|  |
| --- |
| CHAPTER 11 – CORPORATE REPORTING AND ANALYSISChapter Outline |
| **I. Corporate Form of Organization**—An entity that is separate from its owners and has many of the same rights and privileges as individuals. Owners are called *stockholders.* A *publicly held* corporation offers its stock for public sale (organized stock market) whereas a *privately held* (closely held) corporation does not.  |
| A. Corporate Advantages  |
| 1. Separate legal entity—a corporation has many of the same rights, duties, and responsibilities as a person. Takes actions through its agents, who are officers and managers.2. Limited liability—stockholders are not liable for corporate actions or debt.3. Transferable ownership rights—transfer of shares generally has no direct effect on operations except when it causes a change in directors who oversee the corporation.4. Continuous life⎯corporation’s life is indefinite because it is not tied to physical life of owners.5. No mutual agency for stockholders—stockholders, who are not officers and managers, cannot bind the corporation to contracts, called *lack of mutual agency*.6. Easier capital accumulation—Buying stock is attractive to investors because of the advantages above, which helps corporations collect large sums of money. |
| B. Corporation Disadvantages  |
| 1. Governmental regulation—must follow a state’s incorporation laws.2. Corporate taxation—corporate income is taxed; and when income is distributed to shareholders as dividends, it is taxed a second time as personal income (*double taxation*). |
| C. Corporate Organization and Management |
| 1. Incorporation—A corporation is created by getting a charter from a state government. A charter application, signed by prospective stockholders (*incorporators or promoters*) must be filed with the state and fees must be paid.2. Organization Expenses (*organization costs*)—costs to start the corporation and include legal fees, promoters’ fees, and payments for a charter. Expensed as incurred. |
| 3. Management  |
| a. Stockholders control corporation by electing its board of directors. A stockholder usually has one vote for each share of stock owned.b. Board of directors (BOD) is in charge of hiring and firing key executives who manage day-to-day operations. |
| c. Executive officers (appointed by the BOD) manage the day-to-day direction of corporation. President is often the chief executive officer (CEO) unless one person has the dual role of chairperson of the BOD and CEO, then the president is the chief operation officer (COO). |
| D. Corporate Stockholders |
| 1. Rights of Stockholders—*Specific* rights are granted by the charter and *general* rights by state laws. State laws vary but common stockholders general rights usually include right to: |
| a. Vote at stockholders’ meeting.1. Sell or otherwise dispose of their stock.
2. Purchase their proportional shares of any common stock later issued; called *preemptive right*.
3. Receive the same dividend, if any, on each common share of the corporation.
4. Share equally, on a per share basis, in any assets remaining after creditors and preferred stockholders are paid when and if in liquidation.
 |
| 1. Stock Certificates and Transfer
2. Stock certificate is sometimes received as proof of share ownership.
3. Certificates show the company name, stockholder name, number of shares, and other crucial information.
4. Issuances of stock certificates is becoming less common.
 |
| 1. Registrar and Transfer Agents—if stock is traded on a stock exchange, the corporation has a registrar and transfer agent (usually large banks or financial institutions).
2. *Registrar*—keeps a list of stockholders for stockholders’ meetings and dividend payments.
3. *Transfer agent*—assists with purchases and sales of shares.
 |
| E. Corporate Stock —shares issued to obtain capital (owner financing).  |
| 1. **Authorized Stock**—the total amount of stock that the charter authorizes for sale. No journal entry is required for stock authorization.
2. *Outstanding stock* is stock held by stockholders.
3. Corporation must apply for a change in its charter if it wishes to issue more shares than previously authorized.

2. Selling (Issuing) Stock—can be sold directly/indirectly to stockholders. |
| 3. Market Value of Stock—the price at which a stock is bought and sold.  |
| a. Influenced by expected future income, dividends, growth, and economic events.b. Current market value of previously issued shares does not impact that corporation’s stockholders’ equity accounts. |
| 4. Classes of Stock |
| a. Common—the name of stock when all classes have same rights and privileges. b. Preferred stock—gives its owners a priority status over common stockholders in one or more ways.c. Additional classes—corporation may issue more than one class of common and/or preferred stock. |
| 5. Par Value Stock—a class of stock that is assigned a value per share by the corporation in its charter. |
| a. Printed on the stock certificate.b. In many states, used to establish minimum legal capital. |
| 6. No-Par Value Stock—*not* assigned a value per share by the corporate charter.7. Stated Value Stock—no-par stock that is assigned a “stated” value per share by the directors. This stated value becomes legal capital.8. Stockholders’ (Shareholders’) Equity—has two parts: |
| a. Paid-in capital (contributed capital)—the total amount of cash and other assets received by the corporation from its stockholders in exchange for stock.b. Retained earnings—the cumulative net income and losses not distributed as dividends to stockholders. |
| **II. Common Stock—**Issuance of stock affects only paid-in capital accounts, not retained earnings accounts.  |
| 1. Issuing Par Value Stock

