**CHAPTER 6**

**ACCOUNTING FOR CORPORATIONS**

**Objectives:**

* Identify the Basic features of Corporation
* Discuss the advantage and disadvantages of Corporation
* Identify the establishment of a Corporation.
* Describe the main sources of stockholder's equity.
* Identify theCommon characteristics of Capital stock
* Describe the account for Dividends & Retained Earnings
* Describe and illustrate the accounting for treasury stock.
* Describe and illustrate the computation of equity per share of stock.

**9.1 MEANING & BASIC CHARACTERISTICS OF CORPORATION**

**Meaning:** A Corporation is a business unit owned by many people, created under the authority of law, which exists and has powers and liabilities independent of its members.

Corporations are well suited to today's trends towards ***large organization, international trade & profession management*.** Corporations may be classified as nonprofit & Profit.

***Nonprofitcorporations*** include those organized for recreational, educational, charitable, or for philanthropic purposes.

***Profit corporations*** are engaged in business activities, they depend upon profitable operations for their continued existence.

Large profit corporations whose shares of stock are widely traded and distributed in a public markets are often called ***Public Corporations***. On the other hand, corporations whose shares of stock are owned by a small group of people are called ***Nonpublic Corporations.***

**Characteristics of a Corporation**:

The corporation form of business organization has several characteristics, among them are;

**1) Separate Legal Entity**: A Corporation is a separate legal entity that has most of the rights of a person except those of voting and marrying. As such, it can buy, sell or own property, sue and sued; enter into contracts; hire and fire employees, and be taxed.

**2) Limited Liability**: Because a corporation is a separate legal entity, it is responsible for its own actions and liabilities. Since the owners of a corporation are not responsible for the corporation's debts, their liability is limited to their shares in the corporation.

**3) Easy to raise capital**: it is fairly easy for a corporation to raise capital because shares of ownership in the business are widely available to potential investors.

**4) Easy of transfer of ownership**: the ownership of a corporation is represented by a transferable unit, ***a share of stock***. An owner of shares of stock, or *a stockholder*, normally can buy and sell shares of stock without affecting the activities of a corporation or needing the approval of other owners.

**5) Lack of Mutual Agency**: There is no mutual agency in the corporate form of business. If a stockholder, acting as an owner, tries to enter into a contract for the corporation, the corporation is not bound by the contract.

**6) Continuous Existence/ Unlimited life:** Anotherfeature of a corporation being a separate legal entity is that an owner's death, incapacity, or withdrawal, does not affect the life of the corporation.

7) **Centralized Authority and Responsibility:** the board of directors represents the stockholders and delegates the responsibility and authority for the day to day operation of the corporation to single person, usually the president of general manager. This power is not divided among the many owners of the business.

**Stockholders**

**Board of Directors**

**Officers/Management**

**Employees**

**8) Professional Management:** Large corporations are owned by many people who probably do not have the time or training to make timely decisions about the business's operations. So in most cases, management and ownership are separate. This allows the corporation to hire the best talent available to manage the business.

**9) Government Regulation:** Corporation must meet the requirement of the state laws. This creature of the state is subject to greater control and regulation by the state than are other forms of business.

**10) Taxation:** A major disadvantage of the corporation is double taxation. .

**6.2 ADVANTAGES AND DISADVANTAGES OF CORPORATION**

From the foregoing discussion about a corporate business, we can identify the following advantages and disadvantages of a corporation compared to a proprietorship and partnership.

**6.2.1 Advantages of a Corporation**

1. Separate Legal Existence
2. Limited liability of stock holders
3. Transferable ownership rights
4. Ability to acquire Capital
5. Continuous life [unlimited life]
6. Corporation management – Professional management
   * 1. **Disadvantages of a Corporation**
7. Corporation management -- separation of ownership and management
8. Government Regulations
9. Additional taxes [double taxation]

**6.3 FORMATION OF A CORPORATION**

The initial step in the formation of a corporation is to file an application with the secretary of state in which incorporation is desired. After the incorporated fee is paid and the application approved, a ***Charter*** is granted. The charter may be an approved copy of the application form or it may be a separated document containing the same basic data. The issuance of the charter, often referred to as the *Articles of Incorporation*, creates the corporation.

