Corporations: Paid-in Capital and the Balance Sheet

Learning Objective 1

Identify the distinguishing characteristics of a corporation

Advantages and Disadvantages of a Corporation

ADVANTAGES

- Ability to raise money
- Continuous life
- Easy to transfer ownership
- No mutual agency
- Limited liability

DISADVANTAGES

- Separation of ownership and management
- Double taxation
- Expensive government regulation

Capital Stock

- State **authorizes** how many shares of stock a corporation may issue through corporate bylaws
- Corporation **issues** stock certificates when stockholders buy stock
  - Basic unit of stock is a share
- Stock held by stockholders is **outstanding**

Learning Objective 2

- Describe the two sources of stockholders’ equity and the classes of stock

Stockholders' Equity

Paid-in capital

- Amounts received from stockholders
- Common stock is main source
- Externally generated
- Resulting from transactions with outsiders

Retained earnings

- Earned Internally generated
- y profitable operations
- Results from internal corporate decisions and earnings

Classes of Stock

Common stock

- Basic form of capital stock

Preferred stock

- Owners have certain advantages over common
  - Receive dividends before common
  - Upon liquidation, receive assets before common
  - Right to vote sometimes withheld

Learning Objective 3

Journalize the issuance of stock and prepare the stockholders’ equity section of a corporation balance sheet

Accounting for the Issuance of Stock

Issue stock at par					
General Journal					
Date			Ref	Debit	Credit
	Cash				
		Common stock			

Accounting for the Issuance of Stock

Issue stock at a premium					
General Journal					
Date			Ref	Debit	Credit
	Cash				
		Common stock			
		Paid-in capital in excess of par			

Accounting for Stock Issuances

- Issuing stock for noncash assets
  - Asset is debited for its fair value
- Issuing preferred stock
  - Similar to issuing common stock, except "Preferred stock" is credited at par value
  - Preferred stock usually is not issued above par

Stockholders’ Equity on the Balance Sheet

- Equity accounts are listed in the following order on the balance sheet
  - Preferred stock
  - Paid-in capital in excess of par – preferred
  - Common stock
  - Paid-in capital in excess of par – common
  - Retained earnings

Example

Any Company Balance Sheet December 30, 2010	
Stockholders' Equity	
Preferred stock, 6%, $50 par, 2000 shares authorized and issued	$ 100,000
Paid-in capital in excess of par - preferred	5,000
Common stock, $1 par, 1,000,000 shares authorized, 500,000 issued	500,000
Paid-in capital in excess of par - common	750,000
Total paid-in captial	1,355,000
Retained earnings	715,000
Total stockholders' equity	$ 2,070,000

Learning Objective 4

Illustrate Retained earnings transactions

Retained Earnings

General Journal					
Date			Ref	Debit	Credit
	Income summary				
		Retained earnings			

Deficit Balance

- If a company incurs a loss, Retained earnings is decreased
- A debit balance in Retained earnings is called a **deficit**

Learning Objective 5

Account for cash dividends

Dividends

- Preferred dividends expressed as either:
  - A percent of par value

    2,000 shares of $100 par 8% preferred = $16,000 dividend

  - Or a flat dollar amount per share

    2,000 shares of no-par $3 preferred = $6,000 dividend

  - Common dividends expressed as a dollar amount per share

Accounting for Dividends

General Journal				
Date		Ref	Debit	Credit
	Retained earnings			
	Dividends payable			
	Declaration of cash dividend			
	Dividends payable			
	Cash			
	Payment of cash dividend			

Dividing Dividends Between Preferred and Common

- Preferred stockholders receive dividends before common
- Common stockholders will only receive dividends if total declared is large enough

Cumulative and Noncumulative Preferred Stock

- Cumulative preferred stock
  - Accumulates dividends each year until the dividends are paid
  - Dividends in arrears - dividends passed or not paid
- Noncumulative preferred stock
  - Dividends not paid do not accumulated from one year to the next