CHAPTER 21

Accounting for Publicly Held Corporations

What You'll Learn

1. Describe the characteristics of the corporate form of business organization.
2. Prepare journal entries to record the issue of stock to investors.
3. Prepare journal entries to record the distribution of earnings to owners.
4. Prepare financial statements for publicly held corporations.
5. Define the accounting terms introduced in this chapter.

Why It's Important

▸ Many individuals and institutions buy the stock of publicly held corporations.

Before You READ

Predict

1. What does the chapter title tell you?
2. What do you already know about this subject from personal experience?
3. What have you learned about this in the earlier chapters?
4. What gaps exist in your knowledge of this subject?

Exploring the *Real World* of Business

ANALYZING CORPORATE STOCK

Hewlett-Packard

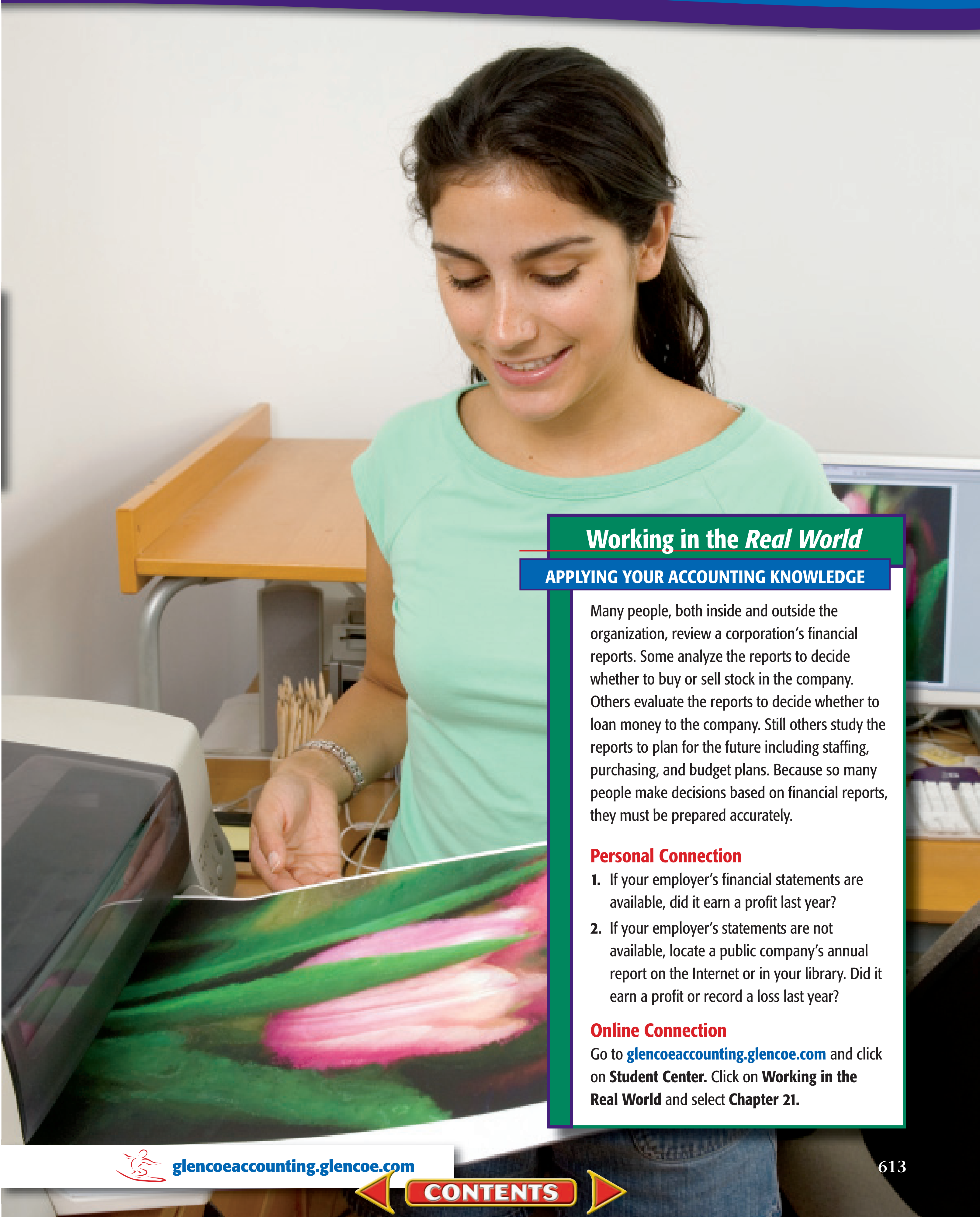
What do vitamins and network systems have in common? When Vitamin Shoppe, a high-quality vitamin retailer, decided to open 100 new stores in one month, **Hewlett-Packard (HP)** went to work. It designed and implemented standardized processes and equipment to connect all the new stores quickly. With **HP's** support, Vitamin Shoppe opened all its new stores on target.

You might think of your printer or computer when you hear **Hewlett-Packard's** name, but its information technology services department is one of the world's largest. Other satisfied clients include 7-11, Frontier Airlines, and Brandywine School District.

Investors like to hear success stories like these. They also like to see positive financial results, such as dividend payments to stockholders.

What Do You Think?

If you were considering purchasing stock in **Hewlett-Packard** or IBM, what factors would you investigate?



Working in the *Real World*

APPLYING YOUR ACCOUNTING KNOWLEDGE

Many people, both inside and outside the organization, review a corporation's financial reports. Some analyze the reports to decide whether to buy or sell stock in the company. Others evaluate the reports to decide whether to loan money to the company. Still others study the reports to plan for the future including staffing, purchasing, and budget plans. Because so many people make decisions based on financial reports, they must be prepared accurately.

Personal Connection

1. If your employer's financial statements are available, did it earn a profit last year?
2. If your employer's statements are not available, locate a public company's annual report on the Internet or in your library. Did it earn a profit or record a loss last year?

Online Connection

Go to **glencoeaccounting.glencoe.com** and click on **Student Center.** Click on **Working in the Real World** and select **Chapter 21.**

SECTION 1

Publicly Held Corporations

Before You READ

Main Idea
Investors from the general public purchase stock of publicly held corporations.

Read to Learn…
- the unique features of a corporation. (p. 614)
- how to account for the issue of stock. (p. 615)

Key Terms
closely held corporation
publicly held corporation
board of directors
authorized capital stock
par value
common stock
proxy
preferred stock
Paid-in Capital in Excess of Par

The United States has more sole proprietorships and partnerships than corporations. Corporations, however, account for more business activity than the other two forms of business combined. Many high profile companies like The Coca-Cola Company and General Motors are organized as corporations.

Characteristics of a Corporation

How Is a Corporation Different from Other Forms of Business Organization?

In Chapters 14 to 20 you learned to record business transactions for corporations. A **closely held corporation** is a corporation owned by a few persons or by a family. The stock of a closely held corporation is *not* sold to the general public.

