Chapter 13

Corporations: Organization and Capital Stock Transactions

STUDY OBJECTIVES

After studying this chapter, you should be able to:

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.

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- Scan **Study Objectives**
- Read **Feature Story**
- Read **Preview**
- Read text and answer **DO IT!** p. 577 p. 579 p. 581 p. 585 p. 589
- Work **Comprehensive DO IT!** p. 589
- Review **Summary of Study Objectives**
- Answer **Self-Study Questions**
- Complete **Assignments**

Feature Story

"HAVE YOU DRIVEN A FORD LATELY?"

A company that has produced such renowned successes as the Model T and the Mustang, and such a dismal failure as the Edsel, would have some interesting tales to tell. Henry Ford was a defiant visionary from the day he formed Ford Motor Company (*www.ford.com*) in 1903. His goal from day one was to design a car he could mass-produce and sell at a price that was affordable to the masses. In short order he accomplished this goal. By 1920,

60% of all vehicles on U.S. roads were Fords.

Henry Ford was intolerant of anything that stood between him and success. In the early years Ford had issued shares to the public in order to finance the company's exponential growth. In 1916 he decided not to pay a dividend in order to increase the funds available to expand the company.

The shareholders sued. Henry Ford's reaction was swift and direct: If the shareholders didn't see things his way, he would get rid of them. In 1919 the Ford family purchased 100 percent of the outstanding shares of Ford, eliminating any outside "interference." It was over 35 years before the company again issued shares to the public.

Ford Motor Company has continued to evolve and grow over the years into one of the largest international corporations. Today there are nearly a billion shares of publicly traded Ford stock outstanding. But some aspects of the company have changed very little: The chairman and chief executive of the company is a member of the Ford family. Also, the Ford family still retains a significant stake in Ford Motor Company. In a move Henry Ford might have supported, top management recently decided to centralize decision making—that is, to have more key decisions made by top management, rather than by division managers. And, reminiscent of Henry Ford's most famous car, the company is attempting to make a "global car"—a mass-produced car that can be sold around the world with only minor changes.

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Inside Chapter 13...

- **How to Read Stock Quotes** (p. 576)
- **Why Did Reebok Buy Its Own Stock?** (p. 584)

Preview of Chapter 13

Corporations like Ford Motor Company have substantial resources. In fact, the corporation is the dominant form of business organization in the United States in terms of number of employees and dollar volume of sales and earnings. All of the 500 largest companies in the United States are corporations. In this chapter we will explain the essential features of a corporation and the accounting for a corporation's capital stock transactions. In Chapter 14 we will look at other issues related to accounting for corporations.

The content and organization of Chapter 13 are as follows.

Corporations: Organization and Capital Stock Transactions

The Corporate Form of Organization
- Characteristics
- Formation
- Stockholder rights
- Stock issue considerations
- Corporate capital

Accounting for Issues of Common Stock
- 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

Statement Presentation
- Capital stock
- Additional paid-in capital
- Retained earnings

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THE CORPORATE FORM OF ORGANIZATION

In 1819, Chief Justice John Marshall defined a corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law." This definition is the foundation for the prevailing legal interpretation that a **corporation** is an **entity separate and distinct from its owners**.

A corporation is created by law, and its continued existence depends upon the statutes of the state in which it is incorporated. As a legal entity, a corporation has most of the rights and privileges of a person. The major exceptions relate to privileges that only a living person can exercise, such as the right to vote or to hold public office. A corporation is subject to the same duties and responsibilities as a person. For example, it must abide by the laws, and it must pay taxes.

Two common ways to classify corporations are by purpose and by ownership. A corporation may be organized for the purpose of making a **profit**, or it may be **not-for-profit**. For-profit corporations include such well-known companies as McDonald's, Ford Motor Company, PepsiCo, and Google. Not-for-profit corporations are organized for charitable, medical, or educational purposes. Examples are the Salvation Army, the American Cancer Society, and the Bill & Melinda Gates Foundation.

Classification by **ownership** distinguishes between publicly held and privately held corporations. A **publicly held corporation** may have thousands of stockholders. Its stock is regularly traded on a national securities exchange such as the New York Stock Exchange. Most of the largest U.S. corporations are publicly held. Examples of publicly held corporations are Intel, IBM, Caterpillar Inc., and General Electric.

ALTERNATIVE TERMINOLOGY

Privately held corporations are also referred to as *closely held corporations.*

In contrast, a **privately held corporation** usually has only a few stockholders, and does not offer its stock for sale to the general public. Privately held companies are generally much smaller than publicly held companies, although some notable exceptions exist. Cargill Inc., a private corporation that trades in grain and other commodities, is one of the largest companies in the United States.

Characteristics of a Corporation

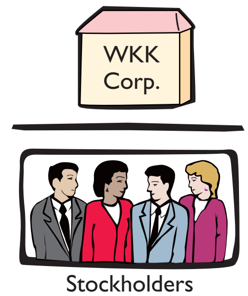
STUDY OBJECTIVE 1
Identify the major characteristics of a corporation.

A number of characteristics distinguish corporations from proprietorships and partnerships. We explain the most important of these characteristics below.

SEPARATE LEGAL EXISTENCE

As an entity separate and distinct from its owners, the corporation acts under its own name rather than in the name of its stockholders. Ford Motor Company may buy, own, and sell property. It may borrow money, and may enter into legally binding contracts in its own name. It may also sue or be sued, and it pays its own taxes.

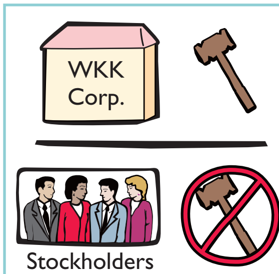
Remember that in a partnership the acts of the owners (partners) bind the partnership. In contrast, the acts of its owners (stockholders) do not bind the corporation unless such owners are **agents** of the corporation. For example, if you owned shares of Ford Motor Company stock, you would not have the right to purchase automobile parts for the company unless you were appointed as an agent of the company, such as a purchasing manager.



Legal existence separate from owners

LIMITED LIABILITY OF STOCKHOLDERS

Since a corporation is a separate legal entity, creditors have recourse only to corporate assets to satisfy their claims. The liability of stockholders is normally limited to their investment in the corporation. Creditors have no legal claim on the personal assets of the owners unless fraud has occurred. Even in the event of bankruptcy, stockholders' losses are generally limited to their capital investment in the corporation.

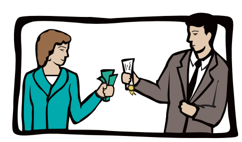


Limited liability of stockholders

TRANSFERABLE OWNERSHIP RIGHTS

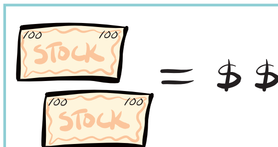
Shares of capital stock give ownership in a corporation. These shares are transferable units. Stockholders may dispose of part or all of their interest in a corporation simply by selling their stock. Remember that the transfer of an ownership interest in a partnership requires the consent of each owner. In contrast, the transfer of stock is entirely at the discretion of the stockholder. It does not require the approval of either the corporation or other stockholders.

The transfer of ownership rights between stockholders normally has no effect on the daily operating activities of the corporation. Nor does it affect the corporation's assets, liabilities, and total ownership equity. The transfer of these ownership rights is a transaction between individual owners. After it first issues the capital stock, the company does not participate in such transfers.


Transferable ownership rights

ABILITY TO ACQUIRE CAPITAL

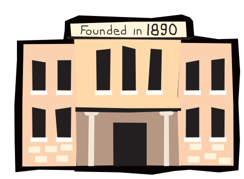
It is relatively easy for a corporation to obtain capital through the issuance of stock. Investors buy stock in a corporation to earn money over time as the share price grows, and because a stockholder has limited liability and shares of stock are readily transferable. Also, individuals can become stockholders by investing relatively small amounts of money. In sum, the ability of a successful corporation to obtain capital is virtually unlimited.



Ability to acquire capital

CONTINUOUS LIFE

The life of a corporation is stated in its charter. The life may be perpetual, or it may be limited to a specific number of years. If it is limited, the company can extend the life through renewal of the charter. Since a corporation is a separate legal entity, its



Continuous life

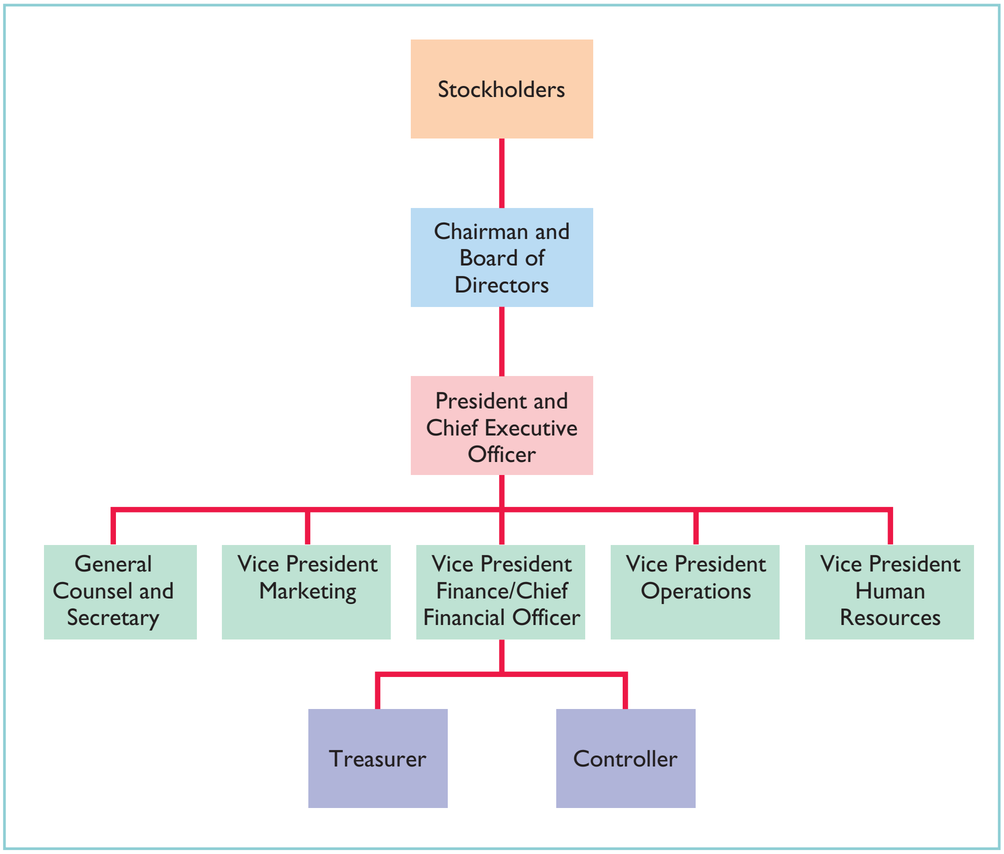
continuance as a going concern is not affected by the withdrawal, death, or incapacity of a stockholder, employee, or officer. As a result, a successful enterprise can have a continuous and perpetual life.

CORPORATION MANAGEMENT

As in Ford Motor Company, stockholders legally own the corporation. But they manage the corporation indirectly through a board of directors they elect. The board, in turn, formulates the operating policies for the company. The board also selects officers, such as a president and one or more vice presidents, to execute policy and to perform daily management functions.

Illustration 13-1 presents a typical organization chart showing the delegation of responsibility. The chief executive officer (CEO) has overall responsibility for managing the business. As the organization chart shows, the CEO delegates responsibility to other officers.

Illustration 13-1
Corporation organization chart



The chief accounting officer is the **controller**. The controller's responsibilities include (1) maintaining the accounting records, (2) maintaining an adequate system of internal control, and (3) preparing financial statements, tax returns, and internal reports. The **treasurer** has custody of the corporation's funds and is responsible for maintaining the company's cash position.

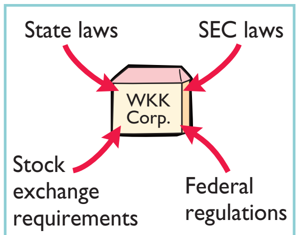
The organizational structure of a corporation enables a company to hire professional managers to run the business. On the other hand, the separation of ownership and management prevents owners from having an active role in managing the company, which some owners like to have.

ETHICS NOTE

Managers who are not owners are often compensated based on the performance of the firm. They thus may be tempted to exaggerate firm performance by inflating income figures.

GOVERNMENT REGULATIONS

A corporation is subject to numerous state and federal regulations. State laws usually prescribe the requirements for issuing stock, the distributions of earnings permitted to stockholders, and the effects of retiring stock. Federal securities laws govern the sale of capital stock to the general public. Also, most publicly held corporations are required to make extensive disclosure of their financial affairs to the Securities and Exchange Commission (SEC) through quarterly and annual reports. In addition, when a corporation lists its stock on organized securities exchanges, it must comply with the reporting requirements of these exchanges. Government regulations are designed to protect the owners of the corporation.