1. Issuing Par Value Stock at Par—debit Cash for # shares issued × market price and credit Common Stock for # shares issued × par value2. Issuing Par Value Stock at a Premium*—Premium on stock* is an amount paid in excess of par by the purchasers of newly issued stock. |
| a. Debit Cash (# shares issued × market price)b. Credit Common Stock (# shares issued × par value)c. Credit Paid-In Capital in Excess of Par Value, Common Stock (for the amount of the premium) |
| 3. Issuing Par Value Stock at a Discount— *Discount* occurs when stock is sold for less than its par value (prohibited by most states)*.* |
| a. Debit Cash (# shares issued × market price)b. Credit Common Stock (# shares issued × par value)c. Debit Discount on Common Stock, a contra to the common stock account (for the amount of the discount).d. When allowed, the purchasers usually become contingently liable to the corporation’s creditors for the amount of the discount. |
| 1. Issuing No-Par Value StockWhen no-par stock is issued, the entire amount received is credited to a no-par value stock account.
2. Issuing Stated Value StockThe stated value is credited to the stock account. Any amount above the stated value, is credited to Paid-In Capital in Excess of Stated Value, Common Stock.
 |
| D. Issuing Stock for Noncash Assets |
| 1. Issuing par value stock for other assets
2. Record the transaction at the market value of the noncash asset as of the transaction date.
3. Record par value or stated value of stock issued in stock account.
4. Record the amount that market value exceeds par value or stated value of stock in the Paid-In Capital in Excess account.
5. Issuing par value stock for organizational costs—stock is issued in exchange for the promoters’ work in organizing the corporation
 |
| 1. Record the transaction at the market value of the services received debiting this amount to *Organization Expense*.

b. Record par or stated value of shares issued in stock account and any value received above this in Paid-In Capital in Excess account. |
| **III. Dividends** |
| A. Cash Dividends—decision to pay dividends rest with the board of directors and is based on evaluating the amounts of retained earnings and cash as well as many other factors. |
| 1. Accounting for Cash Dividends—involves three important dates.
2. Date of Declaration—date the directors vote to pay a dividend (legal liability created).
 |
| b. Date of Record—date specified for identifying stockholders (owners on this date will receive dividend).c. Date of Payment—date corporation makes payment. |
| B. Stock Dividends—Distribution of additional shares of stock to stockholders without receipt of any payment in return. They do not reduce assets or *total* equity, just the components of equity. |
| 1. Reasons for Stock Dividends
2. To keep the market price of stock affordable.
3. To show management’s confidence that the company is doing well.
 |
| 1. Accounting for Stock Dividends—transfers a portion of equity from retained earnings to contributed capital (called *capitalizing* retained earnings)
2. *Small stock dividend* is 25% or less of the issuing corporation’s previously outstanding shares; the market value of the shares to be distributed is capitalized.
3. *Large stock dividend* is more than 25% of the shares outstanding before the dividend; only the legally required minimum amount (par or stated value of shares) must be capitalized.
 |
| 1. Declaration entry—Debit Retained Earnings (full *capitalized* amount), credit Common Stock Dividend Distributable (par value of dividend shares) and credit Paid-in Capital in Excess of Par (any capitalization above par).
2. Payment entry—Debit Common Stock Dividend Distributable and credit Common Stock (to transfer par).
 |
| C. Stock SplitsThe distribution of additional shares of stock to stockholders according to their percent of ownership. Involves “calling in” the outstanding shares of stock and replacing them with a larger number of shares that have a lower par value. |
| 1. Reason for stock splits is similar to those for stock dividends.2. Only a memorandum entry is required.3. Splits do not affect any equity account balances or any individual stockholder’s percentage of ownership.4. Reverse stock splits reduce number of shares and increase par value. |
| **IV. Preferred Stock—**Has special rights that give it priority over common stock in one or more areas such as preference for receiving dividends and in liquidation of assets. Usually does not have right to vote. |
| A. Issuance of Preferred StockUsually has a par value; can be sold at a price different from par. |
| 1. Separate contributed capital accounts are used to record preferred stock.2. Preferred Stock account is used to record the par value of shares issued.3. Paid-in in Excess of Par Value, Preferred Stock is used to record any value received above the par value. |
| B. Dividend Preference of Preferred StockPreferred stockholders are allocated their dividends before any dividends are allocated to common stockholders.  |
| 1. Cumulative or Noncumulative  |
| 1. Cumulative preferred stock has a right to be paid both current and all prior periods’ unpaid dividends before any dividend is paid to common stockholders. These unpaid dividends are referred to as *dividends in arrears*.
2. Most preferred stock carries a cumulative dividend right.