In this chapter you will learn about transactions that apply specifically to *publicly held corporations*. A **publicly held corporation** is one whose stock is widely held, has a large market, and is usually traded on a stock exchange such as the New York Stock Exchange.

In previous chapters On Your Mark could have been either a closely held or publicly held corporation. In this chapter On Your Mark will illustrate transactions for a publicly held corporation.

The corporation has several unique features:

- **Legal Permission to Operate—**To operate a business as a corporation, its incorporators (organizers) file an application with state officials for permission to operate. When the application has been approved, it becomes the corporation's *charter*. The charter indicates the purpose of the business and spells out the rules under which the business is to operate. The charter also states the type and amount of stock a corporation is authorized to issue.
- **Separate Legal Entity—**A corporation is a separate legal entity that is created and exists only by law. A corporation may enter into contracts, borrow money, and conduct business in the same manner as a person. It may acquire, own, and sell property in its name. It can also sue and be sued in the courts.
- **Stockholders—**The ownership of a corporation is divided into units called *shares of stock*. The owners of a corporation are called *stockholders*. Each stockholder receives a *stock certificate* as proof of ownership. The stock certificate lists the name of the stockholder, the number of shares issued, and the date the shares were issued.

As You READ

Key Point
Publicly Held and Closely Held Corporations A closely held corporation's stock is *not* sold to the public.

- **Professional Management**—Stockholders own the corporation, but they do not manage it. The stockholders elect a **board of directors**, who govern and are responsible for the affairs of the corporation.

Capital Stock

How Do You Measure Ownership of a Corporation?

Stockholders' equity is the value of the stockholders' claims to the corporation's assets. As you learned in Chapter 19, corporations report stockholders' equity in two parts:

- the equity paid into the corporation by stockholders
- the equity earned by the corporation and retained in the business

The maximum number of shares a corporation may issue is called its **authorized capital stock**. The authorized number of shares is usually much higher than the number of shares the corporation plans to sell right away. This allows the corporation to sell additional shares at a later time.

State laws may require that an amount or value be assigned to each share of stock before the corporation sells it to the public. The amount assigned to each share is referred to as **par value**, the per-share dollar amount printed on the stock certificates. The par value is used to determine the amount credited to the capital stock account. Par values of $1, $5, and $25 are common.

The corporate charter specifies the types of capital stock that a corporation may issue. The two main types of stock are *common* and *preferred.*

Common Stock

If the corporation issues only one class of capital stock, it is called **common stock**. The owners of common stock participate in the corporation as follows:

- Elect the board of directors and, through it, exercise control over the operations of the corporation. Stockholders are entitled to one vote for each share of stock they own. The election occurs at the stockholders' meeting, which is usually held once a year. If a stockholder cannot attend the meeting, he or she may send in a **proxy**, which gives the stockholder's voting rights to someone else.
- Share in the earnings of the corporation by receiving dividends declared by the board of directors.
- Are entitled to share in the assets of the corporation if it goes out of business.

Preferred Stock

To appeal to as many investors as possible, a corporation may also issue preferred stock. **Preferred stock** has certain privileges (or preferences) over common stock. Preferred stockholders participate as follows:

- Are entitled to receive dividends before common stockholders. The preferred stock dividend is stated in specific dollars, such as $6, or as a percentage of the stock's par value, such as 6 percent. The stock itself is then referred to as "preferred $6 stock" or "preferred 6% stock."

As You READ

In Your Own Words

Capital Stock In your own words, explain the meaning of *capital stock.*

As You READ

It's Not What It Seems

Par Value *Par value* is a fixed amount and is almost never the current value of a share of stock. A stock's current selling price on the stock market is called *market value.*

+/− MATH HINTS

Multiply by Tens To multiply by a power of 10, move the decimal point to the right the same number of places as there are zeros in the power of 10.

$6.00 × 100 = $600.00

Two zeros

The decimal point moved two places

$7.50 × 1,000 = $7,500.00

Three zeros

The decimal point moved three places

- Are given preference over common stockholders to distributions of the corporate assets should the company go out of business.

In return for these special privileges, the preferred stockholders give up two rights:

- to vote
- to participate in the control of the corporation.

Usually, investors buy preferred stock to receive the stated dividend.

Issuing Common Stock

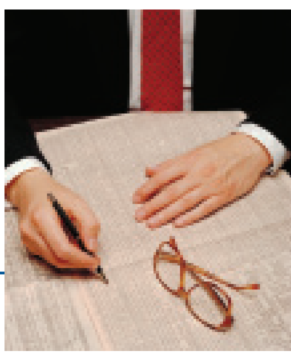
When a corporation issues common stock, the **Common Stock** account is credited for the par value of the stock. Let's look at some examples.

Issuing Common Stock at Par Value. When On Your Mark was incorporated, it had the following transaction.

Business Transaction

On January 3 On Your Mark Athletic Wear issued 10,000 shares of $10 par common stock at $10 per share. On Your Mark received $100,000 for the shares, Memorandum 3.

JOURNAL ENTRY



GENERAL JOURNAL PAGE 46

	DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	*20--*						1
2	*Jan.*	*3*	*Cash in Bank*		*100 000 00*		2
3			*Common Stock*			*100 000 00*	3
4			*Memorandum 3*				4
5							5

Issuing Common Stock in Excess of Par Value. Investors are often willing to pay more than par value for the stock of a corporation. When a corporation sells its stock at a price that is above par, the excess over par is credited to a separate stockholders' equity account called **Paid-in Capital in Excess of Par**. **Paid-in Capital in Excess of Par** appears in the chart of accounts immediately following the **Common Stock** account. The amounts recorded in this account are not profits to the corporation. Instead, they represent part of the stockholders' investment in the corporation. This account follows the same rules of debit and credit as other stockholders' equity accounts.

Paid-in Capital in Excess of Par

Debit	Credit
–	+
Decrease Side	Increase Side Normal Balance

One year after On Your Mark was incorporated, it had the following transaction.

As You READ

Key Point

Recording the Issuance of Common Stock

When a corporation issues common stock, it credits

- **Common Stock** for the par value of the stock.
- **Paid-in Capital in Excess of Par** for any amount received in excess of par value.

CONTENTS

Business Transaction

On January 5 On Your Mark issued 5,000 shares of $10 par common stock at $11.50 per share, Memorandum 147. On Your Mark received $57,500 for the shares.

Before recording the transaction, determine how much of the $57,500 is credited to **Common Stock** and how much is credited to **Paid-in Capital in Excess of Par.**

Credit to **Common Stock:**	
5,000 shares at $10 par value	$50,000
Credit to **Paid-in Capital in Excess of Par:**	
5,000 shares at $1.50	
($11.50 issue price − $10.00 par value) per share	+ 7,500
Total cash received	$57,500

Remember, the amount credited to the **Common Stock** account is the par value of the shares issued.