Government regulations

ADDITIONAL TAXES

Neither proprietorships nor partnerships pay income taxes separate from the owner's share of earnings. Sole proprietors and partners report earnings on their personal income tax returns and pay taxes on this amount. Corporations, on the other hand, must pay federal and state income taxes **as a separate legal entity**. These taxes are substantial.

In addition, stockholders must pay taxes on cash dividends (pro rata distributions of net income). Thus, many argue that the government taxes corporate income **twice (double taxation)**—once at the corporate level, and again at the individual level.

Additional taxes

In summary, we can identify the following advantages and disadvantages of a corporation compared to a proprietorship and a partnership.

Illustration 13-2
Advantages and disadvantages of a corporation

Advantages	Disadvantages
Separate legal existence	Corporation management—separation of ownership and management
Limited liability of stockholders	Government regulations
Transferable ownership rights	Additional taxes
Ability to acquire capital	
Continuous life	
Corporation management—professional managers	

Forming a Corporation

The initial step in forming a corporation is to file an application with the Secretary of State in the state in which incorporation is desired. The application contains such information as: (1) the name and purpose of the proposed corporation; (2) amounts, kinds, and number of shares of capital stock to be authorized; (3) the names of the incorporators; and (4) the shares of stock to which each has subscribed.

After the state approves the application, it grants a **charter**. The charter may be an approved copy of the application form, or it may be a separate document containing the same basic data. The issuance of the charter creates the corporation. Upon receipt of the charter, the corporation develops its by-laws. The **by-laws** establish the internal rules and procedures for conducting the affairs of the corporation. They also indicate the powers of the stockholders, directors, and officers of the enterprise.[1]

ALTERNATIVE TERMINOLOGY

The charter is often referred to as the *articles of incorporation.*

Regardless of the number of states in which a corporation has operating divisions, it is incorporated in only one state. It is to the company's advantage to incorporate in a state whose laws are favorable to the corporate form of business

[1]Following approval by two-thirds of the stockholders, the by-laws become binding upon all stockholders, directors, and officers. Legally, a corporation is regulated first by the laws of the state, second by its charter, and third by its by-laws. Corporations must take care to ensure that the provisions of the by-laws are not in conflict with either state laws or the charter.

organization. General Motors, for example, is incorporated in Delaware, whereas Qualcomm is a New Jersey corporation. Many corporations choose to incorporate in states with rules favorable to existing management. For example, Gulf Oil at one time changed its state of incorporation to Delaware to thwart possible unfriendly takeovers. There, state law allows boards of directors to approve certain defensive tactics against takeovers without a vote by shareholders.

Corporations engaged in interstate commerce must also obtain a license from each state in which they do business. The license subjects the corporation's operating activities to the corporation laws of the state.

Costs incurred in the formation of a corporation are called **organization costs**. These costs include legal and state fees, and promotional expenditures involved in the organization of the business. **Corporations expense organization costs as incurred.** To determine the amount and timing of future benefits is so difficult that it is standard procedure to take a conservative approach of expensing these costs immediately.

Ownership Rights of Stockholders

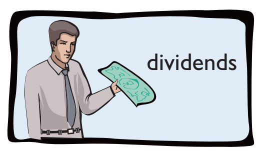
When chartered, the corporation may begin selling ownership rights in the form of shares of stock. When a corporation has only one class of stock, it is **common stock**. Each share of common stock gives the stockholder the ownership rights pictured in Illustration 13-3. A corporation's articles of incorporation or its by-laws state the ownership rights of a share of stock.

Illustration 13-3
Ownership rights of stockholders

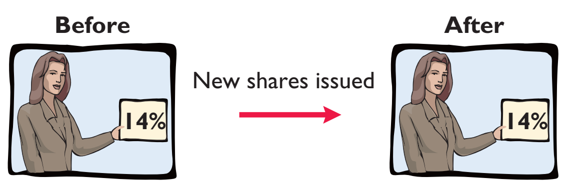
Stockholders have the right to:

1. Vote in election of board of directors at annual meeting and vote on actions that require stockholder approval.

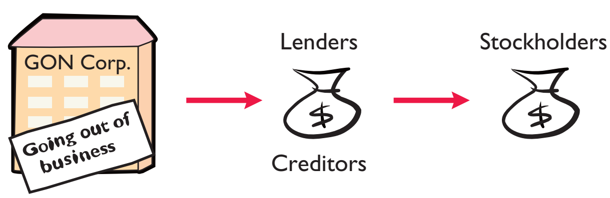
2. Share the corporate earnings through receipt of dividends.



3. Keep the same percentage ownership when new shares of stock are issued (**preemptive right**[2]).



4. Share in assets upon liquidation in proportion to their holdings. This is called a **residual claim:** owners are paid with assets that remain after all creditors' claims have been paid.



[2] A number of companies have eliminated the preemptive right, because they believe it makes an unnecessary and cumbersome demand on management. For example, by stockholder approval, IBM has dropped its preemptive right for stockholders.

Proof of stock ownership is evidenced by a form known as a **stock certificate**. As Illustration 13-4 shows, the face of the certificate shows the name of the corporation, the stockholder's name, the class and special features of the stock, the number of shares owned, and the signatures of authorized corporate officials. Prenumbered certificates facilitate accountability. They may be issued for any quantity of shares.

Illustration 13-4
A stock certificate

Stock Issue Considerations

In considering the issuance of stock, a corporation must resolve a number of basic questions: How many shares should it authorize for sale? How should it issue the stock? At what price should it issue the shares? What value should the corporation assign to the stock? These questions are addressed in the following sections.

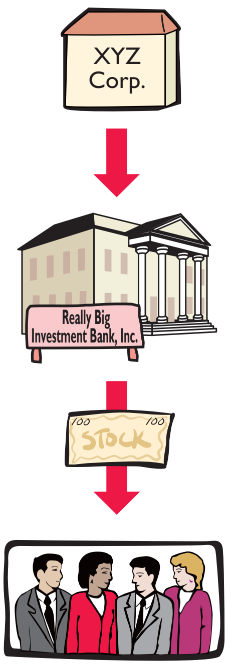
AUTHORIZED STOCK

The charter indicates the amount of stock that a corporation is **authorized** to sell. The total amount of **authorized stock** at the time of incorporation normally anticipates both initial and subsequent capital needs. As a result, the number of shares authorized generally exceeds the number initially sold. If it sells all authorized stock, a corporation must obtain consent of the state to amend its charter before it can issue additional shares.

The authorization of capital stock does not result in a formal accounting entry. This event has no immediate effect on either corporate assets or stockholders' equity. However, the number of authorized shares is often reported in the stockholders' equity section. It is then simple to determine the number of unissued shares that the corporation can issue without amending the charter: subtract the total shares issued from the total authorized. For example, if Advanced Micro was authorized to sell 100,000 shares of common stock and issued 80,000 shares, 20,000 shares would remain unissued.

ISSUANCE OF STOCK

A corporation can issue common stock **directly** to investors. Or it can issue the stock **indirectly** through an investment banking firm that specializes in bringing securities to market. Direct issue is typical in closely held companies. Indirect issue is customary for a publicly held corporation.



Indirect Issuance

In an indirect issue, the investment banking firm may agree to **underwrite** the entire stock issue. In this arrangement, the investment banker buys the stock from the corporation at a stipulated price and resells the shares to investors. The corporation thus avoids any risk of being unable to sell the shares. Also, it obtains immediate use of the cash received from the underwriter. The investment banking firm, in turn, assumes the risk of reselling the shares, in return for an underwriting fee.[3] For example, Google (the world's number-one Internet search engine) used underwriters when it issued a highly successful initial public offering, raising $1.67 billion. The underwriters charged a 3% underwriting fee (approximately $50 million) on Google's stock offering.

How does a corporation set the price for a new issue of stock? Among the factors to be considered are: (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, and (5) the current state of the securities market. The calculation can be complex and is properly the subject of a finance course.

MARKET VALUE OF STOCK

The stock of publicly held companies is traded on organized exchanges. The interaction between buyers and sellers determines the prices per share. In general, the prices set by the marketplace tend to follow the trend of a company's earnings and dividends. But, factors beyond a company's control, such as an oil embargo, changes in interest rates, and the outcome of a presidential election, may cause day-to-day fluctuations in market prices.

The trading of capital stock on securities exchanges involves the transfer of **already issued shares** from an existing stockholder to another investor. These transactions have **no impact** on a corporation's stockholders' equity.

INVESTOR INSIGHT

How to Read Stock Quotes

The volume of trading on national and international exchanges is heavy. Daily trading on the New York Stock Exchange (NYSE) alone often exceeds one billion shares. For each listed stock, the *Wall Street Journal* and other financial media report the total volume of stock traded for a given day, the high and low price for the day, the closing market price, and the net change for the day. A recent stock quote for PepsiCo, listed on the NYSE under the ticker symbol PEP, is shown below.

Stock	Volume	High	Low	Close	Net Change
PepsiCo	4,305,600	60.30	59.32	60.02	+0.41

These numbers indicate that PepsiCo's trading volume was 4,305,600 shares. The high, low, and closing prices for that date were $60.30, $59.32, and $60.02, respectively. The net change for the day was an increase of $0.41 per share.

For stocks traded on organized stock exchanges, how are the dollar prices per share established? What factors might influence the price of shares in the marketplace?

[3] Alternatively, the investment banking firm may agree only to enter into a **best-efforts** contract with the corporation. In such cases, the banker agrees to sell as many shares as possible at a specified price. The corporation bears the risk of unsold stock. Under a best-efforts arrangement, the banking firm is paid a fee or commission for its services.

PAR AND NO-PAR VALUE STOCKS

Par value stock is capital stock to which the charter has 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; that amount was not available for withdrawal by stockholders. Thus, in the past, most states required the corporation to sell its shares at par or above.

However, par value was often immaterial relative to the value of the company's stock—even at the time of issue. Thus, its usefulness as a protective device to creditors was questionable. For example, Reebok's par value is $0.01 per share, yet a new issue in 2006 would have sold at a **market value** in the $33 per share range. Thus, par has no relationship with market value; in the vast majority of cases, it is an immaterial amount. As a consequence, today many states do not require a par value. Instead, they use other means to determine legal capital to protect creditors.

No-par value stock is capital stock to which the charter has not assigned a value. No-par value stock is quite common today. For example, Nike, Procter & Gamble, and North American Van Lines all have no-par stock. In many states the board of directors assigns a **stated value** to no-par shares.

DO IT!

Indicate whether each of the following statements is true or false.

_____ **1.** Similar to partners in a partnership, stockholders of a corporation have unlimited liability.

_____ **2.** It is relatively easy for a corporation to obtain capital through the issuance of stock.

_____ **3.** The separation of ownership and management is an advantage of the corporate form of business.

_____ **4.** The journal entry to record the authorization of capital stock includes a credit to the appropriate capital stock account.

_____ **5.** Most states require a par value per share for capital stock.

CORPORATE ORGANIZATION

action plan

✔ Review the characteristics of a corporation and understand which are advantages and which are disadvantages.

✔ Understand that corporations raise capital through the issuance of stock, which can be par or no-par.

Solution

1. False. The liability of stockholders is normally limited to their investment in the corporation.
2. True.
3. False. The separation of ownership and management is a disadvantage of the corporate form of business.
4. False. The authorization of capital stock does not result in a formal accounting entry.
5. False. Many states do not require a par value.

Related exercise material: **BE13-1, E13-1, E13-2,** and **DO IT! 13-1.**

✔ The Navigator

Corporate Capital

STUDY OBJECTIVE 2

Differentiate between paid-in capital and retained earnings.

Owners' equity is identified by various names: **stockholders' equity**, **shareholders' equity**, or **corporate capital**. The stockholders' equity section of a corporation's balance sheet consists of two parts: (1) paid-in (contributed) capital and (2) retained earnings (earned capital).

The distinction between **paid-in capital** and **retained earnings** is important from both a legal and a financial point of view. Legally, corporations can make distributions of earnings (declare dividends) out of retained earnings in all states. However, in many states they cannot declare dividends out of paid-in capital. Management, stockholders, and others often look to retained earnings for the continued existence and growth of the corporation.

PAID-IN 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. As noted earlier, when a corporation has only one class of stock, it is **common stock**.

