's ordinary shares were selling at P25 per share when the stock dividend were declared. Ultimately, only 90% of the fractional share warrants were finally turned-in in exchange of full shares.

At the end of the year Chris Company declared a cash dividend and a liquidating dividend of P2 and P1 per share, respectively.

Requirements:

1. What is the entry to record the declaration of 10% stock dividends?
2. What is the entry to record the distribution of share dividends and the fractional warrants?
3. What is the entry to record the surrender and exercise of the 90% fractional warrants?
4. Assuming that the remaining fractional warrants expire, what is the entry to record their expiration?
5. How much is the credit to retained earnings as a result of the declaration of the cash dividends at the end of the year?

PROBLEM 12:

On October 31, 2018, ABC Inc. declared a building held as owner-occupied property with an original life of 10 years as dividend distributable to stockholders on January 31 of the following year. This was acquired at P800,000 on October 31, 2017. The property had fair market value P900,000 on October 31, 2018. On December 31, 2018 the value of the property declined to P700,000.

The property was transferred to shareholders on January 31 when the prevailing fair value was at P800,000.

Requirements:

1. The entry to record the declaration of the property dividends would include a debit to retained earnings of:
2. How much property dividends payable should be reported in the statement of financial position as of December 31?
3. How much should be charged to the profit or loss as a result of the remeasurement of the property dividends payable by December 31, 2018?
4. What is the gain or loss to be recognized in the profit or losses as a result of the distribution of the property dividends on January 31?

PROBLEM 13:

JKL Corp. reported the following amounts in the shareholders' equity section of its December 31, 2017, statement of financial position:

Preference shares, P10 par (100,000 shares authorized, 40,000 shares issued)	P400,000
Ordinary shares, P5 par (50,000 shares authorized, 20,000 shares issued)	100,000
Share premium - Ordinary shares	192,000
Accumulated profits	1,200,000

The following transactions occurred during 2018:

- a. At the beginning of 2018, the company paid the annual 2017 P1 per share dividend on preference shares and P0.50 per share dividend on Ordinary shares. These dividends had been declared on December 1, 2017. Further investigations revealed that no entry has been made to account for the declaration of the said dividends.
- b. On February 17, the company purchased 4,000 shares of its own outstanding ordinary shares for P80,000.
- c. On March 30, the company declared and issued ordinary shares split-up (1 is to 2).
- d. On June 19, the company reissued 2,800 treasury shares for an equipment with a fair value at P50,000.
- e. On August 1, the company issued 10,000 shares of preference shares at P15 per share.
- f. On September 30, the company declared a 10% stock dividend on the outstanding ordinary shares when the stock is selling for P6 per share. The share dividends were subsequently issued on October 11.
- g. December 1, the company declared the annual 2018 P1 dividend on preference shares and the P0.25 per share dividend on ordinary shares. These dividends are payable at the beginning of 2019.
- h. The company registered a net income for 2018 at P940,000.

Requirements:

1. What is the effect to stockholders' equity as a result of the share split in item c?
2. What is the amount debited to accumulated profits as a result of the declaration of the 10% stock dividend in item f?

3. What is the amount debited to accumulated profits as a result of the 2018 cash dividend declaration?
4. What is the correct balance of the accumulated profits-unappropriated account as of December 31, 2018?
5. Assuming that the share dividends declared in item f was 20%, what is the amount debited to retained earnings as a result of the declaration of stock dividends?

PROBLEM 14:

Trust Corporation has suffered operating losses for some time, but is now operating profitably and expects to continue to do so. Current and projected income, however, will not be sufficient to eliminate the deficit in the near term. It also appears that plant assets are overstated considering current prices and economic conditions. After receiving permission from government authorities and approval from the shareholders, the board of directors of Trust Corporation decides to restate the company assets and paid-in capital balances in order to remove the deficit and make possible the declaration of dividends from profitable operations. A balance sheet for the company just prior to this action is presented on the next page:

Trust Corporation
Balance Sheet
December 31, 2018

Current assets	P250,000	Liabilities		P300,000
Property, plant and equipment	1,500,000	Ordinary Shares, 10 par,		
Accumulated Depreciation	(600,000)	100,000 shares		1,000,000
		Share premium		100,000
		Deficit		(250,000)
Total assets	<u>1,150,000</u>	Total		<u>P1,150,000</u>

Case 1:

Assuming that the quasi reorganization shall be accomplished as follows:

- a) Property, plant and equipment are to be reduced to their present fair market value of P800,000.
- b) Inventories are to be written down by P50,000.
- c) Unaccrued obligation shall be recognized at P150,000.
- d) Ordinary Shares are to be reduced to a par value of P5.

Requirements:

1. What is the total asset after the quasi-reorganization?
2. What is the total stockholders' equity after the quasi-reorganization?
3. What is the balance of share premium (additional paid in capital) after the quasi-reorganization?
4. What is the correct balance of the retained earnings account as of December 31, 2018?

Case 2:

Assuming that the quasi reorganization shall be accomplished as follows:

- a) Property, plant and equipment are appraised at a replacement cost of P2,500,000.
- b) Inventories are to be written down by P75,000.
- c) Unaccrued obligation shall be recognized at P175,000.

Requirements:

1. What is the total asset after the quasi-reorganization?
2. What is the total stockholders' equity after the quasi-reorganization?

3. What is the balance of share premium (additional paid in capital) after the quasi-reorganization?
4. What is the balance of any revaluation surplus after the quasi-reorganization?
5. What is the correct balance of the retained earnings account as of December 31, 2018?