JOURNAL ENTRY

GENERAL JOURNAL — PAGE 99

	DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--						1
2	Jan.	5	Cash in Bank		57 500 00		2
3			Common Stock			50 000 00	3
4			Paid-in Cap. in Ex. of Par			7 500 00	4
5			Memorandum 147				5
6							6

Issuing Preferred Stock

When preferred stock is issued, a corporation credits the **Preferred Stock** account for the stock's par value. Preferred stock is almost always issued at its par value.

On Your Mark was incorporated on January 3. It was authorized to issue 1,000 shares of preferred stock with a par value of $100 and a stated dividend of $6. The next day the company had the following transaction.

Business Transaction

On January 4 On Your Mark issued 250 shares of preferred $6 stock, $100 par, at $100 per share. On Your Mark received $25,000 for the shares, Memorandum 5.

JOURNAL ENTRY

GENERAL JOURNAL — PAGE 47

	DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--						1
2	Jan.	4	Cash in Bank		25 000 00		2
3			Preferred Stock			25 000 00	3
4			Memorandum 5				4
5							5

SECTION 1 **Assessment**

AFTER YOU READ

Reinforce the Main Idea

Create a chart like this one to compare common stock and preferred stock. Add answer rows as needed.

Characteristic	Common Stock	Preferred Stock

Do the Math

A corporation sells 3,000 shares of $25 par common stock and receives $97,500. How much did each share sell for? What was the per share amount of paid-in capital in excess of par?

Problem 21–1 Examining Capital Stock Transactions

Dublin Corporation was organized and authorized to issue 10,000 shares of $100 par, preferred 8% stock and 500,000 shares of $10 par common stock. The three transactions recorded in the following T accounts took place during the first month of operations.

Instructions In your working papers, describe each of the three transactions.

Cash in Bank

Debit +	Credit −
(1) 300,000	
(2) 200,000	
(3) 700,000	

Preferred Stock

Debit −	Credit +
	(2) 200,000

Common Stock

Debit −	Credit +
	(1) 300,000
	(3) 500,000

Paid-in Capital in Excess of Par

Debit −	Credit +
	(3) 200,000

SECTION 2

Distribution of Corporate Earnings

In Section 1 you learned to record stock issue transactions for a corporation. In this section you will learn how corporations distribute earnings to the stockholders. Corporations like General Motors have a long history of distributing a portion of earnings to their stockholders every year, making their stock an attractive investment.

BEFORE YOU READ

Main Idea

A corporation distributes a portion of its earnings to stockholders in the form of dividends.

Read to Learn…

- how to account for dividends. (p. 619)
- how to record dividend transactions. (p. 620)

Key Terms

dividend

Dividend Accounts

What Are Corporate Dividends?

When an owner of a sole proprietorship or a partnership wishes to take money out of the business, a check is written on the checking account of the business. The amount of the check is recorded as a debit in the owner's withdrawals account, which reduces the owner's equity.

The owners (stockholders) of a publicly held corporation cannot withdraw cash whenever they want. Instead, they receive dividends. A **dividend** is a distribution of cash to stockholders. Dividends reduce retained earnings.

The corporation's board of directors *declares,* or authorizes, dividends. Before a dividend is declared, the corporation should have a sufficient amount of cash available to pay the dividend. In addition, since dividends decrease retained earnings, there must be an adequate balance in the **Retained Earnings** account. **Figure 21–1** on page 620 illustrates the important dates in the dividend process.

A separate account named **Dividends** is used to record dividends declared. The **Dividends** account is a contra-stockholders' equity account. At the end of the accounting period, the **Dividends** account is closed to the **Retained Earnings** account. The rules of debit and credit for **Dividends** are shown in this T account. Notice that they are the opposite of the rules for the stockholders' equity accounts.

Dividends	
Debit + Increase Side Normal Balance	Credit – Decrease Side

Dividend amounts could be debited directly to the **Retained Earnings** account. Most corporations, however, prefer to use a separate account so that the dividend amounts can be easily determined.

A liability account, **Dividends Payable,** is used to record the amount of dividends that will be paid on the payment date. Like all liability accounts, **Dividends Payable** is increased by credits and decreased by debits. The normal balance of the **Dividends Payable** account is a credit balance.