c. Noncumulative preferred stock does not have rights to prior periods’ unpaid dividends if they were not declared.d. Dividends in arrears are usually reported in notes to the financial statements.  |
| C. Reasons for Issuing Preferred Stock |
| 1. To raise money without giving up control of the corporation. 2. To boost the return earned by common stockholders on corporate assets. Also called *financial leverage*.  |
| **V. Treasury Stock**—A corporation buys back their own shares for several reasons such as to acquire another company, to avoid a takeover, to give to employees as compensation, or to maintain a strong market for their stock. |
| A. Purchasing Treasury Stock—Cost Method |
| 1. Reduces the corporation’s assets and stockholders’ equity by equal amounts.2. Debit Treasury Stock (contra equity) and credit Cash for full cost. (Reduces total assets and total equity).1. The equity reduction is reported by subtracting Treasury Stock account balance from the total of Paid-in Capital accounts and Retained Earnings on the Balance Sheet.
2. Places a restriction on retained earnings.
3. Reissuing Treasury Stock

1. Selling Treasury Stock at Cost—Treasury stock is reduced (credited) for the *cost* of the reissued shares and Cash is debited for the amount received.2. Selling Treasury Stock *above* Cost—the amount received in excess of cost is credited to Paid-in Capital, Treasury Stock.3. Selling Treasury Stock *below* cost—entry depends on whether the Paid-in Capital, Treasury Stock account has a balance. If it has no balance, the excess of cost over sales price is debited to Retained Earnings. However, if the Paid-in Capital, Treasury Stock account exists, then it is debited for the excess of the cost over the sales price, not to exceed the balance in the account. The Paid-in Capital, Treasury Stock account can have a credit or zero balance but never a debit balance.4. A company never reports a loss or gain from the sale of  treasury stock.  |
| **VI. Reporting of Equity** |
| A. Statement of Retained Earnings**—**Retained Earnings is the total cumulative amount of reported net income minus any net losses and dividends declared. It is part of stockholders’ equity (claim to the assets) and does *not* mean that any certain amount of cash or other assets actually exists. |
| 1. Restrictions and Appropriations |
| a. Restricted retained earnings refers to both *statutory* and *contractual* restrictions. b. Appropriated retained earnings refers to a voluntary transfer of amounts from the Retained Earnings account.2. Prior Period Adjustmentsa. Corrections of material errors made in past period financial statements.b. Include math errors, improper accounting, and missed facts.c. Reported in *statement of retained earnings* as corrections (net of income tax effects) to the beginning retained earnings balance.d. *Changes in Accounting Estimates* do not result in prior period adjustments, but are accounted for in current and future periods. B. Statement of Stockholders’ Equity1. Provided by most companies rather than a separate statement of retained earnings; the statement of stockholders’ equity includes changes in retained earnings.

2. Lists the beginning and ending balances of each equity  account and describes the changes that occurred during the  period. |
| **VII. Decision Analysis—Earnings per Share, Price-Earnings Ratio, and Dividend Yield**  |
| A. Earnings per Share (EPS) |
| 1. Amount of income earned by each share of outstanding common stock; reported on the income statement. |
| 2. Basic earnings per share is computed by dividing the net income less preferred dividends by the weighted average number of shares outstanding. |
| B. Price-Earnings Ratio (PE ratio) |
| 1. Used to gain understanding of the market’s expected receipts for the stockholders.1. Calculated as market value per share divided by earnings per share.
2. Can be based on current or *expected* EPS.
 |
| C. Dividend Yield |
| 1. Used to determine whether a company’s stock is an income stock (pays large and regular dividends) or a growth stock (pays little or no cash dividends).2. Calculated as annual cash dividends per share divided by market value per share. |
|  |