**Organization cost:** the costs of forming a corporation are called *organization costs*. These costs which are incurred before the corporation begins operation include:

* State incorporation fee
* Attorney's fees for drawing up the articles of incorporation
* Promotional costs
* The cost of printing stock certificates
* Other expenditure which are incurred for forming the corporation.
  1. **AUTHORIZATION AND ISSUANCE OF STOCKS**

**The components of stockholders equity:** The owners' equity in a corporation is commonly called ***Stockholders Equity*** or ***Shareholders Equity*** or ***Shareholders Investment***, or ***ShareholdersCapital***.

* There are two main sources of stockholders' equity;

1. Investments contributed by the stockholders, called **paid in capital** or **Contributed Capital** and
2. Net income retained in the business, called **Retained Earnings**

* They are explained as follows:

1. **Paid in Capital Or Contributed Capital:** It represents the investment made by the stockholders in the corporation or the amount invested by the stockholders in the corporation. The paid in capital contributed by the shareholders is recorded in the accounts maintained for each class of stock. If there is only one class of stock, the account is entitled *Common Stock or Capital Stock*. The capital paid by stockholders is regarded as permanent capital, not ordinarily subject to withdrawal.
2. **Retained Earnings:** is net income retained in a corporation. Net income is recorded in the retained earnings account by a closing entry in which Income Summary is debited and Retained Earnings is credited.

**Example:** Assuming that net income for Delta Company in its first year of operations is Br.130, 000, the closing entry is:

Income Summary ……………………………….130, 000

Retained Earnings …………………………………130,000

***(To close income summary and transfer net income to retained earnings).***

Retained earnings are generated from operations. Net income increases retained earnings, while dividends decrease retained earnings. Thus, retained earnings represent a corporation’s accumulated net income that has not been distributed to stockholders as dividends.

The balance of the retained earnings account at the end of the fiscal year is created by closing entries. First, the balance in the income summary account (the net income or net loss) is transferred to Retained Earnings. Second, the balance of the dividends account, which is similar to the drawing account for a proprietorship, is transferred to Retained Earnings.

Other terms that may be used to identify retained earnings in the financial statements include *earnings retained for use in the business* and *earnings reinvested in the business*. A debit balance in Retained Earnings is called a ***deficit***. Such a balance results from accumulated net losses. In the Stockholders’ Equity section, a deficit is deducted from paid-in capital in determining total stockholders’ equity.

The balance of retained earnings should not be interpreted as representing surplus cash or cash left over for dividends. The reason for this is that earnings retained in the business and the related cash generated from these earnings are normally used by management to improve or expand operations. As cash is used to expand or improve operations, its balance decreases. However, the balance of the retained earnings account is unaffected. As a result, over time the balance of the retained earnings account normally becomes less and less related to the balance of the cash account.

**Characteristics of Capital Stock**

The general termapplied to the shares of ownership of a corporation is ***Capital Stock***. The number of shares that a corporation is authorized to issue is set forth (declared) in the articles of incorporation or charter.

The share of capital stocks are often assigned an arbitrary monetary figure, known as **Par.** The par-amount is printed on the stock certificate, which is the evidence of ownership issued to the stockholder. The stock may also be issued without par, in which case it is called **No-Par** stock. Many states provide that the board of directors must assign a stated value to no-par stock, which makes it similar to part stock.

* **Some common characteristics of a capital stock are:**

**1) Authorized Shares:** It represents the maximum number of shares of stock the corporation is allowed to issue. Most corporations are authorized to issue more shares of stock at the time of organization. However, they issue only a part of these stocks at the time of their establishments. This will enable them to issue the remaining authorized stock in the future whenever they need additional capital needed.

