Study Objectives

1. Identify and discuss the major characteristics of a corporation.
2. Record the issuance of common stock.
3. Explain the accounting for the purchase of treasury stock.
4. Differentiate preferred stock from common stock.
5. Prepare the entries for cash dividends and understand the effect of stock dividends and stock splits.
6. Identify the items that affect retained earnings.
7. Prepare a comprehensive stockholders' equity section.
8. Evaluate a corporation's dividend and earnings performance from a stockholder's perspective.

Characteristics of a Corporation

- Separate Legal Existence
- Limited Liability of Stockholders
- Transferable Ownership Rights
- Ability to Acquire Capital
- Continuous Life
- Corporate Management
- Government Regulations
- Additional Taxes

Advantages

Disadvantages

Other Forms of Business Organization

- Limited partnerships
- Limited liability partnerships (LLPs)
- Limited liability companies (LLCs)
- S Corporation
  - no double taxation
  - cannot have more than 75 shareholders
Forming a Corporation

Initial Steps:
- File application with the Secretary of State.
- State grants charter.
- Corporation develops by-laws.

Companies generally incorporate in a state whose laws are favorable to the corporate form of business (Delaware, New Jersey).

Corporations engaged in interstate commerce must obtain a license from each state in which they do business.

Stockholders Rights

1. **Vote** in election of board of directors and on actions that require stockholder approval.
2. **Share the corporate earnings** through receipt of dividends.

SO 1 Identify and discuss the major characteristics of a corporation.

3. Keep the same percentage ownership when new shares of stock are issued (preemptive right).

SO 1 Identify and discuss the major characteristics of a corporation.

Authorized Stock

- Charter indicates the amount of stock that a corporation is authorized to sell.
- Number of authorized shares is often reported in the stockholders' equity section.

SO 1 Identify and discuss the major characteristics of a corporation.

Par and No-Par Value Stocks

- **Capital stock that has been assigned a value per share.**
- **Years ago,** par value determined the legal capital per share that a company must retain in the business for the protection of corporate creditors.
- **Today** many states do not require a par value.
- **No-par** value stock is quite common today.
- In many states the board of directors assigns a **stated value** to no-par shares.

SO 1 Identify and discuss the major characteristics of a corporation.

Review Question

Which of these statements is false?
- a. Ownership of common stock gives the owner a voting right.
- b. The stockholders' equity section begins with paid-in capital.
- c. The authorization of capital stock does not result in a formal accounting entry.
- d. Legal capital is intended to protect stockholders.
Paid-in capital is the total amount of cash and other assets paid in to the corporation by stockholders in exchange for capital stock.

Retained earnings is net income that a corporation retains for future use.

Stockholders' equity section assuming Hydro-Slide, Inc. has retained earnings of $27,000.

Illustration 11-5

SO 3 Explain the accounting for the purchase of treasury stock.

ABC Corp. issues 1,000 shares of $10 par value common stock at $12 per share. When the transaction is recorded, credits are made to:

a. Common Stock $10,000 and Paid-in Capital in Excess of Stated Value $2,000.

b. Common Stock $12,000.

c. Common Stock $10,000 and Paid-in Capital in Excess of Par Value $2,000.

d. Common Stock $10,000 and Retained Earnings $2,000.

Illustration: Assume that Hydro-Slide, Inc. issues 1,000 shares of $1 par value common stock at par. Prepare the journal entry.

Illustration: Now assume Hydro-Slide, Inc. issues an additional 1,000 shares of the $1 par value common stock for cash at $5 per share. Prepare Hydro-Slide's journal entry.

Other than consideration received, the issuance of common stock affects only paid-in capital accounts.

Review Question

SO 2 Record the issuance of common stock.

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Treasury stock - corporation's own stock that it has reacquired from shareholders, but not retired.

Corporations purchase their outstanding stock:
1. To reissue the shares to officers and employees under bonus and stock compensation plans.
2. To increase trading of the company's stock in the securities market.
3. To have additional shares available for use in acquiring other companies.
4. To increase earnings per share.

