

What is Equity Classification?

Worksheet

Equity is classified mainly into contributed capital (common stock, additional paid-in capital) and earned capital (retained earnings), minus any treasury stock: $\text{Total Equity} = \text{Common Stock} + \text{Additional Paid-in Capital} + \text{Retained Earnings} - \text{Treasury Stock}$.

Questions

1. Which of these is part of contributed capital?

- A) Retained earnings
- B) Common stock
- C) Net income
- D) Treasury stock

2. A company has \$10,000 common stock, \$90,000 additional paid-in capital, and \$60,000 retained earnings, with no treasury stock. What is total equity?

- A) \$100,000
- B) \$150,000
- C) \$160,000
- D) \$170,000

3. Retained earnings represent:

- A) Cash invested by shareholders
- B) Cumulative profits kept in the business
- C) Total liabilities
- D) Par value of stock

4. How does buying back \$5,000 of treasury stock affect total equity?

- A) Increases it by \$5,000
- B) No effect
- C) Decreases it by \$5,000
- D) Doubles retained earnings

5. A company issues stock for \$100,000 total (\$10,000 par value, \$90,000 above par) and has \$60,000 in retained earnings. What is total equity?

6. A company buys back \$5,000 of its own shares (treasury stock). How does this affect total equity of \$160,000?

7. At year-end, a company has \$50,000 net income and pays \$15,000 in dividends. Beginning retained earnings were \$60,000. What is the new retained earnings balance?

8. Define: What is contributed capital?

9. Define: What is earned capital?

10. Define: How does treasury stock affect equity?

Answer Key

1. B) Common stock - Common stock (and additional paid-in capital) represents funds directly invested by shareholders.
2. C) $\$160,000 - 10,000 + 90,000 + 60,000 = \$160,000$.
3. B) Cumulative profits kept in the business - Retained earnings are cumulative net income minus dividends paid.
4. C) Decreases it by $\$5,000$ - Treasury stock is a contra-equity account that reduces total equity.
5. Common stock = $\$10,000$ Additional paid-in capital = $\$90,000$ Retained earnings = $\$60,000$ Total Equity = $10,000 + 90,000 + 60,000 = \$160,000$
6. Treasury stock reduces total equity (it's a contra-equity account) New Total Equity = $160,000 - 5,000 = \$155,000$
7. Retained Earnings = Beginning RE + Net Income - Dividends = $60,000 + 50,000 - 15,000 = \$95,000$ This increases the earned capital portion of equity
8. Funds shareholders directly invested, including common stock and additional paid-in capital.
9. Retained earnings - cumulative profits the company has kept rather than distributed as dividends.
10. It reduces total equity, since it represents shares the company bought back.

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