

Financial Accounting

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MGM611

Lecture (9) **Corporations**



Learning Objectives

1. Identify the major characteristics of a corporation.
2. Differentiate between paid-in capital and retained earnings.
3. Record the issuance of common stock.
4. Explain the accounting for treasury stock.
5. Differentiate preferred stock from common stock.
6. Prepare a stockholders' equity section.
7. Compute book value per share.

Forms of Business Ownership

Proprietorship

Owned by **one person**

Owner is often manager/operator

Owner receives any profits, suffers any losses, **and is personally liable for all debts**

Partnership

- Owned by **two or more persons**
- Often retail and service-type businesses
- Generally **unlimited personal liability**

Corporation

- Owned by **shareholders**
- Separate legal entity organized under state corporation law
- **Limited liability**

Organization and Capital Stock Transactions

The Corporate Form of Organization

- Characteristics
- Formation
- Stockholder rights
- Stock issue considerations
- Corporate capital

Accounting for Common Stock Issues

- Issuing par value stock
- Issuing no-par stock
- Issuing stock for services or noncash assets

Accounting for Treasury Stock

- Purchase of treasury stock
- Disposal of treasury stock

Preferred Stock

- Dividend preferences
- Liquidation preference

Stockholders' equity section

- Presentation
- Analysis—Book value per share

The Corporate Form of Organization

An entity separate and distinct from its owners.

Classified by Purpose

- Not-for-Profit
- For Profit

➤ American Cancer Society

Classified by Ownership

- Publicly held
- Privately held

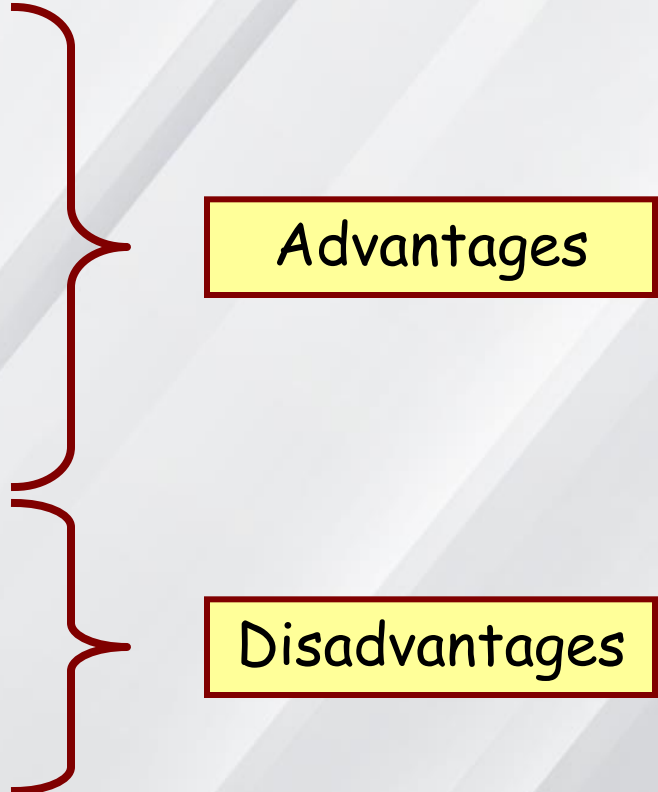
➤ Ford Motor Company
➤ Google

➤ Cargill Inc.

Characteristics of a Corporation

Characteristics that distinguish corporations from proprietorships and partnerships.

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



Advantages

The diagram features a list of eight characteristics of a corporation on the left. To the right of this list, two red curly braces are used to group the items. The top brace groups the first five items (Separate Legal Existence, Limited Liability of Stockholders, Transferable Ownership Rights, Ability to Acquire Capital, and Continuous Life) and points to a yellow box labeled 'Advantages'. The bottom brace groups the last three items (Government Regulations, Additional Taxes, and Corporate Management) and points to a yellow box labeled 'Disadvantages'.

Disadvantages

Characteristics of a Corporation

Characteristics that distinguish corporations from proprietorships and partnerships.

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

Corporation acts under its own name rather than in the name of its stockholders.

Characteristics of a Corporation

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- Limited Liability of Stockholders →
- Transferable Ownership Rights
- Ability to Acquire Capital
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- Corporate Management

Limited to their investment.

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Shareholders may sell their stock.

Characteristics of a Corporation

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- Corporate Management

Corporation can obtain capital through the issuance of stock.

Characteristics of a Corporation

Characteristics that distinguish corporations from proprietorships and partnerships.