Another infrequent reason is to eliminate hostile shareholders.

Accounting for Treasury Stock

SO 3 Explain the accounting for the purchase of treasury stock.

Purchase of Treasury Stock
- Generally accounted for by the cost method.
- Debit Treasury Stock for the price paid.
- Treasury stock is a contra stockholders' equity account, not an asset.
- Purchase of treasury stock reduces stockholders' equity.

Accounting for Treasury Stock

SO 3 Explain the accounting for the purchase of treasury stock.

Illustration: On February 1, 2008, Mead acquires 4,000 shares of its stock at $8 per share. Prepare the entry.

Preferred Stock

Features often associated with preferred stock.
1. Preference as to dividends.
2. Preference as to assets in liquidation.
3. Nonvoting.

Each paid-in capital account title should identify the stock to which it relates:
- Paid-in Capital in Excess of Par Value—Preferred Stock
- Paid-in Capital in Excess of Par Value—Common Stock

Preferred stock may have a par value or no-par value.

Illustration: Stine Corporation issues 10,000 shares of $10 par value preferred stock for $12 cash per share. Journalize the issuance of the preferred stock.

Dividend Preferences
- Right to receive dividends before common stockholders.
- Per share dividend amount is stated as a percentage of the preferred stock's par value or as a specified amount.
- Cumulative dividend - holders of preferred stock must be paid their annual dividend plus any dividends in arrears before common stockholders receive dividends.
Preferred Stock

Liquidation Preference
- Preference on corporate assets if the corporation fails.
- Preference may be
  - for the par value of the shares or
  - for a specified liquidating value.

Review Question
M-Bot Corporation has 10,000 shares of 8%, $100 par value, cumulative preferred stock outstanding at December 31, 2010. No dividends were declared in 2008 or 2009. If M-Bot wants to pay $375,000 of dividends in 2010, common stockholders will receive:
- $0.
- $295,000.
- $215,000.
- $135,000.

Dividends

Cash Dividends
For a corporation to pay a cash dividend, it must have:
1. Retained earnings - Payment of cash dividends from retained earnings is legal in all states.
2. Adequate cash.
3. A declaration of dividends by the Board of Directors.

Dividends require information concerning three dates:

- December 1 (Declaration Date)
- December 22 (Date of Record)
- January 20 (Payment Date)

Illustration: On Dec. 1, the directors of Media General declare a 50¢ per share cash dividend on 100,000 shares of $10 par value common stock. The dividend is payable on Jan. 20 to shareholders of record on Dec. 22?

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Stock Dividends
Reasons why corporations issue stock dividends:
1. To satisfy stockholders' dividend expectations without spending cash.
2. To increase the marketability of the corporation's stock.
3. To emphasize that a portion of stockholders' equity has been permanently reinvested in the business.

Effects of Stock Dividends
- Changes the composition of stockholders' equity.
- Total stockholders' equity remains the same.
- No effect on the par or stated value per share.
- Increases the number of shares outstanding.

Illustration: Medland Corp. declares a 10% stock dividend on its $10 par common stock when 50,000 shares were outstanding. The market price was $15 per share.

<table>
<thead>
<tr>
<th>Stockholders' equity</th>
<th>Before Dividend</th>
<th>Change</th>
<th>After Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid-in capital</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $10 par</td>
<td>500,000</td>
<td>0</td>
<td>500,000</td>
</tr>
<tr>
<td>Paid-in capital in excess of par value</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total paid-in capital</td>
<td>500,000</td>
<td>0</td>
<td>500,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>300,000</td>
<td>0</td>
<td>300,000</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>800,000</td>
<td>0</td>
<td>800,000</td>
</tr>
<tr>
<td>Outstanding shares</td>
<td>50,000</td>
<td>0</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Stock Split
- Reduces the market value of shares.
- No entry recorded for a stock split.
- Decrease par value and increase number of shares.

