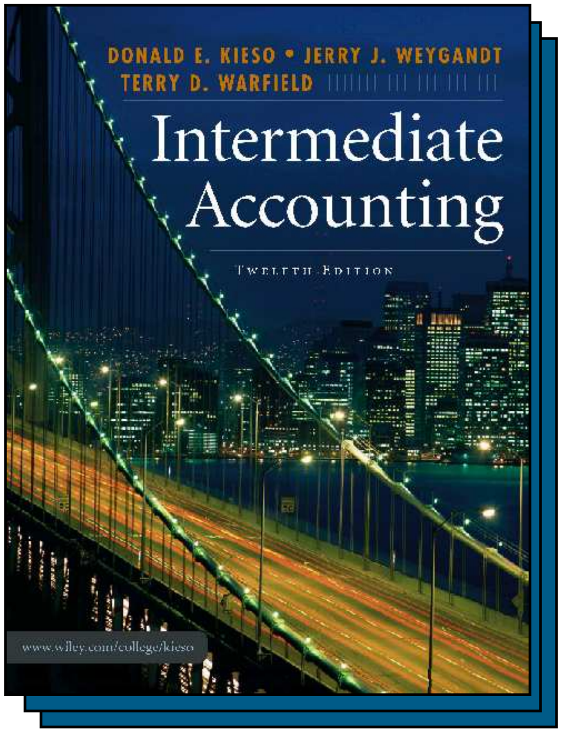
Accounting and Reporting of Stockholders' Equity

Chapter 15

Intermediate Accounting
12th Edition
Kieso, Weygandt, and Warfield



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Learning Objectives

1. Discuss the characteristics of the corporate form of organization.
2. Identify the key components of stockholders' equity.
3. Explain the accounting procedures for issuing shares of stock.
4. Describe the accounting for treasury stock.
5. Explain the accounting for and reporting of preferred stock.
6. Describe the policies used in distributing dividends.
7. Identify the various forms of dividend distributions.
8. Explain the accounting for small and large stock dividends, and for stock splits.
9. Indicate how to present and analyze stockholders' equity.

Stockholders' Equity

The Corporate Form

- State corporate law
- Capital stock or share system
- Variety of ownership interests

Corporate Capital

- Issuance of stock
- Reacquisition of shares

Preferred Stock

- Features
- Accounting for and reporting preferred stock

Dividend Policy

- Financial condition and dividend distributions
- Types of dividends
- Stock split
- Disclosure of restrictions

Presentation and Analysis

- Presentation
- Analysis

The Corporate Form of Organization

Three primary forms of business organization

Proprietorship	Partnership	Corporation

Special characteristics of the corporate form:

1. Influence of state corporate law.
2. Use of capital stock or share system.
3. Development of a variety of ownership interests.

LO 1 Discuss the characteristics of the corporate form of organization.

The Corporate Form of Organization

State Corporate Law

Corporation must submit **articles of incorporation** to the state in which incorporation is desired.

- **General Motors** - incorporated in Delaware.
- **U.S. Steel** - incorporated in New Jersey.

Accounting for stockholders' equity follows the provisions of each states business incorporation act.

LO 1 Discuss the characteristics of the corporate form of organization.

The Corporate Form of Organization

Capital Stock or Share System

In the absence of restrictive provisions, each share carries the following rights:

1. To share proportionately in profits and losses.
2. To share proportionately in management (the right to vote for directors).
3. To share proportionately in assets upon liquidation.
4. To share proportionately in any new issues of stock of the same class—called the **preemptive right**.