RETAINED EARNINGS

Retained earnings is net income that a corporation retains for future use. Net income is recorded in Retained Earnings by a closing entry that debits Income Summary and credits Retained Earnings. For example, assuming that net income for Delta Robotics in its first year of operations is $130,000, the closing entry is:

A = L + SE

−130,000 Inc
+130,000 RE

Cash Flows
no effect

Income Summary	130,000	
Retained Earnings		130,000
(To close Income Summary and transfer net income to retained earnings)		

If Delta Robotics has a balance of $800,000 in common stock at the end of its first year, its stockholders' equity section is as follows.

Illustration 13-5
Stockholders' equity section

DELTA ROBOTICS
Balance Sheet (partial)

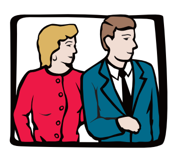
Stockholders' equity		
Paid-in capital		
Common stock	$800,000	
Retained earnings	130,000	
Total stockholders' equity		**$930,000**

The following illustration compares the owners' equity (stockholders' equity) accounts reported on a balance sheet for a proprietorship, a partnership, and a corporation.

Illustration 13-6
Comparison of owners' equity accounts

Proprietorship

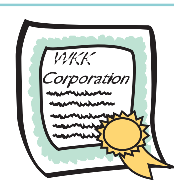
Able, Capital
| | Normal bal.



Partnership

Able, Capital
| | Normal bal.

Baker, Capital
| | Normal bal.



Corporation

Common Stock
| | Normal bal.

Retained Earnings
| | Normal bal.

DO IT!

CORPORATE CAPITAL

At the end of its first year of operation, Doral Corporation has $750,000 of common stock and net income of $122,000. Prepare (a) the closing entry for net income and (b) the stockholders' equity section at year-end.

Solution

(a) Income Summary	122,000	
Retained Earnings		122,000
(To close Income Summary and transfer net income to retained earnings)		

(b) Stockholders' equity

Paid-in capital		
Common stock	$750,000	
Retained earnings	122,000	
Total stockholders' equity		$872,000

Related exercise material: **BE13-2** and **DO IT! 13-2.**

action plan

✔ Record net income in Retained Earnings by a closing entry in which Income Summary is debited and Retained Earnings is credited.

✔ In the stockholders' equity section, show (1) paid-in capital and (2) retained earnings.

The Navigator

ACCOUNTING FOR ISSUES OF COMMON STOCK

STUDY OBJECTIVE 3
Record the issuance of common stock.

Let's now look at how to account for issues of common stock. The primary objectives in accounting for the issuance of common stock are: (1) to identify the specific sources of paid-in capital, and (2) to maintain the distinction between paid-in capital and retained earnings. **The issuance of common stock affects only paid-in capital accounts.**

Issuing Par Value Common Stock for Cash

As discussed earlier, par value does not indicate a stock's market value. Therefore, the cash proceeds from issuing par value stock may be equal to, greater than, or less than par value. When the company records issuance of common stock for cash, it credits to Common Stock the par value of the shares. It records in a separate paid-in capital account the portion of the proceeds that is above or below par value.

To illustrate, assume that Hydro-Slide, Inc. issues 1,000 shares of $1 par value common stock at par for cash. The entry to record this transaction is:

Cash	1,000	
Common Stock		1,000
(To record issuance of 1,000 shares of $1 par common stock at par)		

A	=	L	+	SE
+1,000				
				+1,000 CS

Cash Flows
+1,000

If Hydro-Slide issues an additional 1,000 shares of the $1 par value common stock for cash at $5 per share, the entry is:

Cash	5,000	
Common Stock		1,000
Paid-in Capital in Excess of Par Value		4,000
(To record issuance of 1,000 shares of $1 par common stock)		

A	=	L	+	SE
+5,000				
				+1,000 CS
				+4,000 CS

Cash Flows
+5,000

The total paid-in capital from these two transactions is $6,000, and the legal capital is $2,000. Assuming Hydro-Slide, Inc. has retained earnings of $27,000, Illustration 13-7 (page 580) shows the company's stockholders' equity section.

Illustration 13-7
Stockholders' equity—paid-in capital in excess of par value

HYDRO-SLIDE, INC.
Balance Sheet (partial)

Stockholders' equity	
Paid-in capital	
Common stock	$ 2,000
Paid-in capital in excess of par value	**4,000**
Total paid-in capital	6,000
Retained earnings	27,000
Total stockholders' equity	$33,000

ALTERNATIVE TERMINOLOGY

Paid-in Capital in Excess of Par is also called *Premium on Stock.*

When a corporation issues stock for less than par value, it debits the account Paid-in Capital in Excess of Par Value, if a credit balance exists in this account. If a credit balance does not exist, then the corporation debits to Retained Earnings the amount less than par. This situation occurs only rarely: Most states do not permit the sale of common stock below par value, because stockholders may be held personally liable for the difference between the price paid upon original sale and par value.

Issuing No-Par Common Stock for Cash

When no-par common stock has a stated value, the entries are similar to those illustrated for par value stock. The corporation credits the stated value to Common Stock. Also, when the selling price of no-par stock exceeds stated value, the corporation credits the excess to Paid-in Capital in Excess of Stated Value.

For example, assume that instead of $1 par value stock, Hydro-Slide, Inc. has $5 stated value no-par stock and the company issues 5,000 shares at $8 per share for cash. The entry is:

A	=	L	+	SE
+40,000				
				+25,000 CS
				+15,000 CS

Cash Flows
+40,000

Cash	40,000	
Common Stock		25,000
Paid-in Capital in Excess of Stated Value		15,000
(To record issue of 5,000 shares of $5 stated value no-par stock)		

Hydro-Slide, Inc. reports Paid-in Capital in Excess of Stated Value as part of paid-in capital in the stockholders' equity section.

What happens when no-par stock does not have a stated value? In that case, the corporation credits the entire proceeds to Common Stock. Thus, if Hydro-Slide does not assign a stated value to its no-par stock, it would record the issuance of the 5,000 shares at $8 per share for cash as follows.

A	=	L	+	SE
+40,000				
				+40,000 CS

Cash Flows
+40,000

Cash	40,000	
Common Stock		40,000
(To record issue of 5,000 shares of no-par stock)		

Issuing Common Stock for Services or Noncash Assets

Corporations also may issue stock for services (compensation to attorneys or consultants) or for noncash assets (land, buildings, and equipment). In such cases, what cost should be recognized in the exchange transaction? To comply with the **cost**

principle, in a noncash transaction **cost is the cash equivalent price**. Thus, **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.

To illustrate, assume that attorneys have helped Jordan Company incorporate. They have billed the company $5,000 for their services. They agree to accept 4,000 shares of $1 par value common stock in payment of their bill. At the time of the exchange, there is no established market price for the stock. In this case, the market value of the consideration received, $5,000, is more clearly evident. Accordingly, Jordan Company makes the following entry:

Organization Expense	5,000	
Common Stock		4,000
Paid-in Capital in Excess of Par Value		1,000
(To record issuance of 4,000 shares of $1 par value stock to attorneys)		

A	=	L	+	SE
				−5,000 Exp
				+4,000 CS
				+1,000 CS

Cash Flows
no effect

As explained on page 574, organization costs are expensed as incurred.

In contrast, assume that Athletic Research Inc. is an existing publicly held corporation. Its $5 par value stock is actively traded at $8 per share. The company issues 10,000 shares of stock to acquire land recently advertised for sale at $90,000. The most clearly evident value in this noncash transaction is the market price of the consideration given, $80,000. The company records the transaction as follows.

Land	80,000	
Common Stock		50,000
Paid-in Capital in Excess of Par Value		30,000
(To record issuance of 10,000 shares of $5 par value stock for land)		

A	=	L	+	SE
+80,000				
				+50,000 CS
				+30,000 CS

Cash Flows
no effect

As illustrated in these examples, **the par value of the stock is never a factor in determining the cost of the assets received**. This is also true of the stated value of no-par stock.

DO IT!

Cayman Corporation begins operations on March 1 by issuing 100,000 shares of $10 par value common stock for cash at $12 per share. On March 15 it issues 5,000 shares of common stock to attorneys in settlement of their bill of $50,000 for organization costs. Journalize the issuance of the shares, assuming the stock is not publicly traded.

ISSUANCE OF STOCK

action plan

- ✔ In issuing shares for cash, credit Common Stock for par value per share.
- ✔ Credit any additional proceeds in excess of par value to a separate paid-in capital account.
- ✔ When stock is issued for services, use the cash equivalent price.

Solution

Mar. 1	Cash	1,200,000	
	Common Stock		1,000,000
	Paid-in Capital in Excess of Par Value		200,000
	(To record issuance of 100,000 shares at $12 per share)		

action plan (cont'd)

✔ For the cash equivalent price use either the fair market value of what is given up or the fair market value of what is received, whichever is more clearly determinable.

Mar. 15	Organization Expense	50,000	
	Common Stock		50,000
	(To record issuance of 5,000 shares for attorneys' fees)		

Related exercise material: **BE13-3, BE13-4, BE13-5, E13-3, E13-4, E13-6,** and **DO IT! 13-3.**

✔ The Navigator

ACCOUNTING FOR TREASURY STOCK

STUDY OBJECTIVE 4

Explain the accounting for treasury stock.

Treasury stock is a corporation's own stock that it has issued and subsequently reacquired from shareholders, but not retired. A corporation may acquire treasury stock for various reasons:

1. To reissue the shares to officers and employees under bonus and stock compensation plans.
2. To signal to the stock market that management believes the stock is underpriced, in the hope of enhancing its market value.
3. To have additional shares available for use in the acquisition of other companies.
4. To reduce the number of shares outstanding and thereby increase earnings per share.
5. To rid the company of disgruntled investors, perhaps to avoid a takeover, as illustrated in the Ford Motor Company Feature Story.

HELPFUL HINT

Treasury shares do not have dividend rights or voting rights.

Many corporations have treasury stock. One survey of 600 U.S. companies found that approximately two-thirds have treasury stock.[4] Buybacks are becoming more popular. For example, Exxon Mobil Corp., Microsoft Corp., and Time Warner Inc. purchased a combined $14.37 billion of their shares in the first quarter of a recent year.

Purchase of Treasury Stock

Companies generally account for treasury stock by **the cost method**. This method uses the cost of the shares purchased to value the treasury stock. Under the cost method, the company debits **Treasury Stock** for the **price paid to reacquire the shares**.

When the company disposes of the shares, it credits to Treasury Stock **the same amount** it paid to reacquire the shares. To illustrate, assume that on January 1, 2010, the stockholders' equity section of Mead, Inc. has 100,000 shares of $5 par value common stock outstanding (all issued at par value) and Retained Earnings of $200,000. The stockholders' equity section before purchase of treasury stock is as follows.

[4] *Accounting Trends & Techniques 2007* (New York: American Institute of Certified Public Accountants).

MEAD, INC.
Balance Sheet (partial)

Stockholders' equity	
Paid-in capital	
Common stock, $5 par value, 100,000 shares issued and outstanding	$500,000
Retained earnings	200,000
Total stockholders' equity	$700,000

Illustration 13-8
Stockholders' equity with no treasury stock

On February 1, 2010, Mead acquires 4,000 shares of its stock at $8 per share. The entry is:

Feb. 1	Treasury Stock	32,000	
	Cash		32,000
	(To record purchase of 4,000 shares of treasury stock at $8 per share)		

A	=	L	+	SE
				−32,000 TS
−32,000				

Cash Flows
−32,000

Note that Mead debits Treasury Stock for the cost of the shares purchased. Is the original paid-in capital account, Common Stock, affected? No, because the number of issued shares does not change. In the stockholders' equity section of the balance sheet, Mead deducts treasury stock from total paid-in capital and retained earnings. Treasury Stock is a **contra stockholders' equity account**. Thus, the acquisition of treasury stock reduces stockholders' equity.

The stockholders' equity section of Mead, Inc. after purchase of treasury stock is as follows.

MEAD, INC.
Balance Sheet (partial)

Stockholders' equity	
Paid-in capital	
Common stock, $5 par value, 100,000 shares issued and 96,000 shares outstanding	$500,000
Retained earnings	200,000
Total paid-in capital and retained earnings	700,000
Less: Treasury stock (4,000 shares)	**32,000**
Total stockholders' equity	$668,000

Illustration 13-9
Stockholders' equity with treasury stock

In the balance sheet, Mead discloses both the number of shares issued (100,000) and the number in the treasury (4,000). The difference between these two amounts is the number of shares of stock outstanding (96,000). The term **outstanding stock** means the number of shares of issued stock that are being held by stockholders.

Some maintain that companies should report treasury stock as an asset because it can be sold for cash. Under this reasoning, companies should also show unissued stock as an asset, clearly an erroneous conclusion. Rather than being an asset, treasury stock reduces stockholder claims on corporate assets. This effect is correctly shown by reporting treasury stock as a deduction from total paid-in capital and retained earnings.

