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Notes – Topic 9

Stockholders' Equity

I. Balance Sheet
   a. Stock (Preferred & Common)
   b. Retained Earnings
   c. Reacquired stock (Treasury) – a deduction.
II. Stock
   a. Par Value = Amount that must be kept in the company.
   b. When corporation is chartered, a certain number of shares are authorized.
   c. Issuing: DR Cash, CR Common Stock, CR Additional Paid-In Capital
   d. Common Stock
      i. Common stock is voting stock. Shareholders elect the board of directors.
      ii. Given the preemptive right to buy additional shares so shareholders can maintain their percentage ownership if desired.
      iii. After the firm liquidates, shareholders get any assets left once other obligations are met. They're last in the hierarchy.
   e. Preferred Stock
      i. NOT voting stock.
      ii. Fixed cash dividend (percentage of par value)
      iii. Preference means preferred stockholders get dividends paid before common stockholders.
      iv. More like debt to the company.
      v. Participating. Can get excess dividends if the company is doing well.
      vi. Convertible. Can be converted to common stock.
      vii. Can be callable like bonds.
   f. Treasury Stock
      i. Stock that's been reacquired by the company after it was issued.
      ii. Why?
         1. Need to have shares available for options, et cetera.
         2. Communicates that the company thinks the stock is undervalued. Otherwise why would the company buy it?
         3. Increases earnings-per-share since it reduces the number of shares outstanding.
         4. Avoids hostile takeovers by pulling stock back into ownership.
      iii. Contra equity account
      iv. Accounted for based on the cost paid for acquisition.
      v. Acquire: DR Treasury Stock (Common), CR Cash
      vi. Reissue
         1. DR Cash, CR Treasury Stock (Common), CR Paid-In-Capital – Treasury Stock
         2. DR Cash, CR Treasury Stock, DR Retained Earnings (unless there's an Additional Paid-In Capital balance, then DR that).
III. Retained Earnings
   a. Corporate earnings that have been reinvested in the company.
   b. Dividends
      i. Growth firms don't usually pay dividends – better to reinvest to let the company grow and promote capital gains for investors.
      ii. Stable and established firms normally issue dividends.
      iii. Essentially, if shareholders want capital gains, make the company grow. Otherwise, pay 'em.
      iv. If you pay, do you give cash, stock, or property? Property is very rare.
      v. Declaration date
         1. Company declares that dividends will be paid.

        2. DR Dividends (NOT expense, but contra to Retained Earnings), CR Dividends Payable
    vi. Date of Record
        1. No entry.
        2. Shareholders who own stock on the declaration date will get dividends.
    vii. Payment Date: DR Dividends Payable, CR Cash
    viii. At year-end, DR Retained Earnings, CR Dividends. Close out the nominal account.
    ix. Cash Dividend Preferences
        1. Current-dividend preference. Preferred stockholders get dividends first.
        2. Cumulative-dividend preference. Dividends in Arrears. All outstanding dividends must be paid to preferred stockholders before common shareholders get anything.
    x. Stock Dividends
        1. Issuing more shares of stock for dividends.
        2. Small Stock Dividends
            a. Shares issued make up less than 20% of shares outstanding.
            b. DR Retained Earnings, CR Common Stock (at par), CR Additional Paid-in Capital
        3. Large Stock Dividends
            a. 20% or more of shares outstanding.
            b. DR Retained Earnings, CR Common Stock
            c. Use par value so there's no difference.

IV. Stock Splits
  a. Take back issued stock, issue double the shares for half the par value (two for one).
  b. Make the stock more liquid by having more shares, or make it more accessible to smaller investors by lowering the price.
  c. Three ways to split
    i. DR Additional Paid-in Capital, CR Common Stock
    ii. DR Retained Earnings, CR Common Stock
    iii. Exchange old shares for new. No entry.

V. Other Equity Items
  a. Accumulated Other Comprehensive Income
    i. Foreign Currency Translation Adjustments
        1. May have gains or losses when translating into USD.
        2. Done in Owners' Equity, not Income Statement
    ii. Unrealized Gains/Losses on Available for Sale Securities
        1. Originally had to account for market value changes.
        2. Now recorded in equity rather than on the income statement so earnings aren't affected.
  b. Prior Period Adjustment. Fixes mistakes made in the previous period.