The Corporate Form of Organization

Variety of Ownership Interests

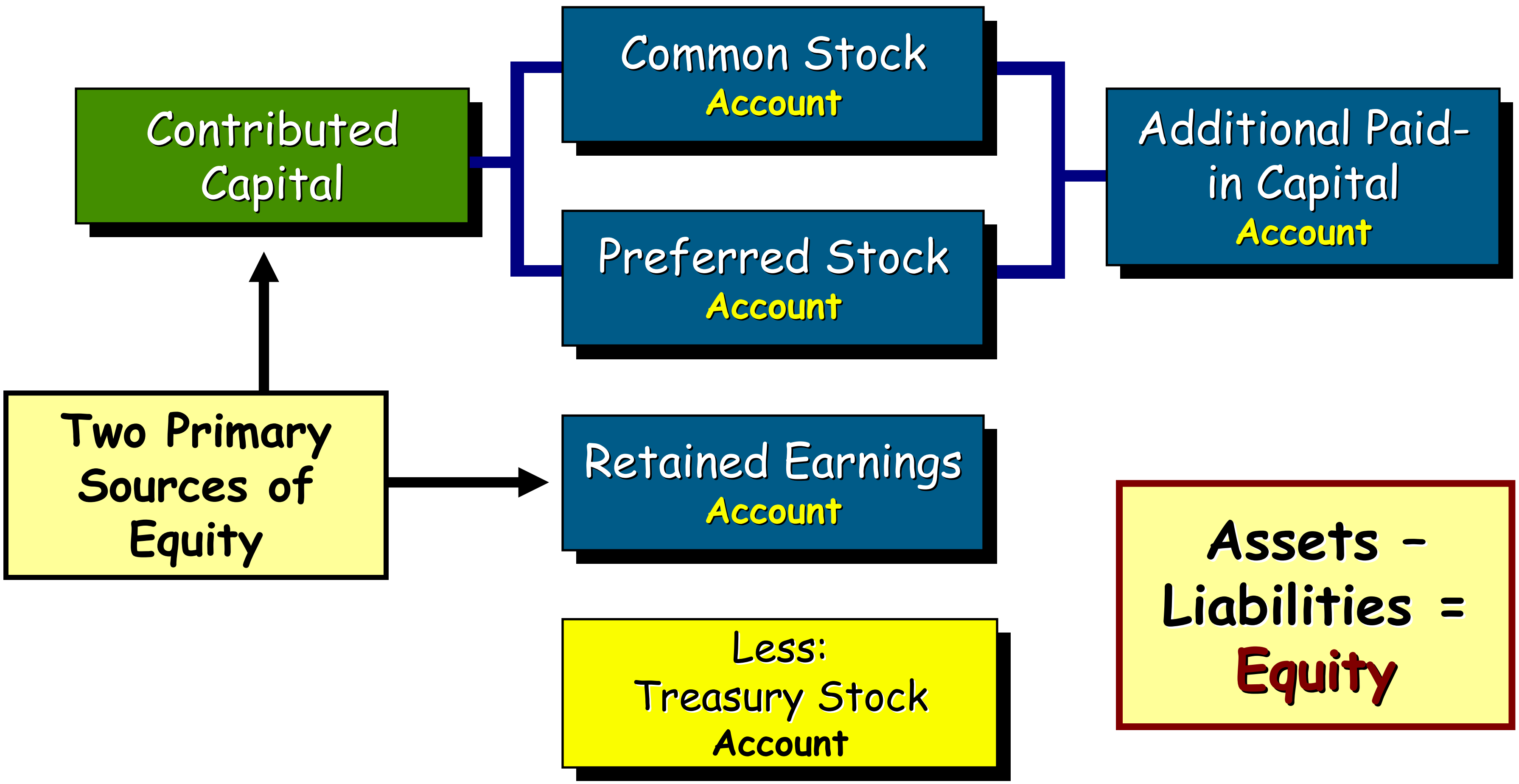
Common stock represents basic ownership interest.

- Bears ultimate risks of loss.
- Receives the benefits of success.
- Not guaranteed dividends nor assets upon dissolution.

Preferred stock is created by contract, when stockholders' sacrifice certain rights in return for other rights or privileges, usually dividend preference.

LO 1 Discuss the characteristics of the corporate form of organization.

Corporate Capital



LO 2 Identify the key components of stockholders' equity.