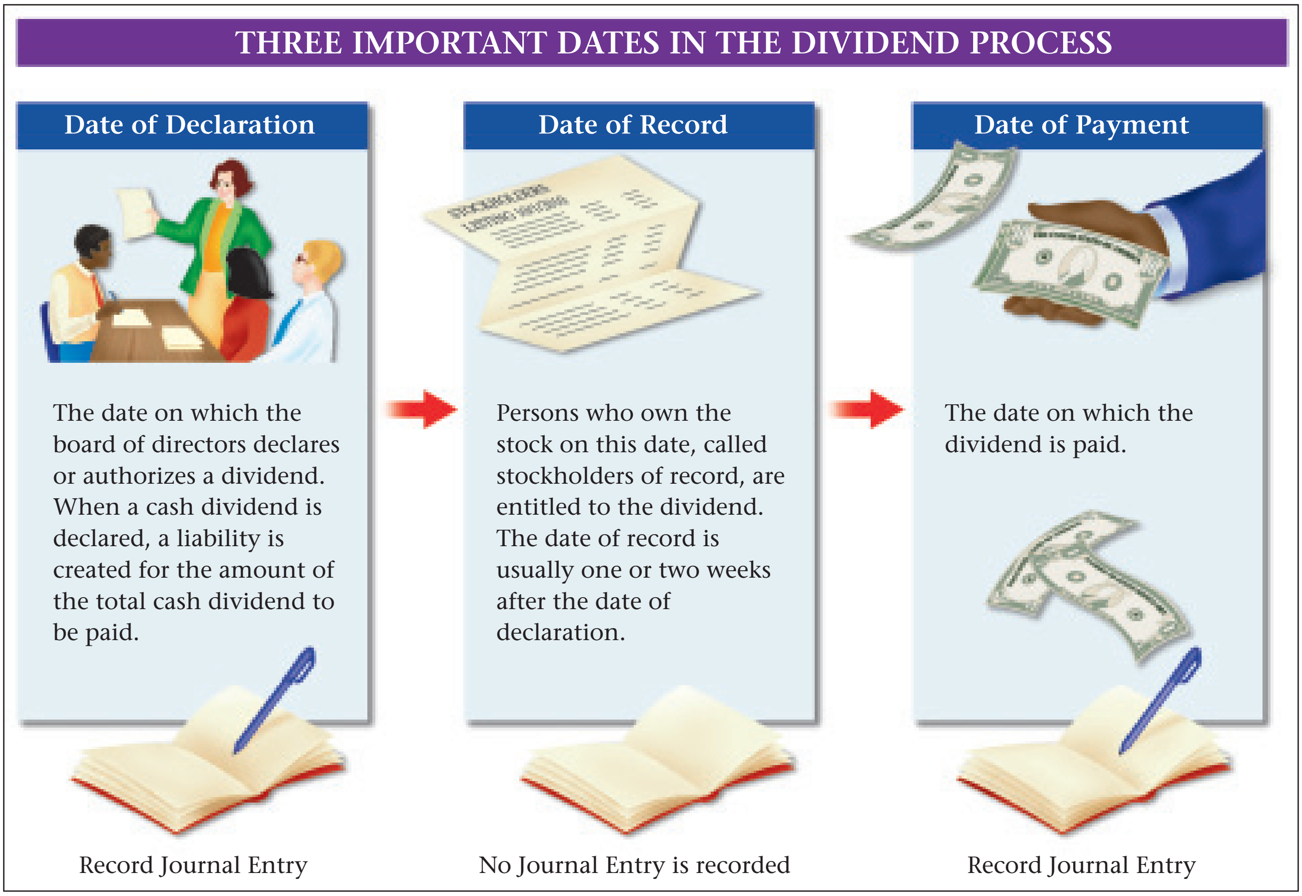


Figure 21–1 Important Dates in the Dividend Process

Dividend Transactions

How Do You Journalize Dividend Transactions?

A corporation authorized to issue two types of stock uses separate dividend and dividend payable accounts for each type. On Your Mark uses these:

Dividends—Preferred	**Dividends Payable—Preferred**
Dividends—Common	**Dividends Payable—Common**

Let's look at the transactions involved when dividends are declared by the board of directors of On Your Mark during its second year of incorporation.

Dividends on Preferred Stock

As mentioned, preferred stockholders have certain preferences over common stockholders; one is the right to receive dividends before common stockholders. The preferred stock dividend amount is predetermined, or *stated*. The stated dividend indicates the amount to be paid to preferred stockholders per year. On Your Mark issued 250 shares of preferred $6 stock; that is, it will pay a $6 dividend for each share of preferred stock annually or in semiannual or quarterly installments:

Annually	$6.00	
Semiannually	$3.00	($6.00 ÷ 2)
Quarterly	$1.50	($6.00 ÷ 4)

Date of Declaration. A journal entry records the dividend on preferred stock on the *date of declaration,* the date the board declares it.

Business Transaction

On November 15 On Your Mark's board of directors declared an annual cash dividend on the 250 shares of preferred $6 stock issued. It is payable to preferred stockholders of record on November 29 and will be paid on December 15. The total preferred dividends amount is $1,500 (250 shares × $6), Memorandum 215.

JOURNAL ENTRY

GENERAL JOURNAL — PAGE 72

	DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--						1
2	Nov.	15	Dividends—Preferred		1 500 00		2
3			Dividends Payable—Preferred			1 500 00	3
4			Memorandum 215				4

Date of Record. On November 29 the corporation checks its records and prepares a list of preferred stockholders entitled to receive the dividend. No journal entry is required on this date.

Date of Payment. On December 15 a check for $1,500, the total dividend payable on preferred stock, is written and deposited in a special dividends checking account. Separate checks written on this account are made payable to each preferred stockholder entitled to receive the dividend.

Business Transaction

On December 15 On Your Mark issued Check 1373 for $1,500 in payment of the dividend on preferred stock declared November 15.

JOURNAL ENTRY

GENERAL JOURNAL — PAGE 81

	DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--						1
2	Dec.	15	Dividends Payable—Preferred		1 500 00		2
3			Cash in Bank			1 500 00	3
4			Check 1373				4

Dividends on Common Stock

Dividends on common stock may be declared in one of two ways.

1. The board of directors may declare a dividend amount *per common share*. On Your Mark's board declared a 50¢ per common share dividend. It will pay a 50¢ dividend for each share of common stock.
2. The board may decide to declare the *total cash dividend* for both preferred and common stock. In this case the company first pays the preferred dividends and then divides the remainder equally among the common stockholders. For example, On Your Mark's board of directors declared a $3,000 total cash dividend. Preferred stockholders will receive $1,500 (250 shares × $6). It splits the remainder, $1,500 ($3,000 − $1,500), among the common stockholders. Each share of common stock receives a 10¢ dividend ($1,500 ÷ 15,000 shares).

Dividends on common stock, like preferred stock, can be paid annually, semiannually, or quarterly. Most publicly held corporations pay quarterly.

SECTION 2 **Assessment**

AFTER YOU READ

Reinforce the Main Idea

Create a diagram like this one to describe which accounts (if any) are debited and credited for each event.

Event	Account Debited	Account Credited
Dividend on common stock–date of declaration		
Dividend on common stock–date of record		
Dividend on common stock–date of payment		

Do the Math

On January 28 the board of directors for Jelly Bean Works declared an annual cash dividend on 200 shares of preferred $10 stock. What is the total amount of the dividend? How is this dividend accounted for in the company's books?

Problem 21–2 Distributing Corporate Earnings

During its first year of operation, Longhorn Corporation issued 17,500 shares of $10 par common stock. At the end of the year, the corporation had a net income of $350,000. The board of directors declared a cash dividend of $5 per share.

Instructions Answer these questions in your working papers. 1.) How much of the net income did Longhorn distribute to the stockholders? 2.) How much of the net income did the corporation retain?

Problem 21–3 Analyzing a Source Document

This memorandum contains data about the first quarter dividend on the common stock of Rob Williams Thrift Market Inc.

Instructions Prepare the journal entries to record the following in your working papers. Use general journal page 18.

- declaration of the dividend
- payment of the dividend, Check 221

Rob Williams Thrift Market Inc.
2347 Eastern Parkway
Orange, IA 50322-6922

MEMORANDUM 37

TO: Chief Financial Officer
FROM: Albert MacFish, Chairman of the Board
DATE: April 8, 20--
SUBJECT: 1st quarter dividend

On April 1, 20--, the board of directors declared a $1 per share dividend on the 5,679 shares of common stock issued. The date of record is April 15, 20--. The date of payment is April 30, 20--.

Accounting Careers in Focus

CONTROLLER

National Association of Black Accountants, Inc. (NABA), Greenbelt, Maryland
Reginald Nance

Q: What does NABA do?

A: We work to expand the influence of minority professionals in the fields of accounting and finance.

Q: What are your day-to-day responsibilities?

A: I manage the overall finances of the organization. I make sure cash flow is where it should be and the financials are in order. Basically, I ensure that all revenue and expenses are accounted for properly. If it has to do with finance, it goes through me.

Q: What do you like most about your job?

A: I like that my job allows me to see the basis of the business. If you know how an organization is doing financially, you can determine where it is going. From a nonprofit standpoint, I enjoy the peace of mind of knowing that I'm working for something greater than just the bottom line—I'm helping the community at large.

Q: What is most challenging about your job?

A: The most challenging aspect is managing deadlines. An efficient time-management system is necessary to keep on top of things.

Q: What advice do you have for accounting students interested in becoming controllers?