ETHICS NOTE

The purchase of treasury stock reduces the cushion for creditors and preferred stockholders. A restriction for the cost of treasury stock purchased is often required. The restriction is usually applied to retained earnings.

ACCOUNTING ACROSS THE ORGANIZATION

Why Did Reebok Buy Its Own Stock?

In a bold (and some would say risky) move, Reebok at one time bought back nearly a *third* of its shares. This repurchase of shares dramatically reduced Reebok's available cash. In fact, the company borrowed significant funds to accomplish the repurchase. In a press release, management stated that it was repurchasing the shares because it believed its stock was severely underpriced. The repurchase of so many shares was meant to signal management's belief in good future earnings.

Skeptics, however, suggested that Reebok's management was repurchasing shares to make it less likely that another company would acquire Reebok (in which case Reebok's top managers would likely lose their jobs). By depleting its cash, Reebok became a less likely acquisition target. Acquiring companies like to purchase companies with large cash balances so they can pay off debt used in the acquisition.

? What signal might a large stock repurchase send to investors regarding management's belief about the company's growth opportunities?

Disposal of Treasury Stock

Treasury stock is usually sold or retired. The accounting for its sale differs when treasury stock is sold above cost than when it is sold below cost.

HELPFUL HINT

Treasury stock transactions are classified as capital stock transactions. As in the case when stock is issued, the income statement is not involved.

SALE OF TREASURY STOCK ABOVE COST

If the selling price of the treasury shares is equal to their cost, the company records the sale of the shares by a debit to Cash and a credit to Treasury Stock. When the selling price of the shares is greater than their cost, the company credits the difference to Paid-in Capital from Treasury Stock.

To illustrate, assume that on July 1, Mead sells for \$10 per share the 1,000 shares of its treasury stock, previously acquired at \$8 per share. The entry is as follows.

A	=	L	+	SE
+10,000				
				+8,000 TS
				+2,000 TS

Cash Flows
+10,000

July 1	Cash	10,000	
	Treasury Stock		8,000
	Paid-in Capital from Treasury Stock		2,000
	(To record sale of 1,000 shares of treasury stock above cost)		

Mead does not record a \$2,000 gain on sale of treasury stock for two reasons: (1) Gains on sales occur when **assets** are sold, and treasury stock is not an asset. (2) A corporation does not realize a gain or suffer a loss from stock transactions with its own stockholders. Thus, companies should not include in net income any paid-in capital arising from the sale of treasury stock. Instead, they report Paid-in Capital from Treasury Stock separately on the balance sheet, as a part of paid-in capital.

SALE OF TREASURY STOCK BELOW COST

When a company sells treasury stock below its cost, it usually debits to Paid-in Capital from Treasury Stock the excess of cost over selling price. Thus, if Mead, Inc.

sells an additional 800 shares of treasury stock on October 1 at $7 per share, it makes the following entry.

Oct. 1	Cash	5,600	
	Paid-in Capital from Treasury Stock	800	
	Treasury Stock		6,400
	(To record sale of 800 shares of treasury stock below cost)		

A	=	L	+	SE
+5,600				
				−800 TS
				+6,400 TS

Cash Flows
+5,600

Observe the following from the two sales entries: (1) Mead credits Treasury Stock at cost in each entry. (2) Mead uses Paid-in Capital from Treasury Stock for the difference between cost and the resale price of the shares. (3) The original paid-in capital account, Common Stock, is not affected. **The sale of treasury stock increases both total assets and total stockholders' equity.**

After posting the foregoing entries, the treasury stock accounts will show the following balances on October 1.

Illustration 13-10
Treasury stock accounts

Treasury Stock			
Feb. 1	32,000	July 1	8,000
		Oct. 1	6,400
Oct. 1 Bal.	17,600		

Paid-in Capital from Treasury Stock			
Oct. 1	800	July 1	2,000
		Oct. 1 Bal.	1,200

When a company fully depletes the credit balance in Paid-in Capital from Treasury Stock, it debits to Retained Earnings any additional excess of cost over selling price. To illustrate, assume that Mead, Inc. sells its remaining 2,200 shares at $7 per share on December 1. The excess of cost over selling price is $2,200 [2,200 × ($8 − $7)]. In this case, Mead debits $1,200 of the excess to Paid-in Capital from Treasury Stock. It debits the remainder to Retained Earnings. The entry is:

Dec. 1	Cash	15,400	
	Paid-in Capital from Treasury Stock	1,200	
	Retained Earnings	1,000	
	Treasury Stock		17,600
	(To record sale of 2,200 shares of treasury stock at $7 per share)		

A	=	L	+	SE
+15,400				
				−1,200 TS
				−1,000 RE
				+17,600 TS

Cash Flows
+15,400

DO IT!

TREASURY STOCK

Santa Anita Inc. purchases 3,000 shares of its $50 par value common stock for $180,000 cash on July 1. It will hold the shares in the treasury until resold. On November 1, the corporation sells 1,000 shares of treasury stock for cash at $70 per share. Journalize the treasury stock transactions.

action plan

✔ Record the purchase of treasury stock at cost.

✔ When treasury stock is sold above its cost, credit the excess of the selling price over cost to Paid-in Capital from Treasury Stock.

Solution

July 1	Treasury Stock	180,000	
	Cash		180,000
	(To record the purchase of 3,000 shares at $60 per share)		

action plan (cont'd)

✔ When treasury stock is sold below its cost, debit the excess of cost over selling price to Paid-in Capital from Treasury Stock.

Nov. 1	Cash	70,000	
	Treasury Stock		60,000
	Paid-in Capital from Treasury Stock		10,000
	(To record the sale of 1,000 shares at $70 per share)		

Related exercise material: **BE13-6, E13-5, E13-7, E13-8,** and **DO IT! 13-4.**

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PREFERRED STOCK

STUDY OBJECTIVE 5

Differentiate preferred stock from common stock.

To appeal to more investors, a corporation may issue an additional class of stock, called preferred stock. **Preferred stock** has provisions that give it some preference or priority over common stock. Typically, preferred stockholders have a priority as to (1) distributions of earnings (dividends) and (2) assets in the event of liquidation. However, they generally do not have voting rights.

Like common stock, corporations may issue preferred stock for cash or for noncash assets. The entries for these transactions are similar to the entries for common stock. When a corporation has more than one class of stock, each paid-in capital account title should identify the stock to which it relates. A company might have the following accounts: Preferred Stock, Common Stock, Paid-in Capital in Excess of Par Value—Preferred Stock, and Paid-in Capital in Excess of Par Value—Common Stock. For example, if Stine Corporation issues 10,000 shares of $10 par value preferred stock for $12 cash per share, the entry to record the issuance is:

A	=	L	+	SE
+120,000				
				+100,000 PS
				+20,000 PS

Cash Flows
+120,000

Cash	120,000	
Preferred Stock		100,000
Paid-in Capital in Excess of Par Value–Preferred Stock		20,000
(To record the issuance of 10,000 shares of $10 par value preferred stock)		

Preferred stock may have either a par value or no-par value. In the stockholders' equity section of the balance sheet, companies list preferred stock first because of its dividend and liquidation preferences over common stock.

We discuss various features associated with the issuance of preferred stock on the following pages.

Dividend Preference

Dividend Preferences

As noted earlier, **preferred stockholders have the right to receive dividends before common stockholders**. For example, if the dividend rate on preferred stock is $5 per share, common shareholders will not receive any dividends in the current year until preferred stockholders have received $5 per share. The first claim to dividends does not, however, guarantee the payment of dividends. Dividends depend on many factors, such as adequate retained earnings and availability of cash. If a company does not pay dividends to preferred stockholders, it cannot of course pay dividends to common stockholders.

The per share dividend amount is stated as a percentage of the preferred stock's par value or as a specified amount. For example, at one time Crane Company specified a 3¾% dividend on its $100 par value preferred ($100 × 3¾% = $3.75 per share). PepsiCo has a $5.46 series of no-par preferred stock.

CUMULATIVE DIVIDEND

Preferred stock often contains a **cumulative dividend** feature. This means that preferred stockholders must be paid both current-year dividends and any unpaid prior-year dividends before common stockholders receive dividends. When preferred stock is cumulative, preferred dividends not declared in a given period are called **dividends in arrears**.

To illustrate, assume that Scientific Leasing has 5,000 shares of 7%, $100 par value, cumulative preferred stock outstanding. The annual dividend is $35,000 (5,000 × $7 per share), but dividends are two years in arrears. In this case, preferred stockholders are entitled to receive the following dividends in the current year.

Dividends in arrears ($35,000 × 2)	$ 70,000
Current-year dividends	35,000
Total preferred dividends	**$105,000**

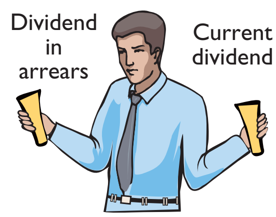
Illustration 13-11
Computation of total dividends to preferred stock

The company cannot pay dividends to common stockholders until it pays the entire preferred dividend. In other words, companies cannot pay dividends to common stockholders while any preferred stock is in arrears.

Are dividends in arrears considered a liability? **No—no payment obligation exists until the board of directors declares a dividend**. However, companies should disclose in the notes to the financial statements the amount of dividends in arrears. Doing so enables investors to assess the potential impact of this commitment on the corporation's financial position.

Companies that are unable to meet their dividend obligations are not looked upon favorably by the investment community. As a financial officer noted in discussing one company's failure to pay its cumulative preferred dividend for a period of time, "Not meeting your obligations on something like that is a major black mark on your record." The accounting entries for preferred stock dividends are explained in Chapter 14.

Payment of a Cumulative Dividend



Liquidation Preference

Most preferred stocks also have a preference on corporate assets if the corporation fails. This feature provides security for the preferred stockholder. The preference to assets may be for the par value of the shares or for a specified liquidating value. For example, EarthLink's preferred stock entitles its holders to receive $20.83 per share, plus accrued and unpaid dividends. The liquidation preference establishes the respective claims of creditors and preferred stockholders.

STATEMENT PRESENTATION

STUDY OBJECTIVE 6

Prepare a stockholders' equity section.

Companies report paid-in capital and retained earnings in the stockholders' equity section of the balance sheet. They identify the specific sources of paid-in capital, using the following classifications.

1. **Capital stock.** This category consists of preferred and common stock. Preferred stock appears before common stock because of its preferential rights. Companies report par value, shares authorized, shares issued, and shares outstanding for each class of stock.
2. **Additional paid-in capital.** This category includes the excess of amounts paid in over par or stated value and paid-in capital from treasury stock.

ALTERNATIVE TERMINOLOGY

Paid-in capital is sometimes called *contributed capital.*

The stockholders' equity section of Connally Inc. in Illustration 13-12 (page 588) includes most of the accounts discussed in this chapter. The disclosures pertaining to

Connally's common stock indicate that: the company issued 400,000 shares; 100,000 shares are unissued (500,000 authorized less 400,000 issued); and 390,000 shares are outstanding (400,000 issued less 10,000 shares in treasury).

Illustration 13-12
Stockholders' equity section

CONNALLY INC.
Balance Sheet (partial)

Stockholders' equity		
Paid-in capital		
Capital stock		
9% preferred stock, $100 par value cumulative, 10,000 shares authorized, 6,000 shares issued and outstanding		$ 600,000
Common stock, no par, $5 stated value, 500,000 shares authorized, 400,000 shares issued, and 390,000 outstanding		2,000,000
Total capital stock		2,600,000
Additional paid-in capital		
In excess of par value—preferred stock	$ 30,000	
In excess of stated value—common stock	860,000	
From treasury stock	140,000	
Total additional paid-in capital		1,030,000
Total paid-in capital		3,630,000
Retained earnings		1,058,000
Total paid-in capital and retained earnings		4,688,000
Less: Treasury stock—common (10,000 shares) (at cost)		(80,000)
Total stockholders' equity		$4,608,000

Published annual reports often combine and report as a single amount the individual sources of additional paid-in capital, as shown in Illustration 13-13. In addition, authorized shares are sometimes not reported.

Illustration 13-13
Published stockholders' equity section

KELLOGG COMPANY
Balance Sheet (partial)
($ in millions)

Stockholders' equity	
Common stock, $0.25 par value, 1,000,000,000 shares authorized	
Issued: 418,669,193 shares	$ 105
Capital in excess of par value	388
Retained earnings	4,217
Treasury stock, at cost	
28,618,052 shares	(1,357)
Accumulated other comprehensive income (loss)	(827)
Total stockholders' equity	$2,526

In practice, companies sometimes use the term "Capital surplus" in place of "Additional paid-in capital," and "Earned surplus" in place of "Retained earnings." The use of the term "surplus" suggests that the company has available an excess amount of funds. Such is not necessarily the case. Therefore, **the term "surplus" should not be employed in accounting**. Unfortunately, a number of financial statements still do use it.