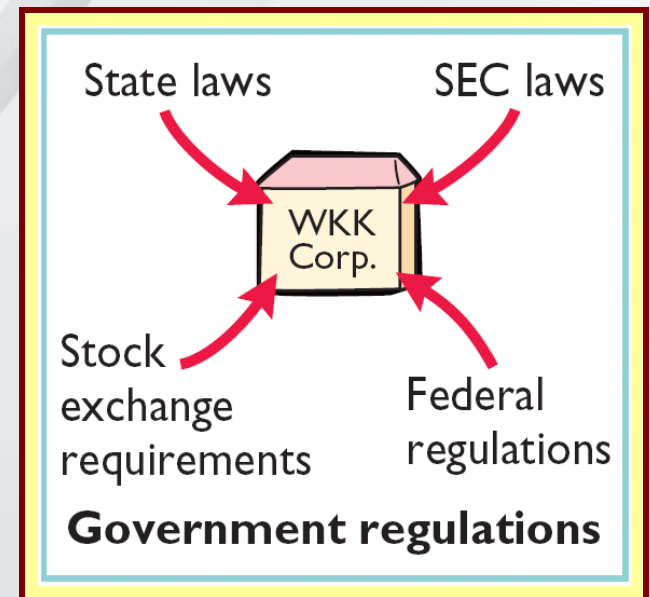
- Separate Legal Existence
- Limited Liability of Stockholders
- Transferable Ownership Rights
- Ability to Acquire Capital
- Continuous Life
- Government Regulations
- Additional Taxes
- Corporate Management

Continuance as a going concern is not affected by the withdrawal, death, or incapacity of a stockholder, employee, or officer.

Characteristics of a Corporation

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- Continuous Life
- Government Regulations
- Additional Taxes →
- Corporate Management

Corporations pay income taxes as a separate legal entity and **in addition**, stockholders pay taxes on cash dividends.

Forming a Corporation

Initial Steps:

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

Corporations expense organization costs as incurred.