Illustration: Assuming instead of issuing a 10% stock dividend, Medland splits its 50,000 shares of common stock on a 2-for-1 basis.

<table>
<thead>
<tr>
<th>Item</th>
<th>Stock Dividend</th>
<th>Stock Split</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total paid-in capital</td>
<td>Increase</td>
<td>No change</td>
</tr>
<tr>
<td>Total retained earnings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total par value (common stock)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Par value per share</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Review Question
Which of these statements about stock dividends is true?
- a. Stock dividends reduce a company's cash balance.
- b. A stock dividend has no effect on total stockholders' equity.
- c. A stock dividend decreases total stockholders' equity.
- d. A stock dividend ordinarily will increase total stockholders' equity.

Retained Earnings
- Retained earnings is net income that a company retains for use in the business.
- Net income increases Retained Earnings and a net loss decreases Retained Earnings.
- Retained earnings is part of the stockholders' claim on the total assets of the corporation.
- A debit balance in Retained Earnings is identified as a deficit.

Illustration 11-14
Amazon.com
Balance Sheet (partial)
December 31, 2007
(in millions)

<table>
<thead>
<tr>
<th>Stockholders' equity</th>
<th>4</th>
<th>3,068</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock</td>
<td>3,092</td>
<td></td>
</tr>
<tr>
<td>Paid-in capital in excess of par value</td>
<td>3,275</td>
<td></td>
</tr>
<tr>
<td>Total paid-in capital</td>
<td>3,072</td>
<td></td>
</tr>
<tr>
<td>Accumulated deficit</td>
<td>1,667</td>
<td></td>
</tr>
<tr>
<td>Total paid-in capital and retained earnings</td>
<td>509</td>
<td></td>
</tr>
<tr>
<td>Less: Treasury stock</td>
<td>51,197</td>
<td></td>
</tr>
</tbody>
</table>
Retained Earnings Restrictions

Restrictions can result from:
1. Legal restrictions.
2. Contractual restrictions.
3. Voluntary restrictions.

 presente the following classified retained earnings statement for Tektronix Inc. (Illustration 11-15)

Illustration 11-15

Certify the Company’s debt agreements require compliance with debt covenants. The Company has met its annual earnings targets of $225 million after meeting those obligations.

Chapter 11-05

SO 6 Identify the items that affect retained earnings.

SO 7 Prepare a comprehensive stockholders’ equity section.

Presentation of Stockholders’ Equity

Balance Sheet Presentation

Two classifications of paid-in capital:
1. Capital stock
2. Additional paid-in capital

Retained Earnings

Retained Earnings

Illustration 11-16

Balance Sheet (partial)

Chapter 11-06

SO 7 Prepare a comprehensive stockholders’ equity section.

SO 8 Evaluate a corporation’s dividend and earnings performance from a stockholder’s perspective.

SO 9 Prepare entries for stock dividends.

Illustration 11A-1

Entries for Stock Dividends

Measuring Corporate Performance

Dividend Record

Illustration: Using the information shown below, calculate the payout ratio for Nike in 2007 and 2006.

SO 8 Evaluate a corporation’s dividend and earnings performance from a stockholder’s perspective.

Illustration 11-18

Measuring Corporate Performance

Earnings Performance

Illustration: Calculate Nike’s return on common stockholders’ equity ratios for 2007 and 2006.

SO 8 Evaluate a corporation’s dividend and earnings performance from a stockholder’s perspective.

Entries for Stock Dividends

Illustration: Medland Corporation declares a 10% stock dividend on its 50,000 shares of $10 par value common stock. The current fair market value of its stock is $15 per share. The entry to record this transaction at the declaration date is:

SO 9 Prepare entries for stock dividends.

Entries for Stock Dividends

Illustration: When Medland issues the dividend shares, it decreases Common Stock Dividends Distributable and increases Common Stock as follows.