DO IT!

STOCKHOLDERS' EQUITY SECTION

Jennifer Corporation has issued 300,000 shares of $3 par value common stock. It authorized 600,000 shares. The paid-in capital in excess of par value on the common stock is $380,000. The corporation has reacquired 15,000 shares at a cost of $50,000 and is currently holding those shares. Treasury stock was reissued in prior years for $72,000 more than its cost.

The corporation also has 4,000 shares issued and outstanding of 8%, $100 par-value preferred stock. It authorized 10,000 shares. The paid-in capital in excess of par value on the preferred stock is $25,000. Retained earnings is $610,000.

Prepare the stockholders' equity section of the balance sheet.

action plan

- ✔ Present capital stock first; list preferred stock before common stock.
- ✔ Present additional paid-in capital after capital stock.
- ✔ Report retained earnings after capital stock and additional paid-in capital.
- ✔ Deduct treasury stock from total paid-in capital and retained earnings.

Solution

JENNIFER CORPORATION
Balance Sheet (partial)

Stockholders' equity		
Paid-in capital		
Capital stock		
8% preferred stock, $100 par value, 10,000 shares authorized, 4,000 shares issued and outstanding		$ 400,000
Common stock, $3 par value, 600,000 shares authorized, 300,000 shares issued, and 285,000 shares outstanding		900,000
Total capital stock		1,300,000
Additional paid-in capital		
In excess of par value—preferred stock	$ 25,000	
In excess of par value—common stock	380,000	
From treasury stock	72,000	
Total additional paid-in capital		477,000
Total paid-in capital		1,777,000
Retained earnings		610,000
Total paid-in capital and retained earnings		2,387,000
Less: Treasury stock—common (15,000 shares) (at cost)		(50,000)
Total stockholders' equity		$2,337,000

Related exercise material: **BE13-8, E13-9, E13-12, E13-13, E13-14, E13-15,** and **DO IT! 13-5.**

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Comprehensive DO IT!

The Rolman Corporation is authorized to issue 1,000,000 shares of $5 par value common stock. In its first year, the company has the following stock transactions.

Jan.	10	Issued 400,000 shares of stock at $8 per share.
July	1	Issued 100,000 shares of stock for land. The land had an asking price of $900,000. The stock is currently selling on a national exchange at $8.25 per share.
Sept.	1	Purchased 10,000 shares of common stock for the treasury at $9 per share.
Dec.	1	Sold 4,000 shares of the treasury stock at $10 per share.

Instructions

(a) Journalize the transactions.
(b) Prepare the stockholders' equity section assuming the company had retained earnings of $200,000 at December 31.

action plan

- ✔ When common stock has a par value, credit Common Stock for par value.
- ✔ Use fair market value in a noncash transaction.
- ✔ Debit and credit the Treasury Stock account at cost.
- ✔ Record differences between the cost and selling price of treasury stock in stockholders' equity accounts, not as gains or losses.

Solution to Comprehensive DO IT!

(a)

Date	Account Titles and Explanation	Debit	Credit
Jan. 10	Cash	3,200,000	
	Common Stock		2,000,000
	Paid-in Capital in Excess of Par Value		1,200,000
	(To record issuance of 400,000 shares of $5 par value stock)		
July 1	Land	825,000	
	Common Stock		500,000
	Paid-in Capital in Excess of Par Value		325,000
	(To record issuance of 100,000 shares of $5 par value stock for land)		
Sept. 1	Treasury Stock	90,000	
	Cash		90,000
	(To record purchase of 10,000 shares of treasury stock at cost)		
Dec. 1	Cash	40,000	
	Treasury Stock		36,000
	Paid-in Capital from Treasury Stock		4,000
	(To record sale of 4,000 shares of treasury stock above cost)		

(b)

ROLMAN CORPORATION
Balance Sheet (partial)

Stockholders' equity		
Paid-in capital		
Capital stock		
Common stock, $5 par value, 1,000,000 shares authorized, 500,000 shares issued, 494,000 shares outstanding		$2,500,000
Additional paid-in capital		
In excess of par value	$1,525,000	
From treasury stock	4,000	
Total additional paid-in capital		1,529,000
Total paid-in capital		4,029,000
Retained earnings		200,000
Total paid-in capital and retained earnings		4,229,000
Less: Treasury stock (6,000 shares)		(54,000)
Total stockholders' equity		$4,175,000

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SUMMARY OF STUDY OBJECTIVES

1 **Identify the major characteristics of a corporation.** The major characteristics of a corporation are separate legal existence, limited liability of stockholders, transferable ownership rights, ability to acquire capital, continuous life, corporation management, government regulations, and additional taxes.

2 **Differentiate between paid-in capital and retained earnings.** Paid-in capital is the total amount paid in on capital stock. It is often called contributed capital. Retained earnings is net income retained in a corporation. It is often called earned capital.

3 **Record the issuance of common stock.** When companies record the issuance of common stock for cash, they credit the par value of the shares to Common Stock. They record in a separate paid-in capital account the portion of the proceeds that is above or below par value. When no-par common stock has a stated value, the entries are similar to those for par value stock. When no-par stock does not have

a stated value, companies credit the entire proceeds to Common Stock.

4 **Explain the accounting for treasury stock.** The cost method is generally used in accounting for treasury stock. Under this approach, companies debit Treasury Stock at the price paid to reacquire the shares. They credit the same amount to Treasury Stock when they sell the shares. The difference between the sales price and cost is recorded in stockholders' equity accounts, not in income statement accounts.

5 **Differentiate preferred stock from common stock.** Preferred stock has contractual provisions that give it priority over common stock in certain areas. Typically, preferred stockholders have a preference (1) to dividends and (2) to assets in liquidation. They usually do not have voting rights.

6 **Prepare a stockholders' equity section.** In the stockholders' equity section, companies report paid-in capital and retained earnings and identify specific sources of paid-in capital. Within paid-in capital, two classifications are shown: capital stock and additional paid-in capital. If a corporation has treasury stock, it deducts the cost of treasury stock from total paid-in capital and retained earnings to obtain total stockholders' equity.

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GLOSSARY

Authorized stock The amount of stock that a corporation is authorized to sell as indicated in its charter. (p. 575).

By-laws The internal rules and procedures for conducting the affairs of a corporation. (p. 573).

Charter A document that creates a corporation. (p. 573).

Corporation A business organized as a legal entity separate and distinct from its owners under state corporation law. (p. 570).

Cumulative dividend A feature of preferred stock entitling the stockholder to receive current and unpaid prior-year dividends before common stockholders receive dividends. (p. 587).

No-par value stock Capital stock that has not been assigned a value in the corporate charter. (p. 577).

Organization costs Costs incurred in the formation of a corporation. (p. 574).

Outstanding stock Capital stock that has been issued and is being held by stockholders. (p. 583).

Paid-in capital Total amount of cash and other assets paid in to the corporation by stockholders in exchange for capital stock. (p. 578).

Par value stock Capital stock that has been assigned a value per share in the corporate charter. (p. 577).

Preferred stock Capital stock that has some preferences over common stock. (p. 586).

Privately held corporation A corporation that has only a few stockholders and whose stock is not available for sale to the general public. (p. 570).

Publicly held corporation A corporation that may have thousands of stockholders and whose stock is regularly traded on a national securities exchange. (p. 570).

Retained earnings Net income that is retained in the corporation for future use. (p. 578).

Stated value The amount per share assigned by the board of directors to no-par stock. (p. 577).

Treasury stock A corporation's own stock that has been issued and subsequently reacquired from shareholders by the corporation but not retired. (p. 582).

SELF-STUDY QUESTIONS

Answers are at the end of the chapter.

(SO 1) **1.** Which of the following is *not* a major advantage of a corporation?
- **a.** Separate legal existence.
- **b.** Continuous life.
- **c.** Government regulations.
- **d.** Transferable ownership rights.

(SO 1) **2.** A major disadvantage of a corporation is:
- **a.** limited liability of stockholders.
- **b.** additional taxes.
- **c.** transferable ownership rights.
- **d.** none of the above.

3. Costs incurred in the formation of a corporation: (SO 2)
- **a.** do not include legal fees.
- **b.** are expensed as incurred.
- **c.** are recorded as an asset.
- **d.** provide future benefits whose amounts and timing are easily determined.

4. Which of the following statements is *false*? (SO 1)
- **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 per share applies to par value stock but not to no-par value stock.

(SO 2) **5.** Total stockholders' equity (in the absense of treasury stock) equals:
a. Paid-in capital + Additional paid-in capital + Retained earnings.
b. Paid-in capital + Capital stock + Retained earnings.
c. Capital stock + Additional paid-in capital − Retained earnings.
d. Paid in capital + Retained earnings.

(SO 2) **6.** The account Retained Earnings is:
a. a subdivision of paid-in capital.
b. net income retained in the corporation.
c. reported as an expense in the income statement.
d. closed to capital stock.

(SO 3) **7.** A-Team Corporation issued 1,000 shares of $5 par value stock for land. The stock is actively traded at $9 per share. The land was advertised for sale at $10,500. The land should be recorded at:
a. $4,000.
b. $5,000.
c. $9,000.
d. $10,500.

(SO 3) **8.** ABC Corporation issues 1,000 shares of $10 par value common stock at $12 per share. In recording the transaction, 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.

(SO 4) **9.** Treasury stock may be repurchased:
a. to reissue the shares to officers and employees under bonus and stock compensation plans.
b. to signal to the stock market that management believes the stock is underpriced.
c. to have additional shares available for use in the acquisition of other companies.
d. more than one of the above.

(SO 4) **10.** XYZ, Inc. sells 100 shares of $5 par value treasury stock at $13 per share. If the cost of acquiring the shares was $10 per share, the entry for the sale should include credits to:
a. Treasury Stock $1,000 and Paid-in Capital from Treasury Stock $300.
b. Treasury Stock $500 and Paid-in Capital from Treasury Stock $800.
c. Treasury Stock $1,000 and Retained Earnings $300.
d. Treasury Stock $500 and Paid-in Capital in Excess of Par Value $800.

11. In the stockholders' equity section, the cost of treasury stock is deducted from: (SO 4)
a. total paid-in capital and retained earnings.
b. retained earnings.
c. total stockholders' equity.
d. common stock in paid-in capital.

12. Preferred stock may have priority over common stock *except* in: (SO 5)
a. dividends.
b. assets in the event of liquidation.
c. cumulative dividend features.
d. voting.

13. Which of the following is *not* reported under additional paid-in capital? (SO 6)
a. Paid-in capital in excess of par value.
b. Common stock.
c. Paid-in capital in excess of stated value.
d. Paid-in capital from treasury stock.

14. 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: (SO 5)
a. $0.
b. $295,000.
c. $215,000.
d. $135,000.

15. In the stockholders' equity section of the balance sheet, common stock: (SO 6)
a. is listed before preferred stock.
b. is added to total capital stock.
c. is part of paid-in capital.
d. is part of additional paid-in capital.

Go to the book's companion website, **www.wiley.com/college/weygandt**, for Additional Self-Study questions.

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QUESTIONS

1. Eric Fink, a student, asks your help in understanding the following characteristics of a corporation: (a) separate legal existence, (b) limited liability of stockholders, and (c) transferable ownership rights. Explain these characteristics to Eric.

2. (a) Your friend Vicky Biel cannot understand how the characteristic of corporation management is both an advantage and a disadvantage. Clarify this problem for Vicky.
(b) Identify and explain two other disadvantages of a corporation.

3. (a) The following terms pertain to the forming of a corporation: (1) charter, (2) by-laws, and (3) organization costs. Explain the terms.
(b) Linda Merando believes a corporation must be incorporated in the state in which its headquarters office is located. Is Linda correct? Explain.