A: Sit for the CPA exam as soon as possible. It is looked upon as a high achievement in the industry and will allow you to advance your career quickly. Also, identify a mentor; I've been fortunate to find several mentors in my career. And develop your written and oral communication skills as much as possible.

Tips from . . .

RHI Robert Half International Inc.

You may have little idea what salary to expect when presented with your first job offer. Determine fair market compensation by conducting research on the Internet, reading industry publications, and contacting staffing firms like Robert Half International for annual salary publications.

CAREER FACTS

- **Nature of the Work:** Coordinate and prepare financial statements; design and implement internal control policies and procedures; hire, train, and retain accounting staff.
- **Training or Education Needed:** A bachelor's degree in accounting or finance; a master's degree in business administration; CPA or CMA designation is preferred; at least seven years of experience.
- **Aptitudes, Abilities and Skills:** Solid communication skills, technology skills, organizational skills, and management skills.
- **Salary Range:** $60,000 to $150,000 depending on location, level of responsibility and company revenues.
- **Career Path:** Gain public accounting experience, and then accept a position in a corporate environment, such as accounting manager, director of accounting, or assistant controller.

Thinking Critically What kind of advice would you ask of a mentor?

SECTION 3

Financial Reporting for a Publicly Held Corporation

Before You READ

Main Idea

Corporate financial statements report stock issues and dividends.

Read to Learn…

- about a corporate income statement. (p. 624)
- how and why corporations prepare a statement of stockholders' equity (p. 624)
- about a corporate balance sheet. (p. 625)
- about a corporate statement of cash flows. (p. 626)

Key Terms

statement of stockholders' equity

Many corporations prepare a statement of stockholders' equity instead of a statement of retained earnings. This section examines the information reported on the statement of stockholders' equity, how this statement is prepared, and how stockholders' equity is reported on a corporation's balance sheet.

The Income Statement

Does a Publicly Held Corporation's Income Statement Differ from That of a Closely Held Corporation?

The income statement of a publicly held corporation is similar to that prepared by a closely held corporation. Remember, the federal corporate income taxes paid by a corporation are reported separately on the income statement.

The Statement of Stockholders' Equity

What Is a Statement of Stockholders' Equity?

In Chapter 19 you learned how to prepare a statement of retained earnings for a closely held corporation. That statement reports the changes in the **Retained Earnings** account during the period. It showed:

	Retained Earnings, beginning balance
+	Net Income
	Retained Earnings, ending balance

An increasing number of corporations prepare a statement of stockholders' equity rather than a statement of retained earnings. In contrast to the statement of retained earnings, the **statement of stockholders' equity** reports the changes in *all* stockholders' equity accounts during the period. It also provides information about the transactions affecting stockholders' equity during the period. The information reported on a statement of stockholders' equity includes

- the number of shares of each type of stock issued,
- the total amount received for those shares,
- the net income or net loss for the period, and
- dividends declared during the period.

Figure 21–2 shows the statement of stockholders' equity for On Your Mark at the end of its second year of incorporation. The information needed to prepare the statement comes from the work sheet and from the general ledger accounts. The statement is prepared as follows:

On Your Mark Athletic Wear
Statement of Stockholders' Equity
For the Year Ended December 31, 20--

		$100 Par Preferred $6 Stock	$10 Par Common Stock	Paid-in Capital in Excess of Par	Retained Earnings	Totals	
1	Balance, January 1, 20--	25,000.00	100,000.00		27,600.00	152,600.00	1
2	Issuance of 5,000 shares of common stock		50,000.00	7,500.00		57,500.00	2
3	Net Income				13,525.00	13,525.00	3
4	Cash Dividends:						4
5	Preferred Stock				(1,500.00)	(1,500.00)	5
6	Common Stock				(7,500.00)	(7,500.00)	6
7	Balance, December 31, 20--	25,000.00	150,000.00	7,500.00	32,125.00	214,625.00	7
8							8

Figure 21–2 Statement of Stockholders' Equity

- The names of the four stockholders' equity accounts appear at the top of the amount columns. There is also a Totals column at the far right.
- The first line shows the balance of each account at the beginning of the period.
- The next lines describe various transactions affecting the stockholders' equity accounts, such as issuance of stock, net income, and dividends declared. The transactions are described in the left column. The increase or decrease amounts are recorded in the individual account columns and in the Totals column. For example, the second line on the statement indicates that the company issued 5,000 shares of common stock during the period. The issuance of the 5,000 shares increased the balance of the **Common Stock** account by $50,000. Since the shares were issued at a price above par value, the **Paid-in Capital in Excess of Par** account increased by $7,500.
- The final line shows the balance of each account at period-end.

As you review **Figure 21–2**, notice that the amounts that decrease account balances, like dividends declared, are enclosed in parentheses. The cash dividends declared are listed separately for preferred and common stock. Also notice that the Retained Earnings column of the statement of stockholders' equity contains the same information that is reported on a statement of retained earnings. Remember that net income increases retained earnings, and dividends declared decrease retained earnings. The statement of stockholders' equity is used to prepare the corporation's balance sheet.

The Balance Sheet

How Do You Prepare the Stockholders' Equity Section of the Balance Sheet?

The assets and liabilities sections of a balance sheet for a publicly held corporation are similar to those of a balance sheet for a closely held corporation. Notice in **Figure 21–3** on page 626 that the **Dividends Payable** accounts are reported in the liabilities section. Since On Your Mark paid the

On Your Mark Athletic Wear
Balance Sheet
December 31, 20--

Liabilities			
Accounts Payable		*14 5 6 2 10*	
Dividends Payable—Preferred		—	
Dividends Payable—Common		—	
Total Liabilities			*27 0 1 6 00*

Figure 21–3 Reporting the Balances of the Dividends Payable Accounts on the Balance Sheet

dividends before the end of the year, it reports zero balances in these liability accounts.

The stockholders' equity section of a publicly held corporation's balance sheet is more detailed than that of a closely held corporation. As you can see in **Figure 21–4**, each type of stock issued by On Your Mark is listed separately under the heading "Paid-in Capital." Preferred stock is listed before common stock. Each listing describes the following:

- the par value,
- the number of shares authorized, and
- the number of shares issued.

The **Dividends** accounts are not listed in the stockholders' equity section because they are closed to **Retained Earnings** at the end of the year. Thus, the retained earnings amount shown on the balance sheet has been reduced by the dividends declared during the period.

The Statement of Cash Flows

Where Are Stock Issues and Dividends Reported on This Statement?

The Financing Activities section of the statement of cash flows reflects activities related to ownership of the corporation. A stock issue results in a cash inflow from a financing activity. Payment of dividends is a cash outflow.