Illustration 13-4

Class

Name of corporation
Stockholder's name

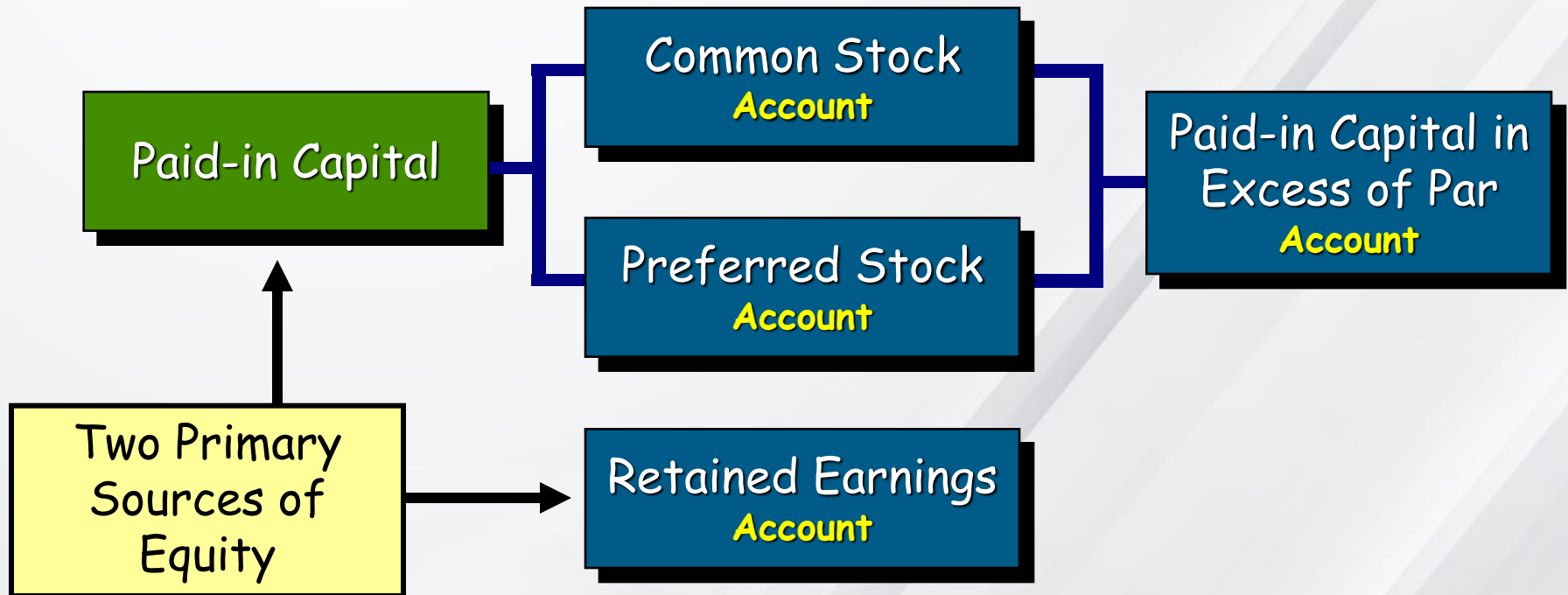
Signature of
corporate official

Prenumbered

Shares

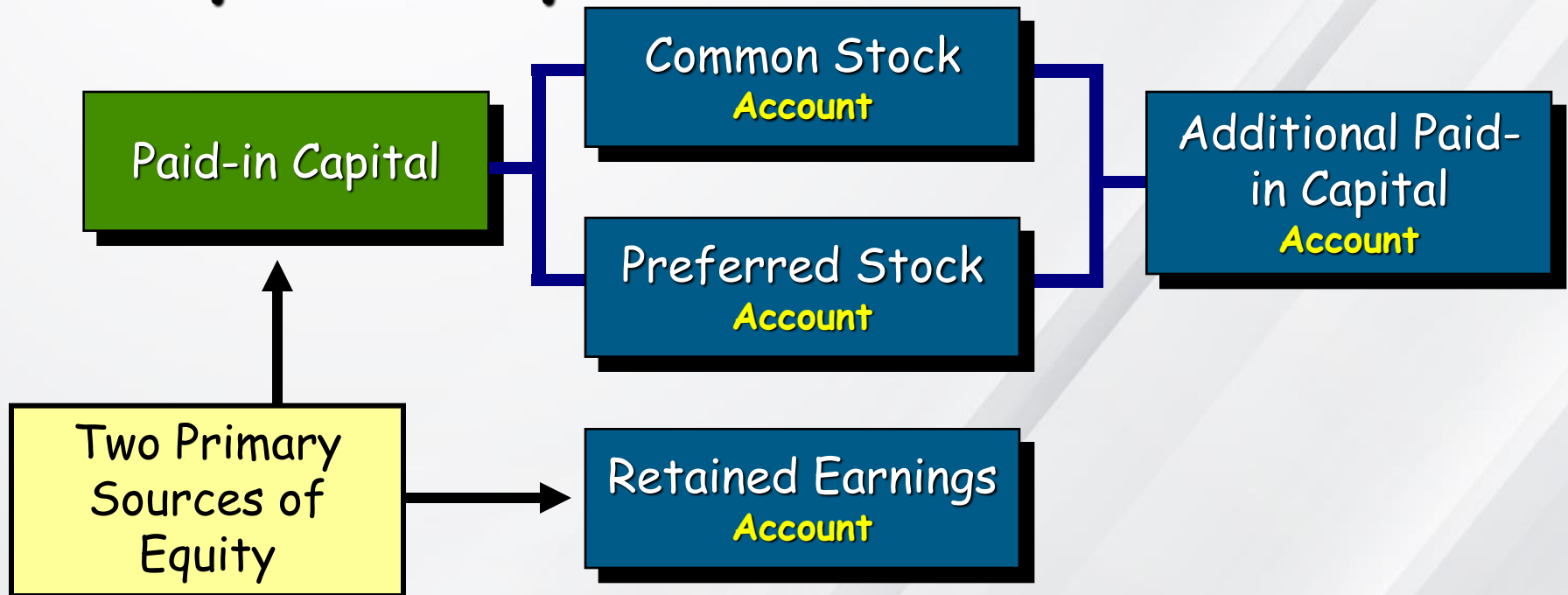


Corporate Capital



Paid-in capital is the total amount of cash and other assets paid in to the corporation by stockholders in exchange for capital stock.

Corporate Capital

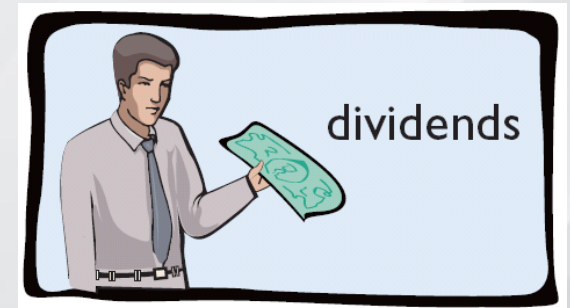


Retained earnings is net income that a corporation retains for future use.