4. What are the basic ownership rights of common stockholders in the absence of restrictive provisions?
5. **(a)** What are the two principal components of stockholders' equity?
   (b) What is paid-in capital? Give three examples.
6. How do the financial statements for a corporation differ from the statements for a proprietorship?
7. The corporate charter of Hawes Corporation allows the issuance of a maximum of 100,000 shares of common stock. During its first two years of operations, Hawes sold 70,000 shares to shareholders and reacquired 7,000 of these shares. After these transactions, how many shares are authorized, issued, and outstanding?
8. Which is the better investment—common stock with a par value of $5 per share, or common stock with a par value of $20 per share? Why?
9. What factors help determine the market value of stock?
10. What effect does the issuance of stock at a price above par value have on the issuer's net income? Explain.
11. Why is common stock usually not issued at a price that is less than par value?
12. Land appraised at $80,000 is purchased by issuing 1,000 shares of $20 par value common stock. The market price of the shares at the time of the exchange, based on active trading in the securities market, is $95 per share. Should the land be recorded at $20,000, $80,000, or $95,000? Explain.
13. For what reasons might a company like IBM repurchase some of its stock (treasury stock)?
14. Kwun, Inc. purchases 1,000 shares of its own previously issued $5 par common stock for $12,000. Assuming the shares are held in the treasury, what effect does this transaction have on (a) net income, (b) total assets, (c) total paid-in capital, and (d) total stockholders' equity?
15. The treasury stock purchased in question 14 is resold by Kwun, Inc. for $18,000. What effect does this transaction have on (a) net income, (b) total assets, (c) total paid-in capital, and (d) total stockholders' equity?
16. **(a)** What are the principal differences between common stock and preferred stock?
    (b) Preferred stock may be cumulative. Discuss this feature.
    (c) How are dividends in arrears presented in the financial statements?
17. Ruiz Inc.'s common stock has a par value of $1 and a current market value of $15. Explain why these amounts are different.
18. Indicate how each of the following accounts should be classified in the stockholders' equity section.
    (a) Common stock
    (b) Paid-in capital in excess of par value
    (c) Retained earnings
    (d) Treasury stock
    (e) Paid-in capital from treasury stock
    (f) Paid-in capital in excess of stated value
    (g) Preferred stock
19. PEPSICO How many shares of treasury stock did PepsiCo have at December 29, 2007, and at December 30, 2006?

BRIEF EXERCISES

PLUS

BE13-1 Ken Fritz is studying for his accounting midterm examination. Identify for Ken the advantages and disadvantages of the corporate form of business organization.

List the advantages and disadvantages of a corporation. (SO 1)

BE13-2 At December 31, Kunkel Corporation reports net income of $450,000. Prepare the entry to close net income.

Prepare closing entries for a corporation. (SO 2)

BE13-3 On May 10, Mazili Corporation issues 2,000 shares of $10 par value common stock for cash at $18 per share. Journalize the issuance of the stock.

Prepare entries for issuance of par value common stock. (SO 3)

BE13-4 On June 1, Mendoza Inc. issues 3,000 shares of no-par common stock at a cash price of $6 per share. Journalize the issuance of the shares assuming the stock has a stated value of $1 per share.

Prepare entries for issuance of no-par value common stock. (SO 3)

BE13-5 Kane 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.

Prepare entries for issuance of stock in a noncash transaction. (SO 3)

BE13-6 On July 1, Goetz Corporation purchases 500 shares of its $5 par value common stock for the treasury at a cash price of $8 per share. On September 1, it sells 300 shares of the treasury stock for cash at $11 per share. Journalize the two treasury stock transactions.

Prepare entries for treasury stock transactions. (SO 4)

BE13-7 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.

Prepare entries for issuance of preferred stock. (SO 5)

Prepare stockholders' equity section.
(SO 6)

BE13-8 Ermler Corporation has the following accounts at December 31: Common Stock, $10 par, 5,000 shares issued, $50,000; Paid-in Capital in Excess of Par Value $20,000; Retained Earnings $45,000; and Treasury Stock—Common, 500 shares, $11,000. Prepare the stockholders' equity section of the balance sheet.

DO IT! REVIEW

Analyze statements about corporate organization.
(SO 1)

DO IT! 13-1 Indicate whether each of the following statements is true or false.

_____ **1.** The corporation is an entity separate and distinct from its owners.
_____ **2.** The liability of stockholders is normally limited to their investment in the corporation.
_____ **3.** The relative lack of government regulation is an advantage of the corporate form of business.
_____ **4.** There is no journal entry to record the authorization of capital stock.
_____ **5.** No-par value stock is quite rare today.

Close net income and prepare stockholders' equity section.
(SO 2)

DO IT! 13-2 At the end of its first year of operation, Dade Corporation has $1,000,000 of common stock and net income of $216,000. Prepare (a) the closing entry for net income and (b) the stockholders' equity section at year-end.

Journalize issuance of stock.
(SO 3)

DO IT! 13-3 Caribbean Corporation began operations on April 1 by issuing 60,000 shares of $5 par value common stock for cash at $13 per share. On April 19, it issued 2,000 shares of common stock to attorneys in settlement of their bill of $27,500 for organization costs. Journalize both issuances, assuming the stock is not publicly traded.

Journalize treasury stock transactions.
(SO 4)

DO IT! 13-4 Chiapas Corporation purchased 2,000 shares of its $10 par value common stock for $120,000 on August 1. It will hold these shares in the treasury until resold. On December 1, the corporation sold 1,200 shares of treasury stock for cash at $72 per share. Journalize the treasury stock transactions.

Prepare stockholders' equity section.
(SO 6)

DO IT! 13-5 Connolly Corporation has issued 100,000 shares of $5 par value common stock. It authorized 500,000 shares. The paid-in capital in excess of par value on the common stock is $240,000. The corporation has reacquired 7,000 shares at a cost of $46,000 and is currently holding those shares. Treasury stock was reissued in prior years for $47,000 more than its cost.

The corporation also has 2,000 shares issued and outstanding of 7%, $100 par-value preferred stock. It authorized 10,000 shares. The paid-in capital in excess of par value on the preferred stock is $23,000.

Retained earnings is $372,000.

Prepare the stockholders' equity section of the balance sheet.

EXERCISES

Identify characteristics of a corporation.
(SO 1)

E13-1 Jeff Lynne has prepared the following list of statements about corporations.

1. A corporation is an entity separate and distinct from its owners.
2. As a legal entity, a corporation has most of the rights and privileges of a person.
3. Most of the largest U.S. corporations are privately held corporations.
4. Corporations may buy, own, and sell property; borrow money; enter into legally binding contracts; and sue and be sued.
5. The net income of a corporation is not taxed as a separate entity.
6. Creditors have a legal claim on the personal assets of the owners of a corporation if the corporation does not pay its debts.
7. The transfer of stock from one owner to another requires the approval of either the corporation or other stockholders.
8. The board of directors of a corporation legally owns the corporation.
9. The chief accounting officer of a corporation is the controller.
10. Corporations are subject to less state and federal regulations than partnerships or proprietorships.

Instructions
Identify each statement as true or false. If false, indicate how to correct the statement.

E13-2 Jeff Lynne (see E13-1) has studied the information you gave him in that exercise and has come to you with more statements about corporations.

Identify characteristics of a corporation.

(SO 1, 2)

1. Corporation management is both an advantage and a disadvantage of a corporation compared to a proprietorship or a partnership.
2. Limited liability of stockholders, government regulations, and additional taxes are the major disadvantages of a corporation.
3. When a corporation is formed, organization costs are recorded as an asset.
4. Each share of common stock gives the stockholder the ownership rights to vote at stockholder meetings, share in corporate earnings, keep the same percentage ownership when new shares of stock are issued, and share in assets upon liquidation.
5. The number of issued shares is always greater than or equal to the number of authorized shares.
6. A journal entry is required for the authorization of capital stock.
7. Publicly held corporations usually issue stock directly to investors.
8. The trading of capital stock on a securities exchange involves the transfer of already issued shares from an existing stockholder to another investor.
9. The market value of common stock is usually the same as its par value.
10. Retained earnings is the total amount of cash and other assets paid in to the corporation by stockholders in exchange for capital stock.

Instructions

Identify each statement as true or false. If false, indicate how to correct the statement.

E13-3 During its first year of operations, Harlan Corporation had the following transactions pertaining to its common stock.

Journalize issuance of common stock.

(SO 3)

Jan. 10 Issued 70,000 shares for cash at $5 per share.
July 1 Issued 40,000 shares for cash at $7 per share.

Instructions

(a) Journalize the transactions, assuming that the common stock has a par value of $5 per share.
(b) Journalize the transactions, assuming that the common stock is no-par with a stated value of $1 per share.

E13-4 Grossman Corporation issued 1,000 shares of stock.

Journalize issuance of common stock.

(SO 3)

Instructions

Prepare the entry for the issuance under the following assumptions.

(a) The stock had a par value of $5 per share and was issued for a total of $52,000.
(b) The stock had a stated value of $5 per share and was issued for a total of $52,000.
(c) The stock had no par or stated value and was issued for a total of $52,000.
(d) The stock had a par value of $5 per share and was issued to attorneys for services during incorporation valued at $52,000.
(e) The stock had a par value of $5 per share and was issued for land worth $52,000.

E13-5 Leone Co. had the following transactions during the current period.

Journalize issuance of common and preferred stock and purchase of treasury stock.

(SO 3, 4, 5)

Mar. 2 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.
June 12 Issued 60,000 shares of $5 par value common stock for cash of $375,000.
July 11 Issued 1,000 shares of $100 par value preferred stock for cash at $110 per share.
Nov. 28 Purchased 2,000 shares of treasury stock for $80,000.

Instructions

Journalize the transactions.

E13-6 As an auditor for the CPA firm of Bunge and Dodd, you encounter the following situations in auditing different clients.

Journalize noncash common stock transactions.

(SO 3)

1. Desi Corporation is a closely held corporation whose stock is not publicly traded. On December 5, the corporation acquired land by issuing 5,000 shares of its $20 par value common stock. The owners' asking price for the land was $120,000, and the fair market value of the land was $115,000.

2. Lucille Corporation is a publicly held corporation whose common stock is traded on the securities markets. On June 1, it acquired land by issuing 20,000 shares of its $10 par value stock. At the time of the exchange, the land was advertised for sale at $250,000. The stock was selling at $12 per share.

Instructions

Prepare the journal entries for each of the situations above.

Journalize treasury stock transactions.
(SO 4)

E13-7 On January 1, 2010, the stockholders' equity section of Nunez Corporation shows: Common stock ($5 par value) $1,500,000; paid-in capital in excess of par value $1,000,000; and retained earnings $1,200,000. During the year, the following treasury stock transactions occurred.

Mar. 1 Purchased 50,000 shares for cash at $15 per share.
July 1 Sold 10,000 treasury shares for cash at $17 per share.
Sept. 1 Sold 8,000 treasury shares for cash at $14 per share.

Instructions

(a) Journalize the treasury stock transactions.
(b) Restate the entry for September 1, assuming the treasury shares were sold at $12 per share.

Journalize treasury stock transactions.
(SO 4)

E13-8 Mad City Corporation purchased from its stockholders 5,000 shares of its own previously issued stock for $250,000. It later resold 2,000 shares for $54 per share, then 2,000 more shares for $49 per share, and finally 1,000 shares for $40 per share.

Instructions

Prepare journal entries for the purchase of the treasury stock and the three sales of treasury stock.

Journalize preferred stock transactions and indicate statement presentation.
(SO 5, 6)

E13-9 Polzin Corporation is authorized to issue both preferred and common stock. The par value of the preferred is $50. During the first year of operations, the company had the following events and transactions pertaining to its preferred stock.

Feb. 1 Issued 20,000 shares for cash at $53 per share.
July 1 Issued 12,000 shares for cash at $57 per share.

Instructions

(a) Journalize the transactions.
(b) Post to the stockholders' equity accounts.
(c) Indicate the financial statement presentation of the related accounts.

Differentiate between preferred and common stock.
(SO 5)

E13-10 AI Corporation issued 100,000 shares of $20 par value, cumulative, 8% preferred stock on January 1, 2009, for $2,100,000. In December 2011, AI declared its first dividend of $500,000.

Instructions

(a) Prepare AI's journal entry to record the issuance of the preferred stock.
(b) If the preferred stock is *not* cumulative, how much of the $500,000 would be paid to **common** stockholders?
(c) If the preferred stock is cumulative, how much of the $500,000 would be paid to **common** stockholders?

Prepare correct entries for capital stock transactions.
(SO 3, 4, 5)

E13-11 Roemer Corporation recently hired a new accountant with extensive experience in accounting for partnerships. Because of the pressure of the new job, the accountant was unable to review his textbooks on the topic of corporation accounting. During the first month, the accountant made the following entries for the corporation's capital stock.

May 2	Cash	130,000	
	Capital Stock		130,000
	(Issued 10,000 shares of $10 par value common stock at $13 per share)		
10	Cash	600,000	
	Capital Stock		600,000
	(Issued 10,000 shares of $50 par value preferred stock at $60 per share)		

15	Capital Stock	15,000	
	Cash		15,000
	(Purchased 1,000 shares of common stock for the treasury at $15 per share)		
31	Cash	8,000	
	Capital Stock		5,000
	Gain on Sale of Stock		3,000
	(Sold 500 shares of treasury stock at $16 per share)		

Instructions

On the basis of the explanation for each entry, prepare the entry that should have been made for the capital stock transactions.

E13-12 The following stockholders' equity accounts, arranged alphabetically, are in the ledger of Freeze Corporation at December 31, 2010.