Corporate Capital

Issuance of Stock

Shares authorized - Shares sold - Shares issued

Accounting problems:

1. Par value stock.
2. No-par stock.
3. Stock issued with other securities.
4. Stock issued in noncash transactions.
5. Costs of issuing stock.

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

Par Value Stock

Low par values help companies avoid a contingent liability.

Corporations maintain accounts for:

- Preferred Stock or Common Stock.
- Additional Paid-in Capital

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

BE15-1: Lost Vikings Corporation issued 300 shares of $10 par value common stock for $4,100. Prepare Lost Vikings' journal entry.

Journal entry:

Cash	4,100	
Common stock (300 x $10)		3,000
Additional paid-in capital		1,100

Corporate Capital

No-Par Stock

Reasons for issuance:

- Avoids contingent liability.
- Avoids confusion over recording par value versus fair market value.

Some states require that no-par stock have a **stated value**.

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

BE15-2: Shinobi Corporation issued 600 shares of no-par common stock for $10,200. Prepare Shinobi's journal entry if (a) the stock has no stated value, and (b) the stock has a stated value of $2 per share.

Journal entry:

		Debit	Credit
a.	Cash	10,200	
	Common stock		10,200
b.	Cash	10,200	
	Common stock (600 x $2)		1,200
	Additional paid-in capital		9,000

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

Stock Issued with Other Securities

Two methods of allocating proceeds:

1. the **proportional** method and
2. the **incremental** method.

Corporate Capital

BE15-4: Primal Rage Corporation issued 300 shares of $10 par value common stock and 100 shares of $50 par value preferred stock for a lump sum of $14,200. The common stock has a market value of $20 per share, and the preferred stock has a market value of $90 per share.

	Number		Amount		Total	Percent
Common stock	300	x	$ 20.00	=	$ 6,000	40%
Preferred stock	100	x	90.00		9,000	60%
		Fair Market Value			$ 15,000	100%

Allocation:	Common	Preferred
Issue price	$ 14,200	$ 14,200
Allocation %	40%	60%
Total	$ 5,680	$ 8,520

Proportional Method

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

BE15-4: Primal Rage Corporation issued 300 shares of $10 par value common stock and 100 shares of $50 par value preferred stock for a lump sum of $14,200. The common stock has a market value of $20 per share, and the preferred stock has a market value of $90 per share.

Journal entry (Proportional):

Cash	14,200	
Preferred stock (100 x $50)		5,000
Additional paid-in capital-preferred		3,520
Common stock (300 x $10)		3,000
Additional paid-in capital-common		2,680

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

BE15-4: (Variation) Primal Rage Corporation issued 300 shares of $10 par value common stock and 100 shares of $50 par value preferred stock for a lump sum of $14,200. The common stock has a market value of $20 per share, and the value of the preferred stock is unknown.

	Number		Amount		Total
Common stock	300	x	$ 20.00	=	$ 6,000
Preferred stock	100	x			-
			Fair Market Value		$ 6,000

Allocation:	Common	Preferred
Issue price		$ 14,200
Common		(6,000)
Total	$ 6,000	$ 8,200

Incremental Method

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

BE15-4: (Variation) Primal Rage Corporation issued 300 shares of $10 par value common stock and 100 shares of $50 par value preferred stock for a lump sum of $14,200. The common stock has a market value of $20 per share, and the value of the preferred stock is unknown.

Journal entry (Incremental):

Cash	14,200	
Preferred stock (100 x $50)		5,000
Additional paid-in capital-preferred		3,200
Common stock (300 x $10)		3,000
Additional paid-in capital-common		3,000

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

Stock Issued in Noncash Transactions

The general rule: Companies should record stock issued for services or property other than cash at either the:

- fair value of the stock issued or
- fair value of the noncash consideration received,

whichever is more clearly determinable.

Corporate Capital

E15-2: Kathleen Battle Corporation was organized on January 1, 2007. It is authorized to issue 500,000 shares of no par common stock with a stated value of $1 per share. Prepare the journal entry to record the following.