Ownership Rights of Stockholders

Stockholders have the right to:

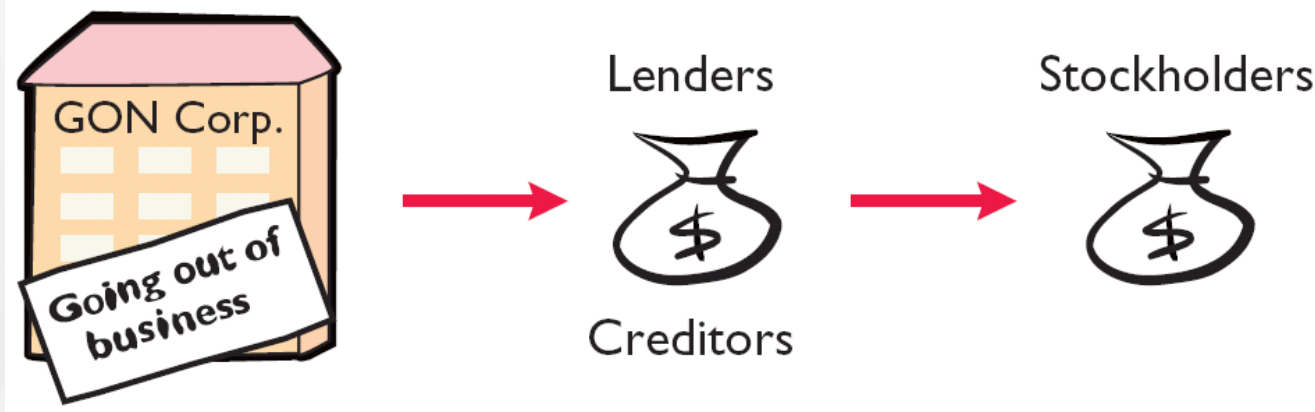
1. **Vote** (for common stocks only) in election of board of directors and on actions that require stockholder approval.
2. **Share** the corporate **earnings** through receipt of dividends.



Ownership Rights of Stockholders

Stockholders have the right to:

3. Share in assets upon liquidation in proportion to their holdings. This is called a **residual claim**.



Stock Issue Considerations

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.

Stock Issue Considerations

Issuance of Stock

- Corporation can issue common stock directly to investors or indirectly through an investment banking firm.
- Factors in setting price for a new issue of stock:
 1. the company's anticipated future earnings
 2. its expected dividend rate per share
 3. its current financial position
 4. the current state of the economy
 5. the current state of the securities market

Stock Issue Considerations

Par and No-Par Value Stock

- 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.

Corporate Capital

Comparison of the owners' equity (stockholders' equity) accounts reported on a balance sheet for a proprietorship, a partnership, and a corporation.

Proprietorship

Able, Capital

	Normal bal.
--	-------------

Partnership

Able, Capital

	Normal bal.
--	-------------

Baker, Capital

	Normal bal.
--	-------------

Corporation

Common Stock

	Normal bal.
--	-------------

Retained Earnings

	Normal bal.
--	-------------

Accounting for Common Stock Issues

Primary objectives:

- 1) Identify the specific sources of paid-in capital.
- 2) Maintain the distinction between paid-in capital and retained earnings.

The issuance of common stock affects only paid-in capital accounts.

Accounting for Common Stock Issues

Illustration: Viking Corporation issued 300 shares of \$10 par value common stock for \$4,100. Prepare Vikings' journal entry.

Cash	4,100	
Common stock (300 × \$10)		3,000
Paid-in capital in excess of par		1,100

Illustration: Knopfle Corporation issued 600 shares of no-par common stock for \$10,200. Prepare Knopfle's journal entry if (a) the stock has no stated value, and (b) the stock has a stated value of \$2 per share.

a.	Cash	10,200	
	Common stock		10,200
b.	Cash	10,200	
	Common stock (600 × \$2)		1,200
	Paid-in capital in excess of stated value		9,000

Accounting for Common Stock Issues

Issuing Common Stock for Services or Noncash Assets

Corporations also may issue stock for:

- Services (attorneys or consultants).
- Noncash assets (land, buildings, and equipment).

Cost is either the fair market value of the consideration given up, or the fair market value of the consideration received, whichever is more clearly determinable.