Prepare a stockholders' equity section.

(SO 6)

Common Stock ($5 stated value)	$1,700,000
Paid-in Capital in Excess of Par Value—Preferred Stock	280,000
Paid-in Capital in Excess of Stated Value—Common Stock	900,000
Preferred Stock (8%, $100 par, noncumulative)	500,000
Retained Earnings	1,134,000
Treasury Stock—Common (10,000 shares)	120,000

Instructions

Prepare the stockholders' equity section of the balance sheet at December 31, 2010.

E13-13 The stockholders' equity section of Jarvis Corporation at December 31 is as follows.

Answer questions about stockholders' equity section.

(SO 3, 4, 5, 6)

JARVIS CORPORATION
Balance Sheet (partial)

Paid-in capital	
Preferred stock, cumulative, 10,000 shares authorized, 6,000 shares issued and outstanding	$ 300,000
Common stock, no par, 750,000 shares authorized, 600,000 shares issued	1,200,000
Total paid-in capital	1,500,000
Retained earnings	1,858,000
Total paid-in capital and retained earnings	3,358,000
Less: Treasury stock (10,000 common shares)	(64,000)
Total stockholders' equity	$3,294,000

Instructions

From a review of the stockholders' equity section, as chief accountant, write a memo to the president of the company answering the following questions.

(a) How many shares of common stock are outstanding?
(b) Assuming there is a stated value, what is the stated value of the common stock?
(c) What is the par value of the preferred stock?
(d) If the annual dividend on preferred stock is $30,000, what is the dividend rate on preferred stock?
(e) If dividends of $60,000 were in arrears on preferred stock, what would be the balance in Retained Earnings?

E13-14 In a recent year, the stockholders' equity section of Aluminum Company of America (Alcoa) showed the following (in alphabetical order): additional paid-in capital $6,101, common stock $925, preferred stock $55, retained earnings $7,428, and treasury stock 2,828. All dollar data are in millions.

Prepare a stockholders' equity section.

(SO 6)

The preferred stock has 557,740 shares authorized, with a par value of $100 and an annual $3.75 per share cumulative dividend preference. At December 31, 557,649 shares of preferred are issued and 546,024 shares are outstanding. There are 1.8 billion shares of $1 par value common stock authorized, of which 924.6 million are issued and 844.8 million are outstanding at December 31.

Instructions

Prepare the stockholders' equity section, including disclosure of all relevant data.

Classify stockholders' equity accounts.

(SO 6)

E13-15 The ledger of Mathis Corporation contains the following accounts: Common Stock, Preferred Stock, Treasury Stock—Common, Paid-in Capital in Excess of Par Value—Preferred Stock, Paid-in Capital in Excess of Stated Value—Common Stock, Paid-in Capital from Treasury Stock, and Retained Earnings.

Instructions

Classify each account using the following table headings.

	Paid-in Capital			
Account	**Capital Stock**	**Additional**	**Retained Earnings**	**Other**

EXERCISES: SET B

Visit the book's companion website at **www.wiley.com/college/weygandt**, and choose the Student Companion site, to access Exercise Set B.

PROBLEMS: SET A

Journalize stock transactions, post, and prepare paid-in capital section.

(SO 3, 5, 6)

P13-1A Franco Corporation was organized on January 1, 2010. It is authorized to issue 10,000 shares of 8%, $100 par value preferred stock, and 500,000 shares of no-par common stock with a stated value of $2 per share. The following stock transactions were completed during the first year.

Jan.	10	Issued 80,000 shares of common stock for cash at $4 per share.
Mar.	1	Issued 5,000 shares of preferred stock for cash at $105 per share.
Apr.	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 $85,000.
May	1	Issued 80,000 shares of common stock for cash at $4.50 per share.
Aug.	1	Issued 10,000 shares of common stock to attorneys in payment of their bill of $30,000 for services provided in helping the company organize.
Sept.	1	Issued 10,000 shares of common stock for cash at $5 per share.
Nov.	1	Issued 1,000 shares of preferred stock for cash at $109 per share.

Instructions

(a) Journalize the transactions.

(b) Post to the stockholders' equity accounts. (Use J5 as the posting reference.)

(c) Prepare the paid-in capital section of stockholders' equity at December 31, 2010.

(c) Total paid-in capital $1,479,000

Journalize and post treasury stock transactions, and prepare stockholders' equity section.

(SO 4, 6)

P13-2A Jacobsen Corporation had the following stockholders' equity accounts on January 1, 2010: Common Stock ($5 par) $500,000, Paid-in Capital in Excess of Par Value $200,000, and Retained Earnings $100,000. In 2010, the company had the following treasury stock transactions.

Mar.	1	Purchased 5,000 shares at $9 per share.
June	1	Sold 1,000 shares at $12 per share.
Sept.	1	Sold 2,000 shares at $10 per share.
Dec.	1	Sold 1,000 shares at $6 per share.

Jacobsen Corporation uses the cost method of accounting for treasury stock. In 2010, the company reported net income of $30,000.

Instructions

(a) Journalize the treasury stock transactions, and prepare the closing entry at December 31, 2010, for net income.

(b) Open accounts for (1) Paid-in Capital from Treasury Stock, (2) Treasury Stock, and (3) Retained Earnings. Post to these accounts using J10 as the posting reference.

(c) Prepare the stockholders' equity section for Jacobsen Corporation at December 31, 2010.

(b) Treasury Stock $9,000

(c) Total stockholders' equity $823,000

Journalize and post transactions, prepare stockholders' equity section.

(SO 2, 3, 4, 5, 6)

P13-3A The stockholders' equity accounts of Neer Corporation on January 1, 2010, were as follows.

Preferred Stock (8%, $50 par, cumulative, 10,000 shares authorized)	$ 400,000
Common Stock ($1 stated value, 2,000,000 shares authorized)	1,000,000
Paid-in Capital in Excess of Par Value—Preferred Stock	100,000
Paid-in Capital in Excess of Stated Value—Common Stock	1,450,000
Retained Earnings	1,816,000
Treasury Stock—Common (10,000 shares)	50,000

During 2010, the corporation had the following transactions and events pertaining to its stockholders' equity.

Feb. 1	Issued 25,000 shares of common stock for $120,000.
Apr. 14	Sold 6,000 shares of treasury stock—common for $33,000.
Sept. 3	Issued 5,000 shares of common stock for a patent valued at $35,000.
Nov. 10	Purchased 1,000 shares of common stock for the treasury at a cost of $6,000.
Dec. 31	Determined that net income for the year was $452,000.

No dividends were declared during the year.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts, and post the journal entries to the stockholders' equity accounts. (Use J5 for the posting reference.)

(c) Prepare a stockholders' equity section at December 31, 2010, including the disclosure of the preferred dividends in arrears.

(c) Total stockholders' equity $5,350,000

Journalize and post stock transactions, and prepare stockholders' equity section.

(SO 2, 3, 5, 6)

P13-4A Vargas Corporation is authorized to issue 20,000 shares of $50 par value, 10% preferred stock and 125,000 shares of $3 par value common stock. On January 1, 2010, the ledger contained the following stockholders' equity balances.

Preferred Stock (10,000 shares)	$500,000
Paid-in Capital in Excess of Par Value—Preferred	75,000
Common Stock (70,000 shares)	210,000
Paid-in Capital in Excess of Par Value—Common	700,000
Retained Earnings	300,000

During 2010, the following transactions occurred.

Feb. 1	Issued 2,000 shares of preferred stock for land having a fair market value of $125,000.
Mar. 1	Issued 1,000 shares of preferred stock for cash at $65 per share.
July 1	Issued 16,000 shares of common stock for cash at $7 per share.
Sept. 1	Issued 400 shares of preferred stock for a patent. The asking price of the patent was $30,000. Market values were preferred stock $70 and patent indeterminable.
Dec. 1	Issued 8,000 shares of common stock for cash at $7.50 per share.
Dec. 31	Net income for the year was $260,000. No dividends were declared.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts, and post the journal entries to the stockholders' equity accounts. (Use J2 for the posting reference.)

(c) Prepare a stockholders' equity section at December 31, 2010.

(c) Total stockholders' equity $2,435,000

Prepare stockholders' equity section.

(SO 6)

P13-5A The following stockholders' equity accounts arranged alphabetically are in the ledger of Tyner Corporation at December 31, 2010.

Common Stock ($5 stated value)	$2,000,000
Paid-in Capital from Treasury Stock	10,000
Paid-in Capital in Excess of Stated Value—Common Stock	1,600,000
Paid-in Capital in Excess of Par Value—Preferred Stock	679,000
Preferred Stock (8%, $50 par, noncumulative)	800,000
Retained Earnings	1,748,000
Treasury Stock—Common (10,000 shares)	130,000

Instructions

Prepare a stockholders' equity section at December 31, 2010.

Total stockholders' equity $6,707,000

Prepare entries for stock transactions and prepare stockholders' equity section.
(SO 3, 4, 5, 6)

P13-6A Palmaro Corporation has been authorized to issue 20,000 shares of $100 par value, 10%, noncumulative preferred stock and 1,000,000 shares of no-par common stock. The corporation assigned a $2.50 stated value to the common stock. At December 31, 2010, the ledger contained the following balances pertaining to stockholders' equity.

Preferred Stock	$120,000
Paid-in Capital in Excess of Par Value—Preferred	20,000
Common Stock	1,000,000
Paid-in Capital in Excess of Stated Value—Common	1,800,000
Treasury Stock—Common (1,000 shares)	13,000
Paid-in Capital from Treasury Stock	500
Retained Earnings	82,000

The preferred stock was issued for land having a fair market value of $140,000. All common stock issued was for cash. In November, 1,500 shares of common stock were purchased for the treasury at a per share cost of $13. In December, 500 shares of treasury stock were sold for $14 per share. No dividends were declared in 2010.

Instructions

(a) Prepare the journal entries for the:
- **(1)** Issuance of preferred stock for land.
- **(2)** Issuance of common stock for cash.
- **(3)** Purchase of common treasury stock for cash.
- **(4)** Sale of treasury stock for cash.

(b) Prepare the stockholders' equity section at December 31, 2010.

(b) Total stockholders' equity $3,009,500

PROBLEMS: SET B

Journalize stock transactions, post, and prepare paid-in capital section.
(SO 3, 5, 6)

P13-1B Donelson Corporation was organized on January 1, 2010. It is authorized to issue 20,000 shares of 6%, $40 par value preferred stock, and 500,000 shares of no-par common stock with a stated value of $2 per share. The following stock transactions were completed during the first year.

Jan.	10	Issued 100,000 shares of common stock for cash at $3 per share.
Mar.	1	Issued 10,000 shares of preferred stock for cash at $55 per share.
Apr.	1	Issued 25,000 shares of common stock for land. The asking price of the land was $90,000. The company's estimate of fair market value of the land was $75,000.
May	1	Issued 75,000 shares of common stock for cash at $4 per share.
Aug.	1	Issued 10,000 shares of common stock to attorneys in payment of their bill for $50,000 for services provided in helping the company organize.
Sept.	1	Issued 5,000 shares of common stock for cash at $6 per share.
Nov.	1	Issued 2,000 shares of preferred stock for cash at $60 per share.

Instructions

(a) Journalize the transactions.
(b) Post to the stockholders' equity accounts. (Use J1 as the posting reference.)
(c) Prepare the paid-in capital section of stockholders' equity at December 31, 2010.

(c) Total paid-in capital $1,425,000

Journalize and post treasury stock transactions, and prepare stockholders' equity section.
(SO 4, 6)

P13-2B Gentry Corporation had the following stockholders' equity accounts on January 1, 2010: Common Stock ($1 par) $400,000, Paid-in Capital in Excess of Par Value $500,000, and Retained Earnings $100,000. In 2010, the company had the following treasury stock transactions.

Mar.	1	Purchased 5,000 shares at $7 per share.
June	1	Sold 1,000 shares at $10 per share.
Sept.	1	Sold 2,000 shares at $9 per share.
Dec.	1	Sold 1,000 shares at $5 per share.

Gentry Corporation uses the cost method of accounting for treasury stock. In 2010, the company reported net income of $80,000.

Instructions

(a) Journalize the treasury stock transactions, and prepare the closing entry at December 31, 2010, for net income.

(b) Open accounts for (1) Paid-in Capital from Treasury Stock, (2) Treasury Stock, and (3) Retained Earnings. Post to these accounts using J12 as the posting reference.

(c) Prepare the stockholders' equity section for Gentry Corporation at December 31, 2010.

(b) Treasury Stock $7,000
(c) Total stockholders' equity $1,078,000

Journalize and post transactions, prepare stockholders' equity section.

(SO 2, 3, 4, 5, 6)

P13-3B The stockholders' equity accounts of Miles Corporation on January 1, 2010, were as follows.