April 1 Issued 24,000 shares of common stock for land. The asking price of the land was $90,000; the fair market value of the land was $80,000.

Land	80,000	
Common stock (24,000 x $1)		24,000
Additional paid-in capital		56,000

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

E15-2: Kathleen Battle Corporation was organized on January 1, 2007. It is authorized to issue 500,000 shares of no par common stock with a stated value of \$1 per share. Prepare the journal entry to record the following.

Aug. 1 Issued 10,000 shares of common stock to attorneys in payment of their bill of \$50,000 for services rendered in helping the company organize.

Organization expense	50,000	
Common stock (10,000 x \$1)		10,000
Additional paid-in capital		40,000

LO 3 Explain the accounting procedures for issuing shares of stock.

Corporate Capital

Costs of Issuing Stock

Direct costs incurred to sell stock, such as

- underwriting costs,
- accounting and legal fees,
- printing costs, and
- taxes,

should be reported as a **reduction** of the amounts paid in (additional paid-in capital).

Corporate Capital

Reacquisition of Shares

Corporations purchase their outstanding stock:

- To provide tax-efficient distributions of excess cash to shareholders.
- To increase earnings per share and return on equity.
- To provide stock for employee stock compensation contracts or to meet potential merger needs.
- To thwart takeover attempts or to reduce the number of stockholders.
- To make a market in the stock.

Corporate Capital

Purchase of Treasury Stock

Two acceptable methods:

- Cost method (more widely used).
- Par or Stated value method.

Treasury stock, reduces stockholders' equity.

LO 4 Describe the accounting for treasury stock.

Corporate Capital

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:

April 1st the company re-acquired 1,000 shares for $28 per share.

Treasury stock (1,000 x $28)	28,000	
Cash		28,000

LO 4 Describe the accounting for treasury stock.

Corporate Capital

Sale of Treasury Stock

- Above Cost
- Below Cost

Both increase total assets and stockholders' equity.

Corporate Capital

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:

June 1st Sold 500 shares of its Treasury Stock for $30 per share.

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

Corporate Capital

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:

Oct. 15th Sold 300 shares of its Treasury Stock for $9 per share.

Cash (300 x $9)	2,700	
Treasury stock (300 x $28)		8,400
Paid-in capital treasury stock	1,000	
Retained earnings	4,700	

Limited to balance on hand

LO 4 Describe the accounting for treasury stock.

Corporate Capital

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:

Oct. 30th Sold 100 shares of its Treasury Stock for $11 per share.

Cash (100 x $11)	1,100	
Treasury stock (100 x $28)		2,800
Retained earnings	1,700	

Corporate Capital

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:

Nov. 10th Retired remaining 100 shares of its Treasury Stock.

Common stock (100 x $1)	100	
Paid-in capital common (100 x $24)	2,400	
Treasury stock (100 x $28)		2,800
Retained earnings	300	

Corporate Capital

Illustration 15-4

Stockholders' Equity with No Treasury Stock

Stockholders' equity	
Paid-in capital	
Common stock, $1 par value, 100,000 shares issued and outstanding	$ 100,000
Additional paid-in capital	900,000
Total paid-in capital	1,000,000
Retained earnings	300,000
Total stockholders' equity	$1,300,000

LO 4 Describe the accounting for treasury stock.

Corporate Capital

Illustration 15-5

Stockholders' Equity with Treasury Stock

Stockholders' equity	
Paid-in capital	
Common stock, $1 par value, 100,000 shares issued and 90,000 outstanding	$ 100,000
Additional paid-in capital	900,000
Total paid-in capital	1,000,000
Retained earnings	300,000
Total paid-in capital and retained earnings	1,300,000
Less: Cost of treasury stock (10,000 shares)	110,000
Total stockholders' equity	$1,190,000

LO 4 Describe the accounting for treasury stock.

Preferred Stock

Features often associated with preferred stock.

1. Preference as to dividends.
2. Preference as to assets in liquidation.
3. Convertible into common stock.
4. Callable at the option of the corporation.
5. Nonvoting.

