

# Organizing a Corporation and Paying Dividends

Section 11.1 Starting a Corporation

# Chapter 11

## Objectives

- Define accounting terms related to corporate accounting
- Identify accounting concepts & practices related to corporate accounting
- **Journalize** transactions related to stock subscriptions
- Prepare a **balance sheet** for a newly formed corporation
- Calculate dividends for a corporation
- **Journalize** transactions of a corporation related to declaring and paying dividends

# Terms

- Corporation
- Board of directors
- Articles of incorporation
- Charter
- Common stock
- Preferred stock
- Stock certificate
- Par value
- Par-value stock
- No-par-value stock
- Stated value stock
- Organization costs
- Subscribing for capital stock
- Intangible assets
- Declaring a dividend
- Date of declaration
- Date of record
- Date of payment

# Starting a corporation

## Corporation

- Has the legal rights of a person
- Owned by many persons
- Organized by law *to exist separately and apart from its owners*
- How it differs from other forms of businesses comes down to:
  1. Nature of ownership
  2. Management

# Corporation Ownership

- Ownership is divided into units known as \_\_\_\_\_.

*Answer: Share of stock*

- Total shares of ownership in a corporation are known as \_\_\_\_\_.

*Answer: Capital stock*

- An owner of one or more shares of a corporation as known as a \_\_\_\_\_.

*Answer: Stockholder*

# Corporation Earnings

- Earnings distributed to stockholders are known as \_\_\_\_\_.

*Answer: Dividends*

## Distribution of dividends:

- Corporations may retain some or all of their earnings. Why?
- Most corporations distribute a portion of their earnings to stockholders. Why?

# Articles of Incorporation, pg 315

Article I – Name

Article II – Nature of Business

- Why do you think it says “*may engage in ANY activity or business...*”

Article III – Capital Stock

- Two basic types of stock
  1. Common Stock – does not give stockholders any special preferences
  2. Preferred Stock – gives stockholders preference in earnings and other rights

Stock certificate

- Issued when a corporation receives full payment for the stock.
- Issue date, certificate number, number of shares, & name of the stockholder.

# Articles of Incorporation, pg 315

Two basic types of stock:

## Common Stock

- Does not give stockholders any special preferences
- Gives you the opportunity to vote in the election of the board of directors
- Never know the value of their dividends in advance
- Common shareholders rarely get anything in bankruptcy cases

## Preferred Stock

- Gives stockholders preference in earnings and other rights
- Usually guarantees the payment of dividends but does not come with voting rights
- Receive dividends at a fixed rate; tend to be higher than those on common stock
- Very important - the company does not have the obligation to pay missed dividends
- In the case of bankruptcy, preferred stock owners rank above common stock owners

Both represent some degree of ownership.



# Articles of Incorporation, pg 315

Article IV – Initial Capital

Article V – Terms of Existence

- *Perpetual* existence

Article VI – Address

Article VII – Directors

- Board of Directors

- A group of persons elected by the stockholders to manage a corporation
- Determine corporate policies and selects corporate officers to supervise the day-to-day management of a corporation

# Articles of Incorporation, pg 315

Article VIII – Initial directors

Article IX – Incorporators and Initial Subscribers

Article X – Beginning of Corporate Existence

- *Articles of incorporation*

- ❖ A written application requesting permission to form a corporation
- ❖ Some filed with the federal government; most are filed with the state
- ❖ When approved, a corporation comes into existence
- ❖ Approved articles of incorporation are called a *charter*.

Article XI - Amendments

# Rights of Stockholders

## 3 Basic Rights

1. To vote at stockholder's meetings unless an exception is made for holders of a particular kind of stock
2. To share in a corporation meeting
3. To share in the distribution of the assets of the corporation if it ceases operations and sells all of its assets

# Capital Stock of a Corporation

Two types of stock are:

1. \_\_\_\_\_
2. \_\_\_\_\_

Written evidence of the number of shares that each stockholder owns in a corporation is called a

\_\_\_\_\_

Changing of ownership of stock is referred to as a *stock transfer*.

*Transfer agent* - issues certificates and keep stock ownership records.

# Value of Stock

Par Value – value assigned to a share of stock and printed on the stock certificate

- Par-value stock
  - Has an *authorized value printed on the stock certificate*
  - Represents the minimum amount that must be paid per share
- No-par-value stock – has no authorized value printed on the stock certificate
- Stated-value stock
  - No-par-value stock that is assigned a value by a corporation
  - Value is not printed on the stock certificate

# Par vs. Non-Par

- On one hand, if shareholders pay less than the par value for a share of stock and the issuing company later becomes unable to meet its financial obligations, its creditors can require that shareholders pay the difference between the purchase price and the par value as a means of fulfilling the company's unpaid debts. On the other hand, if the market price of the stock falls below the par value, the company may be liable to shareholders for the difference. To circumvent both these scenarios, most companies issue stock with very low par values, often one cent.