On Your Mark Athletic Wear
Balance Sheet
December 31, 20--

Stockholders' Equity			
Paid-in Capital:			
$6 Preferred Stock, $100 par, 1,000 shares authorized,			
250 shares issued	*25 0 0 0 00*		
Common stock, $10 par, 20,000 shares authorized,			
15,000 shares issued	*150 0 0 0 00*		
Paid-in Capital in Excess of Par	*7 5 0 0 00*		
Total Paid-in Capital		*182 5 0 0 00*	
Retained Earnings		*32 1 2 5 00*	
Total Stockholders' Equity			*214 6 2 5 00*
Total Liabilities and Stockholders' Equity			*241 6 4 1 00*

Figure 21–4 The Stockholders' Equity Section of the Balance Sheet

AFTER YOU READ

Reinforce the Main Idea

Create a chart like this one to identify the financial statement on which each of the following appear: cash dividends, common stock, dividends payable, paid-in capital in excess of par, preferred stock, retained earnings. Add answer rows as needed.

Statement of Stockholders' Equity	Balance Sheet

Do the Math

Ron Kanai, president of Sunny Days, a Hawaiian-based sun care products manufacturer and retailer, is looking for a buyer. He believes an analysis of stock prices and dividends will appeal to potential corporate buyers. As the company's accounting manager, use spreadsheet, accounting, or graphics software to prepare the following information in a clustered column chart showing the stock price and dividends declared for the past two years. What does the chart say about Sunny Days' financial condition that could attract potential buyers?

	Year 1				Year 2			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Stock Price	13.50	13.60	14.90	17.00	17.50	20.00	23.00	25.50
Dividend Declared	2.50	2.50	2.90	3.00	3.25	3.50	4.90	4.95

Problem 21–4 Examining the Statement of Stockholders' Equity

The following transactions of Victor Jewelry Corporation took place during the period.

Instructions Use the form in your working papers to indicate which of the transactions is reported on the statement of stockholders' equity.

Transactions:

1. Paid accounts payable of $50,000.
2. Issued 2,000 shares of $10 par common stock, receiving $15 per share.
3. The board of directors declared a cash dividend of $12,000 for all common stockholders.
4. Bought equipment on account at a total cost of $125,000.
5. Paid the cash dividend declared in Transaction 3.
6. Issued 500 shares of $100 par, $7 preferred stock.
7. Paid the federal income tax installment of $5,000.
8. Earned a net income of $150,000 for the period.

CHAPTER 21 Summary

Key Concepts

1. The corporation has several unique characteristics:
   - legal permission from the state to operate
   - recognized as a separate legal entity
   - owned by stockholders
   - operated by professional managers hired by a board of directors that is elected by stockholders

   Two types of corporations are:
   - *closely held,* owned by a few persons or by a family
   - *publicly held,* whose stock is widely held, has a large market, and is usually traded on a stock exchange

2. Corporations may issue two types of stock, common and preferred. The T-account analysis of issuance of stock follows.

   a. Issuing preferred stock at par value:

Cash in Bank		Preferred Stock	
Debit + xxx	Credit –	Debit –	Credit + xxx

   b. Issuing common stock at par value:

Cash in Bank		Common Stock	
Debit + xxx	Credit –	Debit –	Credit + xxx

   c. Issuing common stock in excess of par (the issue of stock at a higher price than its par value):

Cash in Bank		Common Stock	
Debit + xxx	Credit –	Debit –	Credit + xxx

Paid-in Capital in Excess of Par	
Debit – xxx	Credit + xxx

3. Corporations may distribute part of their earnings to stockholders in the form of *dividends*. These are the journal entries required.

Event	Importance	Journal Entry Required
Dividend is declared	Corporation's board of directors votes to distribute earnings to owners.	Debit **Dividends** Credit **Dividends Payable**
Dividend date of record	The corporation makes a list to show who owns stock on the date of record.	No journal entry is made.
Dividend is paid	The corporation writes the dividend checks to owners.	Debit **Dividends Payable** Credit **Cash in Bank**
End of the year	The corporation closes the **Dividends** account.	Debit **Retained Earnings** Credit **Dividends**

4. Publicly held corporations prepare the following financial reports:
   - income statement
   - statement of stockholders' equity
   - the balance sheet
   - the statement of cash flows

   The statement of stockholders' equity reports all changes in stockholders' equity accounts during the period. It usually replaces the statement of retained earnings. The statement of stockholders' equity includes information about

   - the number of shares of each type of stock issued,
   - the total amount received for those shares,
   - net income (or loss) for the period, and
   - the dividends declared during the period.

   Refer to **Figure 21–2** on page 625 to review the statement of stockholders' equity.

Key Terms

authorized capital stock	(p. 615)	**par value**	(p. 615)
board of directors	(p. 615)	**preferred stock**	(p. 615)
closely held corporation	(p. 614)	**proxy**	(p. 615)
common stock	(p. 615)	**publicly held corporation**	(p. 614)
dividend	(p. 619)	**statement of stockholders' equity**	(p. 624)
Paid-in Capital in Excess of Par	(p. 616)		

CHAPTER 21 Review and Activities

After You READ

Check Your Understanding

1. **Corporation Characteristics**
   a. Name three characteristics of a corporation.
   b. Explain the difference between a closely held corporation and a publicly held corporation.
2. **Record Stock Issue**
   a. When stock is sold at a price above its par value, what amount is credited to the capital stock account?
   b. What is the classification of the **Paid-in Capital in Excess of Par** account? What is its normal balance?
3. **Record Earnings Distribution**
   a. When a dividend is declared, which accounts are debited and which accounts are credited?
   b. Name and explain the three dates important to the dividend process.
4. **Corporate Financial Statements**
   a. What type of information is reported on the statement of stockholders' equity?
   b. Explain the difference between the statement of retained earnings and the statement of stockholders' equity.

Apply Key Terms

For each key term, give or find an example of the term in a newspaper, periodical, annual report, or on an Internet site. Then use the example in a sentence.

authorized capital stock
board of directors
closely held corporation
common stock
dividend
Paid-in Capital in Excess of Par
par value
preferred stock
proxy
publicly held corporation
statement of stockholders' equity

Customizing Financial Statements

Making the Transition from a Manual to a Computerized System

Task	Manual Methods	Computerized Methods
Customizing financial statements	• Using accounting stationery, you may reorganize information or add details to financial statements.	• Accounting software gives you the option to select and sort data that appears on each financial statement. • You may also customize information on a report.

Peachtree® Q & A

Peachtree Question	Answer
How do I change the appearance or content of financial reports in Peachtree?	1. From the ***Reports*** menu, select **Financial Stmts.** 2. Select the report you wish to customize from the list. 3. Display it on the screen. 4. Select the **Design** icon above the report. 5. You can adjust the size of the columns, the types of information displayed in the report, the font style and size, and the report layout. 6. If you wish to save the report in the new format, rename the file, leaving the original files in their original form.
How do I filter information on preformatted reports?	1. After you have selected a report from the list, click **Preview** to display it on your screen. 2. At the **Filter** option, you may accept the current settings or make changes to the displayed fields. The information that can be filtered varies according to the report.