LO 5 Explain the accounting for and reporting of preferred stock.

Preferred Stock

Specific Features of Preferred Stock

- Cumulative
- Participating
- Convertible
- Callable
- Redeemable

A corporation may attach whatever preferences or restrictions, as long as it does not violate its state incorporation law.

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

LO 5 Explain the accounting for and reporting of preferred stock.

Dividend Policy

Dividend distributions generally are based on accumulated profits (retained earnings).

Few companies pay dividends in amounts equal to their legally available retained earnings. Why?

- Maintain agreements with creditors.
- Meet state incorporation requirements.
- To finance growth or expansion.
- To smooth out dividend payments.
- To build up a cushion against possible losses.

LO 6 Describe the policies used in distributing dividends.

Types of Dividends

1. Cash dividends.
2. Property dividends.
3. Liquidating dividends.
4. Stock dividends.

Dividends require information concerning three dates:

a. Date of declaration

b. Date of record

c. Date of payment

Types of Dividends

Cash Dividends

- Board of directors vote on the declaration of cash dividends.
- A declared cash dividend is a liability.
- Companies do not declare or pay cash dividends on treasury stock.

LO 7 Identify the various forms of dividend distributions.

Cash Dividend

Illustration What would be the journal entries made by a corporation that declared a $50,000 cash dividend on March 10, payable on April 6 to shareholders of record on March 25?

	Debit	Credit
March 10 (Declaration Date)		
Retained earnings	50,000	
Dividends payable		50,000
March 25 (Date of Record)	No entry	
April 6 (Payment Date)		
Dividends payable	50,000	
Cash		50,000

Types of Dividends

Property Dividends

- Dividends payable in assets other than cash.
- Restate at fair value the property it will distribute, recognizing any gain or loss.

Property Dividend

Illustration A dividend is declared Jan. 5th and paid Jan. 25th, in bonds held as an investment; the bonds have a book value of $100,000 and a fair market value of $135,000.

Date of Declaration	Debit	Credit
Investment in bonds	35,000	
Gain on investment		35,000
and		
Retained earnings	135,000	
Property dividend payable		135,000
Date of Issuance		
Property dividend payable	135,000	
Investment in bonds		135,000

LO 7 Identify the various forms of dividend distributions.

Types of Dividends

Liquidating Dividends

- Any dividend not based on earnings reduces corporate paid-in capital.

Liquidating Dividend

BE15-12 Radical Rex Mining Company declared, on April 20, a dividend of $700,000 payable on June 1. Of this amount, $125,000 is a return of capital. Prepare the April 20 and June 1 entries for Radical Rex.

	Debit	Credit
April 20 (Declaration Date)		
Retained earnings	575,000	
Additional paid-in capital	125,000	
Dividends payable		700,000
June 1 (Payment Date)		
Dividends payable	700,000	
Cash		700,000

LO 7 Identify the various forms of dividend distributions.

Types of Dividends

Stock Dividends

- Issuance of own stock to stockholders on a pro rata basis, without receiving any consideration.
- When stock dividend is less than 20–25 percent of the common shares outstanding, company transfers **fair market value** from retained earnings (**small stock dividend**).

LO 8 Explain the accounting for small and large stock dividends, and for stock splits.

Stock Dividend

Illustration HH Inc. has 5,000 shares issued and outstanding. The per share par value is $1, book value $32 and market value is $40.

10% stock dividend is declared	Debit	Credit
Retained earnings	20,000	
Common stock dividend distributable		500
Additional paid-in capital		19,500

Stock issued	Debit	Credit
Common stock div. distributable	500	
Common stock		500

LO 8 Explain the accounting for small and large stock dividends, and for stock splits.

Types of Dividends

Stock Split

- To reduce the market value of shares.
- No entry recorded for a stock split.
- Decrease par value and increased number of shares.

LO 8 Explain the accounting for small and large stock dividends, and for stock splits.