# Par vs. Non-Par

- For example, if company ABC issues 1,000 shares of stock with a par value of \$50, then the minimum amount of equity that should be generated by the sale of those shares is \$50,000. Since the market value of stock has virtually nothing to do with par value, it is possible for investors to purchase this stock on the open market for considerably less than \$50. Assume all 1,000 shares are purchased below par, say \$30, generating only \$30,000 in equity. If the business goes under and cannot meet its financial obligations, shareholders can be held liable for the \$20-per-share difference between par and the purchase price.

# Common Stock

- If a corporation only issues one type of stock it will be common stock. In this case, common stockholders will be entitled to all of the dividends.
- Have the right to vote whereas preferred stock holders do not (example – when and how much dividends are paid).



# Preferred Stock

- Used to attract more investors.
- Do not have the right to vote
- Preferred stock comes with certain right that common stock holders do not have:
  - Unpaid dividends may accumulate from one year to another
  - Preferred dividends must be paid before any common stock dividends are paid.
  - Dividends may be shared with common stockholders above a stated percentage or amount.

# Preferred Stock

- Every preference granted to preferred stock holders comes at an expense to common stock holders.
  - For example – if preferred stockholders share in dividends above a stated percentage, common stockholders give up the right to some dividends.
- No dividends are paid until the board of director's votes to pay dividends.

# Preferred Stock

- Dividends may be stated as:
  1. A percentage of par value
  2. An amount per share

M-Bot Corporation has 10,000 shares of 8%, \$100 par value, cumulative preferred stock outstanding at December 31, 2012. No dividends were declared in 2010 or 2011. If M-Bot wants to pay \$375,000 of dividends in 2012, how much will common stockholders receive?

What do we know? Calculate preferred dividends first...

10,000 shares X 8% X \$100 par value

2010 - \$80,000

2011 - \$80,000

2012 - \$80,000

Total preferred dividends - \$240,000

M-Bot wants to pay \$375,000 total

$\$375,000 - \$240,000 = \$135,000$  common dividends

# Capital Accounts of a Corporation

- Because of the number of owners, a corporation does not keep a separate capital account for each stockholder.
- A single general ledger capital account for each kind of stock issued.
  - If only one stock issued, 1 capital account
  - If both common and preferred stock issued, 2 capital accounts

# Capital Accounts of a Corporation

## Retained Earnings:

- Capital account used to record net income
- Keeps net income separate from the recorded values of issued capital stock.
  - Net income – credited
  - Net loss - debited

A debit balance in retained earnings is often referred to as a *deficit*.

Retained earnings is a Capital account and it should have a normal balance of a \_\_\_\_\_.

# Issuing Capital Stock When Forming a Corporation, pg 319

January 5. Received cash from six incorporators for 30,000 shares of \$10 stated-value common stock, \$300,000. Receipt Nos. 1-6.

Which two accounts are affected?

*Answer: Cash and Capital Stock-Common*

*Cash will be debited for \$300,000*

*Capital Stock – Common will be credited for \$300,000*

Accounting equation & T Account review:

# Assets = Liabilities + Owner's Equity

Cash		Capital Stock - Common	
Dr	Cr	Dr	Cr
Normal Balance			Normal Balance
\$300,000			\$300,000



# Organization costs of a corporation

Fees and other expenses of organizing a corporation. Include:

1. Incorporation fee paid to the state when the article of incorporation are submitted.
2. Attorney fees for legal services during the process of incorporation.
3. Other incidental expenses incurred prior to receiving a charter.

# Organization costs of a corporation

- Corporation cannot be formed without organization costs
- Until it receives a charter, a corporation does not exist to pay organization costs.
- Could take months to start a new corporation

So who pays?

- Normally, one of the incorporators agrees to pay organization costs until corporation formed.

# Organization costs of a corporation

January 5. Paid cash to Amy Thacker as reimbursement for organization costs, \$2400.00. Check No. 1

Which two accounts will be affected?

Cash

Organization cost – what type of account?

Benefits derived from organization costs extend over many years. Initially, recorded as an ASSET until it is charged as an expense.

What are two other accounts that we have worked with that are similar to organization costs?

# Organization Costs of a Corporation

Organization Costs		Cash	
Dr	Cr	Dr	Cr
Normal Balance		Normal Balance	
\$2,400			\$2,400

# Audit your understanding

What are the responsibilities of a corporations board of directors?

- Determine corporate policies
- Select corporate officers to supervise day-to-day management of the corporation

# Audit your understanding

What three basic rights do stockholders usually have?

- Right to vote at stockholders' meetings
- Right to share in the corporation's earnings
- Right to share in the distribution of a corporation's assets if a corporation ceases operations and sells its assets

# Audit your understanding

What two basic kinds of stock may a corporation have?

- Common Stock
- Preferred Stock

# Audit your understanding

In place of a general ledger capital account for each owner, how does a corporation show stock ownership?

- A single summary general ledger capital account is used for each kind of stock issued.

What are the two types of stock?



# Audit your understanding

What accounts are affected, and how, when a corporation initially sells and issues common stock to incorporators?

- Cash is debited
- Capital Stock – Common is credited

# Audit your understanding

What three items may be included in the organization costs of a corporation?

1. An incorporation fee paid to the state when the articles of incorporation are submitted
2. Attorney fees for legal services during the process of incorporation
3. Other incidental expenses incurred prior to receiving a charter