QuickBooks Q & A

QuickBooks Question	Answer
How do I change the appearance or content of financial reports in QuickBooks?	1. From the ***Reports*** menu, select **Company & Financial.** 2. Select the report you wish to customize. 3. Click the **Modify Report** button. You can adjust the size of columns, the types of information displayed in the report, the font style and size, and the report layout. 4. If you wish to save the report in the new format, click the **Memorize** button and give the report a new name.
How do I filter information on preformatted reports?	1. After you have selected a report, click the **Modify Report** button. 2. In the Filters tab, choose the item you wish to filter and enter the filter criteria. The information that can be filtered varies according to the report. 3. Click **OK.**

For detailed instructions, see your Glencoe Accounting Chapter Study Guides and Working Papers.

CHAPTER 21 Problems

Complete problems using: Manual Glencoe Working Papers OR Peachtree Complete Accounting Software OR QuickBooks Templates OR Spreadsheet Templates

Peachtree®

SMART GUIDE

Step-by-Step Instructions: Problem 21–6

1. Select the problem set for InBeat CD Shop (Prob. 21–6).
2. Rename the company and set the system date.
3. Record all transactions using the **General Journal Entry** option.
4. Print a General Journal report and proof your work.
5. Complete the Analyze activity.
6. End the session.

QuickBooks

PROBLEM GUIDE

Step-by-Step Instructions: Problem 21–6

1. Restore the Problem 21-6.QBB file.
2. Record all transactions using the **Make General Journal Entries** option.
3. Print a Journal report and proof your work.
4. Complete the Analyze activity.
5. Back up your work.

Problem 21–5 Distributing Corporate Earnings

During the first year of operations, Sunset Surfwear issued 18,500 shares of $10 par common stock. At the end of the year, the corporation had net income of $380,000. The board of directors declared a $5 cash dividend per share of common stock.

Instructions Answer the following questions in your working papers:

1. How much of the net income earned for the year was paid to the common stockholders?
2. How much of the net income was retained by the corporation?

Analyze **Compare the date of declaration and date of payment with the date of record. Explain what entry or action is required on each date.**

Problem 21–6 Journalizing the Issue of Stock

On June 1 InBeat CD Shop was incorporated and authorized to issue 1,000 shares of $100 par, preferred 9% stock, and 10,000 shares of $25 par common stock.

Instructions In your working papers, record the following transactions on general journal page 1.

Date		Transactions
June	1	Issued 200 shares of preferred 9% stock at $100 per share, Memorandum 3.
	2	Issued 3,000 shares of common stock at $25 per share, Memorandum 7.
	6	Received $31 per share for 2,000 shares of common stock issued, Memorandum 10.
	7	Issued 50 shares of preferred 9% stock at par, Memorandum 11.

Analyze **Identify the stock issued at a price above par. Calculate the total amount of capital that InBeat CD Shop received in the first week of June.**

Problem 21–7 Journalizing Common and Preferred Stock Dividend Transactions

Shutterbug Cameras issued 8,000 shares of $80 par, preferred 7% stock and 35,000 shares of $25 par common stock.

Instructions In your working papers:

1. Record the following transactions on general journal page 14.
2. Post the transactions to the general ledger accounts provided in your working papers. Net income was $296,490.

Date		Transactions
Oct.	15	The board of directors declared an annual cash dividend on the preferred 7% stock, payable on December 1, Memorandum 407.
Nov.	5	Declared an annual cash dividend of $1.25 on 35,000 shares of common stock, payable on December 17, Memorandum 415.
Dec.	1	Paid the dividend declared on October 15, Check 1163.
	17	Paid the dividend declared on November 5, Check 1201.

Analyze Calculate the amount of dividends payable on common stock and dividends payable on preferred stock at the end of December.

Problem 21–8 Preparing Corporate Financial Statements

River's Edge Canoe & Kayak is authorized to issue 10,000 shares of $100 par, preferred 9% stock and 500,000 shares of $5 par common stock. The following balances appeared in the Balance Sheet section of the company's work sheet for the year ended December 31.

Instructions

1. Prepare the statement of stockholders' equity.
   a. During the period the corporation issued 500 shares of 9% preferred stock at par and 25,000 shares of common stock at $9.
   b. The net income for the year was $425,000.
2. Prepare the balance sheet.

101	Cash in Bank	$506,010
115	Accounts Receivable	850,680
120	Notes Receivable	400,000
130	Merchandise Inventory	388,815
135	Prepaid Ins.	3,600
140	Supplies	10,500
145	Delivery Truck	139,298
150	Store Equipment	363,009
201	Accounts Payable	62,412
202	Dividends Payable—Preferred	22,500

Peachtree®

SMART GUIDE

Step-by-Step Instructions: Problem 21–7

1. Select the problem set for Shutterbug Cameras (Prob. 21–7).
2. Rename the company and set the system date.
3. Record all transactions using the **General Journal Entry** option. Enter each transaction in the proper accounting period (month).
4. Print a General Journal report for the entire quarter and proof your work.
5. Print a General Ledger report.
6. Complete the Analyze activity.
7. End the session.

TIP: Set the date filter options to print a General Journal report that includes all of the entries for the quarter.

SPREADSHEET SMART GUIDE

Step-by-Step Instructions: Problem 21–8

1. Select the spreadsheet template for Problem 21–8.
2. Enter your name and the date in the spaces provided on the template.
3. Complete the spreadsheet using the instructions in your working papers.
4. Print the spreadsheet and proof your work.
5. Complete the Analyze activity.
6. Save your work and exit the spreadsheet program.

CONTINUE

203	Dividends Payable—Common	$150,000
210	Fed. Corp. Income Tax Payable	20,000
215	Sales Tax Payable	4,500
301	Preferred Stock	500,000
303	Common Stock	750,000
304	Paid-in Capital in Excess of Par	300,000
305	Retained Earnings	735,000
307	Dividends—Common	262,500
308	Dividends—Preferred	45,000

Analyze Identify the total stockholders' equity on December 31.

Peachtree®

SMART GUIDE

Step–by–Step Instructions: Problem 21–9

1. Select the problem set for Buzz Newsstand (Prob. 21–9).
2. Rename the company and set the system date.
3. Record all transactions. Enter each transaction in the proper accounting period (month).
4. Print a General Journal report and proof your work.
5. Print a Balance Sheet.
6. Complete the Analyze activity.
7. End the session.

SOURCE DOCUMENT PROBLEM

Problem 21–9

Use the source documents in your working papers to complete this problem.

QuickBooks

PROBLEM GUIDE

Step–by–Step Instructions: Problem 21–9

1. Restore the Problem 21-9.QBB file.
2. Record all transactions.
3. Print a Journal report and proof your work.
4. Print a Balance Sheet.
5. Complete the Analyze activity.
6. Back up your work.