Preferred Stock (10%, $100 par, noncumulative, 5,000 shares authorized)	$ 300,000
Common Stock ($5 stated value, 300,000 shares authorized)	1,000,000
Paid-in Capital in Excess of Par Value—Preferred Stock	20,000
Paid-in Capital in Excess of Stated Value—Common Stock	425,000
Retained Earnings	488,000
Treasury Stock—Common (5,000 shares)	40,000

During 2010, the corporation had the following transactions and events pertaining to its stockholders' equity.

Feb. 1	Issued 3,000 shares of common stock for $25,500.
Mar. 20	Purchased 1,500 additional shares of common treasury stock at $8 per share.
June 14	Sold 4,000 shares of treasury stock—common for $36,000.
Sept. 3	Issued 2,000 shares of common stock for a patent valued at $19,000.
Dec. 31	Determined that net income for the year was $350,000.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts and post the journal entries to the stockholders' equity accounts. (Use J1 as the posting reference.)

(c) Prepare a stockholders' equity section at December 31, 2010.

(c) Total stockholders' equity $2,611,500

Journalize and post stock transactions, and prepare stockholders' equity section.

(SO 2, 3, 5, 6)

P13-4B Molina Corporation is authorized to issue 10,000 shares of $40 par value, 10% preferred stock and 200,000 shares of $5 par value common stock. On January 1, 2010, the ledger contained the following stockholders' equity balances.

Preferred Stock (5,000 shares)	$200,000
Paid-in Capital in Excess of Par Value—Preferred	60,000
Common Stock (70,000 shares)	350,000
Paid-in Capital in Excess of Par Value—Common	700,000
Retained Earnings	300,000

During 2010, the following transactions occurred.

Feb. 1	Issued 1,000 shares of preferred stock for land having a fair market value of $65,000.
Mar. 1	Issued 2,000 shares of preferred stock for cash at $60 per share.
July 1	Issued 20,000 shares of common stock for cash at $5.80 per share.
Sept. 1	Issued 800 shares of preferred stock for a patent. The asking price of the patent was $60,000. Market values were preferred stock $65 and patent, indeterminable.
Dec. 1	Issued 10,000 shares of common stock for cash at $6 per share.
Dec. 31	Net income for the year was $210,000. No dividends were declared.

Instructions

(a) Journalize the transactions and the closing entry for net income.

(b) Enter the beginning balances in the accounts, and post the journal entries to the stockholders' equity accounts. (Use J2 as the posting reference.)

(c) Prepare a stockholders' equity section at December 31, 2010.

(c) Total stockholders' equity $2,233,000

Prepare stockholders' equity section.

(SO 6)

P13-5B The following stockholders' equity accounts arranged alphabetically are in the ledger of Jenkins Corporation at December 31, 2010.

Common Stock ($10 stated value)	$1,200,000
Paid-in Capital from Treasury Stock	6,000
Paid-in Capital in Excess of Stated Value—Common Stock	690,000
Paid-in Capital in Excess of Par Value—Preferred Stock	288,400
Preferred Stock (8%, $100 par, noncumulative)	300,000
Retained Earnings	826,000
Treasury Stock—Common (8,000 shares)	88,000

Total stockholders' equity $3,222,400

Instructions
Prepare a stockholders' equity section at December 31, 2010.

Prepare entries for stock transactions and prepare stockholders' equity section.
(SO 3, 4, 5, 6)

P13-6B Steven Corporation has been authorized to issue 40,000 shares of $100 par value, 8%, noncumulative preferred stock and 2,000,000 shares of no-par common stock. The corporation assigned a $5 stated value to the common stock. At December 31, 2010, the ledger contained the following balances pertaining to stockholders' equity.

Preferred Stock	$ 240,000
Paid-in Capital in Excess of Par Value—Preferred	56,000
Common Stock	2,000,000
Paid-in Capital in Excess of Stated Value—Common	4,400,000
Treasury Stock—Common (1,000 shares)	22,000
Paid-in Capital from Treasury Stock	3,000
Retained Earnings	560,000

The preferred stock was issued for land having a fair market value of $296,000. All common stock issued was for cash. In November, 1,500 shares of common stock were purchased for the treasury at a per share cost of $22. In December, 500 shares of treasury stock were sold for $28 per share. No dividends were declared in 2010.

Instructions
(a) Prepare the journal entries for the:
 (1) Issuance of preferred stock for land.
 (2) Issuance of common stock for cash.
 (3) Purchase of common treasury stock for cash.
 (4) Sale of treasury stock for cash.
(b) Prepare the stockholders' equity section at December 31, 2010.

(b) Total stockholders' equity $7,237,000

PROBLEMS: SET C

Visit the book's companion website at **www.wiley.com/college/weygandt**, and choose the Student Companion site, to access Problem Set C.

CONTINUING COOKIE CHRONICLE

(*Note:* This is a continuation of the Cookie Chronicle from Chapters 1 through 12.)

CCC13 Natalie's friend, Curtis Lesperance, decides to meet with Natalie after hearing that her discussions about a possible business partnership with her friend Katy Peterson have failed. Because Natalie has been so successful with Cookie Creations and Curtis has been just as successful with his coffee shop, they both conclude that they could benefit from each other's business expertise. Curtis and Natalie next evaluate the different types of business organization, and because of the advantage of limited personal liability, decide to form a corporation. Natalie and Curtis are very excited about this new business venture. They come to you with information about their businesses and with a number of questions.

Go to the book's companion website, **www.wiley.com/college/weygandt**, *to see the completion of this problem.*

BROADENING YOUR PERSPECTIVE

FINANCIAL REPORTING AND ANALYSIS

Financial Reporting Problem: PepsiCo

BYP13-1 The stockholders' equity section for PepsiCo, Inc. is shown in Appendix A. You will also find data relative to this problem on other pages of the appendix.

Instructions

(a) What is the par or stated value per share of PepsiCo's common stock?
(b) What percentage of PepsiCo's authorized common stock was issued at December 29, 2007?
(c) How many shares of common stock were outstanding at December 29, 2007, and at December 30, 2006?
(d) What was the high and low market price per share in the fourth quarter of fiscal 2007, as reported under Selected Financial Data?

Comparative Analysis Problem: PepsiCo vs. Coca-Cola

BYP13-2 PepsiCo, Inc.'s financial statements are presented in Appendix A. Financial statements of The Coca-Cola Company are presented in Appendix B.

Instructions

(a) What is the par or stated value of Coca-Cola's and PepsiCo's common of capital, stock?
(b) What percentage of authorized shares was issued by Coca-Cola at December 31, 2007, and by PepsiCo at December 29, 2007?
(c) How many shares are held as treasury stock by Coca-Cola at December 31, 2007, and by PepsiCo at December 29, 2007?
(d) How many Coca-Cola common shares are outstanding at December 31, 2007? How many PepsiCo shares of capital stock are outstanding at December 29, 2007?

Exploring the Web

BYP13-3 SEC filings of publicly traded companies are available to view online.

Address: http://biz.yahoo.com/i, or go to **www.wiley.com/college/weygandt**

Steps

1. Pick a company and type in the company's name.
2. Choose **Quote**.

Instructions

Answer the following questions.

(a) What company did you select?
(b) What is its stock symbol?
(c) What was the stock's trading range today?
(d) What was the stock's trading range for the year?

CRITICAL THINKING

Decision Making Across the Organization

BYP13-4 The stockholders' meeting for Strauder Corporation has been in progress for some time. The chief financial officer for Strauder is presently reviewing the company's financial statements and is explaining the items that comprise the stockholders' equity section of the balance sheet for the current year. The stockholders' equity section of Strauder Corporation at December 31, 2010, is as follows.

STRAUDER CORPORATION
Balance Sheet (partial)
December 31, 2010

Paid-in capital		
Capital stock		
Preferred stock, authorized 1,000,000 shares cumulative, $100 par value, $8 per share, 6,000 shares issued and outstanding		$ 600,000
Common stock, authorized 5,000,000 shares, $1 par value, 3,000,000 shares issued, and 2,700,000 outstanding		3,000,000
Total capital stock		3,600,000
Additional paid-in capital		
In excess of par value—preferred stock	$ 50,000	
In excess of par value—common stock	25,000,000	
Total additional paid-in capital		25,050,000
Total paid-in capital		28,650,000
Retained earnings		900,000
Total paid-in capital and retained earnings		29,550,000
Less: Common treasury stock (300,000 shares)		9,300,000
Total stockholders' equity		$20,250,000

At the meeting, stockholders have raised a number of questions regarding the stockholders' equity section.

Instructions
With the class divided into groups, answer the following questions as if you were the chief financial officer for Strauder Corporation.

(a) "What does the cumulative provision related to the preferred stock mean?"
(b) "I thought the common stock was presently selling at $29.75, but the company has the stock stated at $1 per share. How can that be?"
(c) "Why is the company buying back its common stock? Furthermore, the treasury stock has a debit balance because it is subtracted from stockholders' equity. Why is treasury stock not reported as an asset if it has a debit balance?"

Communication Activity

BYP13-5 Sid Hosey, your uncle, is an inventor who has decided to incorporate. Uncle Sid knows that you are an accounting major at U.N.O. In a recent letter to you, he ends with the question, "I'm filling out a state incorporation application. Can you tell me the difference in the following terms: (1) authorized stock, (2) issued stock, (3) outstanding stock, (4) preferred stock?"

Instructions
In a brief note, differentiate for Uncle Sid among the four different stock terms. Write the letter to be friendly, yet professional.

Ethics Case

BYP13-6 The R&D division of Marco Chemical Corp. has just developed a chemical for sterilizing the vicious Brazilian "killer bees" which are invading Mexico and the southern states of the United States. The president of Marco is anxious to get the chemical on the market to boost Marco's profits. He believes his job is in jeopardy because of decreasing sales and profits. Marco has an opportunity to sell this chemical in Central American countries, where the laws are much more relaxed than in the United States.

The director of Marco's R&D division strongly recommends further testing in the laboratory for side-effects of this chemical on other insects, birds, animals, plants, and even humans.

He cautions the president, "We could be sued from all sides if the chemical has tragic side-effects that we didn't even test for in the labs." The president answers, "We can't wait an additional year for your lab tests. We can avoid losses from such lawsuits by establishing a separate wholly owned corporation to shield Marco Corp. from such lawsuits. We can't lose any more than our investment in the new corporation, and we'll invest just the patent covering this chemical. We'll reap the benefits if the chemical works and is safe, and avoid the losses from lawsuits if it's a disaster." The following week Marco creates a new wholly owned corporation called Brecht Inc., sells the chemical patent to it for $10, and watches the spraying begin.

Instructions

(a) Who are the stakeholders in this situation?
(b) Are the president's motives and actions ethical?
(c) Can Marco shield itself against losses of Brecht Inc.?

"All About You" Activity

BYP13-7 A high percentage of Americans own stock in corporations. As a shareholder in a corporation, you will receive an annual report. One of the goals of this course is for you to learn how to navigate your way around an annual report.

Instructions

Use the annual report provided in Appendix A to answer the following questions.

(a) What CPA firm performed the audit of PepsiCo's financial statements?
(b) What was the amount of PepsiCo's earnings per share in 2007?
(c) What was net revenue in 2007?
(d) How many shares of treasury stock did the company have at the end of 2007?
(e) How much cash did PepsiCo spend on capital expenditures in 2007?
(f) Over what life does the company depreciate its buildings?
(g) What was the total amount of dividends paid in 2007?

Answers to Insight and Accounting Across the Organization Questions

p. 576 How to Read Stock Quotes

Q: For stocks traded on organized stock exchanges, how are the dollar prices per share established?

A: *The dollar prices per share are established by the interaction between buyers and sellers of the shares.*

Q: What factors might influence the price of shares in the marketplace?

A: *The price of shares is influenced by a company's earnings and dividends as well as by factors beyond a company's control, such as changes in interest rates, labor strikes, scarcity of supplies or resources, and politics. The number of willing buyers and sellers (demand and supply) also plays a part in the price of shares.*

p. 584 Why Did Reebok Buy Its Own Stock?

Q: What signal might a large stock repurchase send to investors regarding management's belief about the company's growth opportunities?

A: *When a company has many growth opportunities it will normally conserve its cash in order to be better able to fund expansion. A large use of cash to buy back stock (and essentially shrink the company) would suggest that management was not optimistic about its growth opportunities.*

Answers to Self-Study Questions

1. c **2.** b **3.** b **4.** d **5.** d **6.** b **7.** c **8.** c **9.** d **10.** a **11.** a **12.** d **13.** b **14.** d **15.** c

Remember to go back to the Navigator box on the chapter-opening page and check off your completed work.