Stock Dividend

Illustration HH Inc. has 5,000 shares issued and outstanding. The per share par value is $1, book value $32 and market value is $40.

2 for 1 Stock Split

No Entry -- Disclosure that par is now $.50 and shares outstanding are 10,000.

Types of Dividends

Stock Split and Stock Dividend Differentiated

- If the stock dividend is large, it has the same effect on market price as a stock split.
- A stock dividend of more than 20–25 percent of the number of shares previously outstanding is called a **large stock dividend**.
- With a large stock dividend, transfer from retained earnings to capital stock the **par value** of the stock issued.

Stock Dividend

Illustration HH Inc. has 5,000 shares issued and outstanding. The per share par value is $1, book value $32 and market value is $40.

50% stock dividend is declared	Debit	Credit
Retained earnings	2,500	
Common stock dividend distributable		2,500

Stock issued	Debit	Credit
Common stock dividend distributable	2,500	
Common stock		2,500

LO 8 Explain the accounting for small and large stock dividends, and for stock splits.

Presentation and Analysis of Stockholders' Equity

Presentation

Balance Sheet

Illustration 15-13

FROST CORPORATION
STOCKHOLDERS' EQUITY
DECEMBER 31, 2007

Capital stock		
Preferred stock, $100 par value, 7% cumulative, 100,000 shares authorized, 30,000 shares issued and outstanding		$ 3,000,000
Common stock, no par, stated value $10 per share, 500,000 shares authorized, 400,000 shares issued		4,000,000
Common stock dividend distributable, 20,000 shares		200,000
Total capital stock		7,200,000
Additional paid-in capital[21]		
Excess over par—preferred	$150,000	
Excess over stated value—common	840,000	990,000
Total paid-in capital		8,190,000
Retained earnings		4,360,000
Total paid-in capital and retained earnings		12,550,000
Less: Cost of treasury stock (2,000 shares, common)		(190,000)
Accumulated other comprehensive loss[22]		(360,000)
Total stockholders' equity		$12,000,000

LO 9 Indicate how to present and analyze stockholders' equity.

Presentation and Analysis of Stockholders' Equity

Presentation Statement of Stockholders' Equity

Illustration 15-14

(in millions, except number of shares in thousands)	Common Stock Number of Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance October 31, 2003	3,042,761	$30	$24,587	$13,332	$ (203)	$37,746
Net earnings				3,497		3,497
Net unrealized loss on available-for-sale securities					(20)	(20)
Net unrealized loss on cash flow hedges					(28)	(28)
Minimum pension liability, net of taxes					(13)	(13)
Cumulative translation adjustment					21	21
Comprehensive income						3,457
Assumption of stock options in connection with business acquisitions			15			15
Issuance of common stock in connection with employee stock plans and other	40,467		592			592
Repurchases of common stock	(172,468)	(1)	(3,100)	(208)		(3,309)
Tax benefit from employee stock plans			35			35
Dividends				(972)		(972)
Balance October 31, 2004	2,910,760	$29	$22,129	$15,649	$(243)	$37,564

LO 9 Indicate how to present and analyze stockholders' equity.

Presentation and Analysis of Stockholders' Equity

Analysis

Rate of Return on Common Stock Equity $= \dfrac{\text{Net income} - \text{Preferred dividends}}{\text{Average common stockholders' equity}}$

Ratio shows how many dollars of net income the company earned for each dollar invested by the owners.

Presentation and Analysis of Stockholders' Equity

Analysis

$$\textbf{Payout Ratio} = \frac{\text{Cash dividends}}{\text{Net income} - \text{Preferred dividends}}$$

It is important to some investors that the payout be sufficiently high to provide a good yield on the stock.

Presentation and Analysis of Stockholders' Equity

Analysis

$$\text{Book Value Per Share} = \frac{\text{Common stockholders' equity}}{\text{Outstanding shares}}$$

The amount each share would receive if the company were liquidated on the basis of amounts reported on the balance sheet.

LO 9 Indicate how to present and analyze stockholders' equity.

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