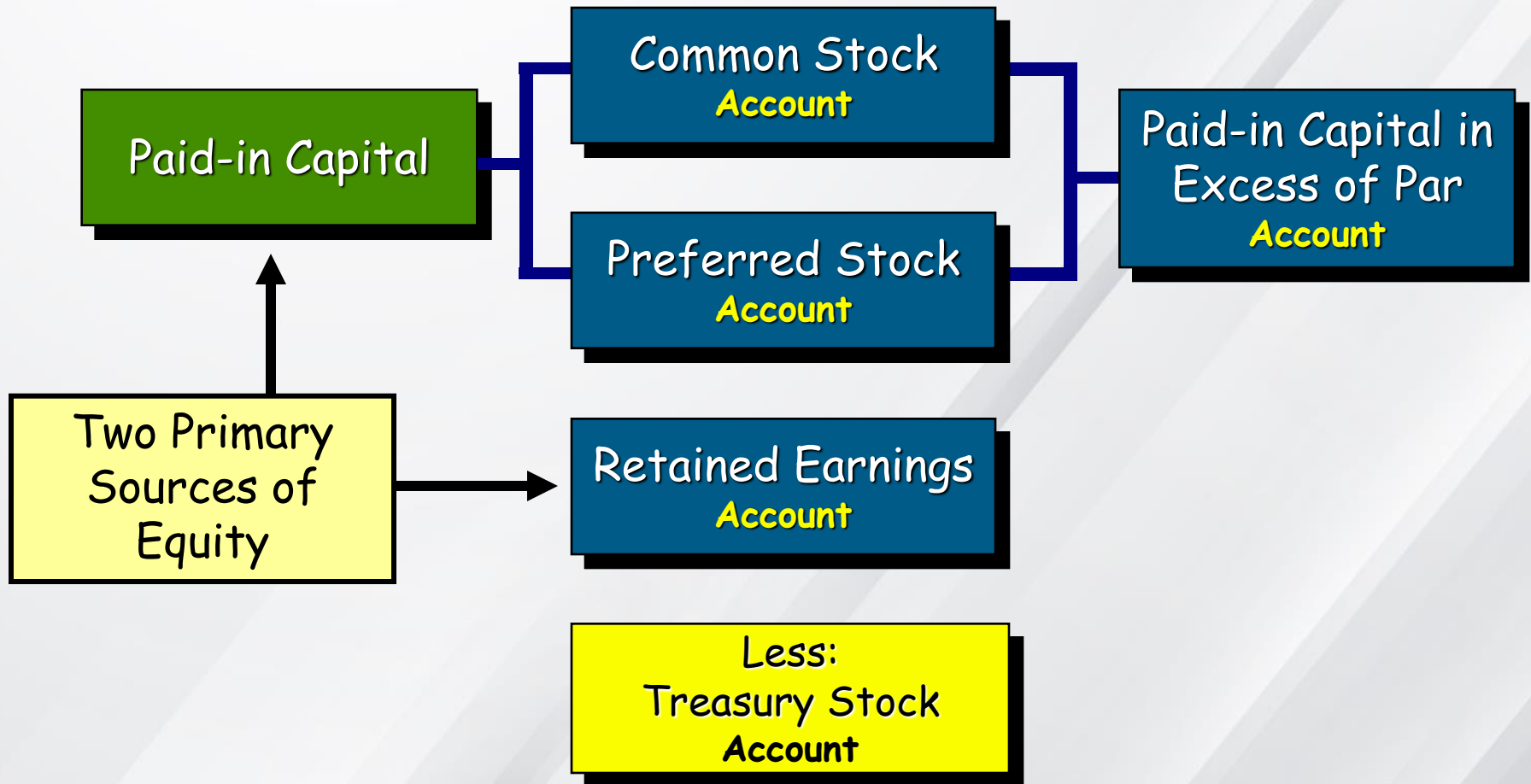
Ex On March 2nd, Leone Co. issued 5,000 shares of \$5 par value common stock to attorneys in payment of a bill for \$30,000 for services provided in helping the company to incorporate.

Organizational expense	30,000	
Common stock (5,000 × \$5)		25,000
Paid-in capital in excess of par		5,000

ex Hany Inc.'s \$10 par value common stock is actively traded at a market value of \$15 per share. Kane issues 5,000 shares to purchase land advertised for sale at \$85,000. Journalize the issuance of the stock in acquiring the land.