CHALLENGE PROBLEM

Problem 21–9 Recording Stockholders' Equity Transactions

Buzz Newsstand is authorized to issue 100,000 shares of $5 par common stock and 5,000 shares of $100 par, preferred 8% stock. On January 1, the beginning of the period, the stockholders' equity accounts had the following balances:

301	Preferred Stock	$150,000
302	Paid-in Capital in Excess of Par—Preferred	11,250
303	Common Stock	225,000
304	Paid-in Capital in Excess of Par—Common	112,500
305	Retained Earnings	366,800
307	Dividends—Preferred	0
308	Dividends—Common	0

Instructions In your working papers:

1. Record the following transactions on general journal page 42. Close the **Dividends** and **Retained Earnings** accounts.
2. Prepare the stockholders' equity section of the balance sheet.

Date	Transactions
Mar. 15	The board of directors approved a semiannual cash dividend of $62,250 for both preferred and common stockholders. The dividend is payable to stockholders of record as of April 15 with payment on May 1, Memorandum 635.
Apr. 19	Issued 500 shares of preferred stock at $108, Memorandum 651.
May 1	Paid the dividends declared on March 15, Check 1256.
Sept. 1	The board of directors approved a semiannual cash dividend of $79,250 for both preferred and common stockholders. The dividend is payable to stockholders of record as of October 1 with payment on November 1, Memorandum 828.
Nov. 1	Paid the dividend declared on September 1, Check 2451.

Analyze Compare the December 31 Retained Earnings balance with the beginning balance of $366,800. Why did the balance change?

Winning Competitive Events

CHAPTER 21

Practice your test-taking skills! The questions on this page are reprinted with permission from national organizations:

- Future Business Leaders of America
- Business Professionals of America

Use a separate sheet of paper to record your answers.

Future Business Leaders of America

Multiple Choice

1. Earnings distributed to stockholders are called

a. retained earnings.
b. revenue.
c. capital gains.
d. dividends.
e. none of these answers

2. ________ stock is the type of stock issued by a corporation when only one class of stock is issued.

a. Preferred
b. Common
c. Capital
d. Dividend

3. When 10,000 shares of $10 par-value common stock are issued at $14 per share, Paid-In Capital in Excess of Par, Common Stock is credited for

a. $140,000.
b. $40,000.
c. $100,000.
d. none of the above

4. When a dividend is paid in cash, the accounts debited and credited are

a. Dividends Received and Dividends Payable.
b. Cash and Dividends Payable.
c. Dividends Payable and Cash.
d. Common Stock and Cash.

Business Professionals of America

Multiple Choice

5. A legal form that asks stockholders to transfer their voting rights is called a

a. security.
b. proxy.
c. preemptive right.
d. stock split.

Need More Help?

Go to glencoeaccounting.glencoe.com and click on **Student Center.** Click on **Winning Competitive Events** and select **Chapter 21.**

- Practice Questions and Test-Taking Tips
- Concept Capsules and Terminology

CHAPTER 21 Real-World Applications and Connections

CRITICAL Thinking

Publicly Held Corporations

1. What is a publicly held corporation?
2. Describe the components of stockholders' equity.
3. Summarize the accounting entries when a corporation sells 200 shares of 9% preferred stock, with a par value of $100, for $125 per share.
4. Compare and contrast preferred and common stock.
5. Write a rule expressing when a dividend becomes a liability for a corporation. Explain the reason for the rule.
6. Justify the fact that corporations that sell their stock for an amount in excess of par cannot record the excess as profit.

CASE STUDY

Merchandising Business: Coffee Shop

Cyber Café is a retail store that sells a variety of coffees, gourmet pastries, and other snacks. The store also offers computer stations where customers can surf the Web.

Early success helped the owners of Cyber Café to incorporate and franchise the business. They now have franchises in 15 cities and want to raise additional money to open cafés in Japan.

INSTRUCTIONS

1. List at least three ways the business could raise money for the new franchises.
2. If you were considering investing in Cyber Café, describe the ratios and analyses you would calculate from its financial statements.
3. Explain how these calculations would help you make an investment decision.

a matter of ETHICS

Using Insider Information

You are an accountant for a large shipping company, like United Parcel Service (UPS). Through your work, you learn that your company is planning to buy a company that makes shipping containers. It's a small company whose stock is traded on the stock exchange. You think about purchasing several thousand shares of this company's stock, expecting to make a profit when your company purchases it.

ETHICAL DECISION MAKING

1. What are the ethical issues?
2. What are the alternatives?
3. Who are the affected parties?
4. How do the alternatives affect the parties?
5. What would you do?

COMMUNICATING ACCOUNTING

Describing Corporations

You work for a locally owned partnership that was just purchased by a corporation. You decide to share information about corporations with your co-workers. Create a one-page information sheet identifying the characteristics of a corporation. Write a paragraph explaining each characteristic.

Real-World Application and Connections CHAPTER 21

Skills Beyond Numbers

Working in Teams

Annabelle Bradly owns Aussie Diners in Australia and North America. The corporation is considering going public and offering common stock on the New York Stock Exchange. She calls you to invite the North American executive management team to meet before she makes the final decision to go public.

INSTRUCTIONS

1. Describe how to get all executive management team members together quickly.
2. In groups of five, role-play holding an executive team meeting. Each student will be a manager: Marketing, Accounting, Personnel, Facilities, or Purchasing. List your department's concerns about going public.

International Accounting

World Federation of Exchanges

The World Federation of Exchanges (WFE) is the trade organization for regulated securities markets and organizations that serve the industry. Over 97 percent of the world's exchanges belong to the WFE, including the New York Stock Exchange and the Tokyo Stock Exchange. Enforcement, trading policies, business conduct, and self-regulation are a few of the issues that it studies.

INSTRUCTIONS Locate the WFE Web site and describe its general mission.

Making It Personal

Your Investment Choices

In some ways your future depends on how well you plan for financial security. You can make wiser investment decisions when you know the choices available.

PERSONAL FINANCE ACTIVITY Use the library or Internet to find basic information about stock, bond, and real estate investments. Explain which investment most appeals to you and why.

PERSONAL FINANCE ONLINE Log on to **glencoeaccounting.glencoe.com** and click on **Student Center.** Click on **Making It Personal** and select **Chapter 21.**

Analyzing Financial Reports

Evaluating Stockholders' Equity

The statement of stockholders' equity provides details about changes in the stockholders' equity accounts during the period. This information helps investors and analysts better understand the company's capital. Successful companies earn money for future operations (reported as retained earnings) through sales and rely less on raising new capital through the issuance of stock.

INSTRUCTIONS Use PETsMART's statement of stockholders' equity in Appendix F to answer these questions.

1. Explain how retained earnings changed from a balance of $40,239,000 in 2003 to a balance of $174,053,000 in 2004.
2. How much did additional paid-in capital increase during this same time?

WebQuest

Why Invest?

Not all companies pay dividends. So, why invest? Visit **glencoeaccounting.glencoe.com** and click on **Student Center.** Click on **WebQuest** and select **Unit 4** to continue your Internet project.