Land (5,000 × \$15)	75,000	
Common stock (5,000 × \$10)		50,000
Paid-in capital in excess of par		25,000

Accounting for Treasury Stock



Accounting for Treasury Stock

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 enhance the stocks market value.
3. To have additional shares available for use in the acquisition of other companies.
4. To increase earnings per share.
5. To rid the company of disgruntled investors, perhaps to avoid a takeover.

Purchase of Treasury Stock

- Debit Treasury Stock for the price paid to reacquire the shares.
- Treasury stock is a contra stockholders' equity account, not an asset.
- Purchase of treasury stock **reduces stockholders' equity**.

Illustration: UC Company originally issued 15,000 shares of \$1 par, common stock for \$25 per share. Record the journal entry for the following transaction:
On April 1st the company reacquired 1,000 shares for \$28 per share.

Treasury stock (1,000 × \$28)	28,000	
Cash		28,000

Accounting for Treasury Stock

Sale of Treasury Stock

- Above Cost
- Below Cost

Both increase total assets and stockholders' equity.

Accounting for Treasury Stock

Illustration: UC Company originally issued 15,000 shares of \$1 par, common stock for \$25 per share. On February 10, UC acquired 500 shares of its stock at \$28 per share. Record the journal entry for the following transaction:

On June 1, UC sold 500 shares of its treasury stock for \$30 per share.

Cash (500 × \$30)	15,000	
Treasury stock (500 × \$28)		14,000
Paid-in capital treasury stock		1,000

Accounting for Treasury Stock

Below
Cost

Illustration: UC Company originally issued 15,000 shares of \$1 par, common stock for \$25 per share. On February 10, UC acquires 500 shares of its stock for \$28 per share and on May 15 sold 200 shares of treasury for \$29 per share. Record the journal entry for the following transaction:

On October 15, UC sold the remaining 300 shares of its treasury stock for \$24 per share.

Cash (300 × \$24)	7,200	
Paid-in capital treasury stock	200	←
Retained earnings	1,000	
Treasury stock (300 × \$28)		8,400

Limited
to
balance
on hand

Preferred Stock

Features often associated with preferred stock.

1. Preference as to dividends.
2. Preference as to assets in liquidation.
3. Nonvoting.

Accounting for preferred stock at issuance is similar to that for common stock.

Preferred Stock

ex Acker Inc. issues 5,000 shares of \$100 par value preferred stock for cash at \$130 per share. Journalize the issuance of the preferred stock.

Cash (5,000 × \$130)	650,000	
Preferred stock (5,000 × \$100)		500,000
Paid-in capital in excess of par - Preferred stock		150,000

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

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.

Stockholders' Equity Section

...% Cumulative preferred stock , L.E ... Par value, Authorized ... Shares, issued shares	X
....% Non-cumulative preferred stock , L.E ... Par value, Authorized ... Shares, issued shares	X
Common stock , L.E ... par value, Authorized ... Shares, issued shares	X
Total capital stock (Legal capital)	XX
* Additional paid in capital (issue price - par value)	
- Preferred stock	X
- Common stock	X
Total additional paid-in Capital	XX
Total paid-in capital	XX
+ Retained earnings Or (-) Deficit (-) Treasury stock	
Total stockholders' equity	XX

Do IT

When **Zaher**, inc. was formed, the company was authorized to issue 5000 shares of L.E 100 par value, 8% cumulative preferred stock, and 100.000 shares of L.E 2 par value common stock..

Half of preferred stock was issued at a price of L.E 103 per share, and 70000 shares of the common stock were sold for L.E 13 per share. At the end of the current year, **Zaher**, inc. has retained earning of L.E 297.000.

Required:

Prepare the **stockholders' equity section**

8% cumulative preferred stock, L.E 100 par value, callable at L.E 106, 5000 shares authorized, <u>2500</u> shares issued.	250.000 (1)
Common stock L.E 2 par value, 100.000 shares authorized, <u>70.000</u> shares issued	140.000 (2)
Total capital stock	390.000
<u>Additional paid-in capital</u>	
Preferred stock (2500×3)	7500 (3)
Common stock (70000×11)	770.000 (4)
Total additional paid-in capital	777.500
Total paid-in capital	1.167.500
Retained earnings	297.000
Total stockholders' equity	1.464.500

Book Value per share

$$\text{Book Value Per Share} = \frac{\text{Total Stockholders' Equity}^*}{\text{Number of Common Shares Outstanding}}$$

Book value per share generally does not equal market value per share.

* When a company has preferred stock, the preferred stockholders claim on net assets must be deducted from total stockholders' equity.

Thank You