**2) Issued Shares:** The issued stock of a corporation is the shares sold, or otherwise transferred to stockholders.

**3) Outstanding Shares:** It represents the number of shares that have been issued and are in the hands of shareholders. Outstanding shares may be equal to or less than issue shares. The number of outstanding shares is less than issued shares if the corporation reacquired some shares.

**4) Par Value:** It represents an arbitrary monetary figure assigned to a share of stock by the corporation. Par value is a legal concept in the sense that it represents the *legal capital per share.* Legal capital is the amount below which stockholders' equity cannot be reduced except by losses from business operations.

**Classes of Stock**

Generally, there two basic types of stock: Common Stock and Preferred Stock.

1. **Common Stock:**

Common stock is the basic type of capital stock issued by every corporation. Every corporation has common stock. The major basic rights accompany ownership of a share of common stock are:

1. The right to vote in matters concerning the corporation.
2. The right to share in distributions of earnings.
3. The preemptive right , which is the right to maintain the same fractional interest in the corporation by purchasing a proportionate number of shares of any additional issuance of stock and,
4. The right to share in assets upon liquidation. Each share generally has equal rights.
5. **Preferred Stock:**

The second kind of stock a company can issue is called *Preferred Stock*. Both common and preferred stocks are sold to raise money. But investors in preferred stock have different investment goals from investors in common stock.

Preferred stock has preference over common stock in one or more areas. There can be several different classes of preferred stock, each with distinctive characteristics to attract different investor. Most preferred stock has one or more of the following characteristics.

1. Preference as to dividend:Preferred stockholders are entitled to receive a dividend of a specified amount each year before any dividend is paid to common stockholders. Preferred stock has fixed dividend rate. This rate may be stated as dollar amount per share, or a percentage of par values.
2. Preference as to the assets of the business upon liquidation of the organization.
3. Convertibility: This preferred stock can be exchanged with common stock, or redeemed.
4. Has no voting right
5. Callable at the option of the issuing corporation: the corporation may call back some or all of the preferred stocks.

**1. Cumulative and Non-cumulative preferred stock.**

**Cumulative Preferred Stock:**

Here a fixed dividend amount per share accumulates from year to year, and the whole amount must be paid before any common dividend can be paid. If dividends that are not paid in the year they are due are called ***dividends in arrears***. Note that dividends in arrears are not recorded as a liability of the corporation because no liability exist unit the board of directors declares a dividend. When a dividend is declared, the corporation records the declaration as a *debit to dividends* and a *credit to dividends payable* as current liability.

**Non-Cumulative Preferred Stock:**

It is a preferred stock that does not have cumulative right. Any dividend that is passed will not be paid to preferred stockholders.

**Example:** Assume that a corporation has been authorized to issued 10,000 shares Br 100 par value, Br 5 cumulative preferred stock, and that the shares have been issued and are outstanding. If no dividends were paid in 1991, at the end of the year there would be preferred dividends of Br 50,000 (1,000 shares Br 5) in arrears. If dividends are paid in 1992 preferred dividends must paid before any dividends on common stock can be paid.

**2) Participating and Nonparticipating Preferred Stock**

It is apparent that holders of preferred stock have relatively greater assurance than common stockholders of receiving dividends regularly. On the other hand, holders of common stock have the possibility of receiving larger dividends than preferred stockholders. The preferred stockholders' preferential right to dividends is usually limited to a certain amount. Such stock is said to be ***nonparticipating***.

Preferred stock which provides for the possibility of dividends in excess of a certain amount is said to be ***participating***. Preferred shares may participate with common shares to varying degrees, and the agreement with the shareholders must be examined to determine the extent of this participation.

**Example:** Eldan Corporation has outstanding stock composed of 2,000 shares of Br 7 and participating preferred stock of Br 100 par and 10,000 shares of Br 50 par common stock. The preferred stock entitled to participate equally with the common, on a share for share basis, in any dividend distribution, which exceeds the regular preferred dividend and a Br 3 per share common dividend. The directors declare dividends of Br 62,000 for current year. The Br 62,000 dividend distribution would be allocated as follows:

**Preferred Common Total**

**Dividend Dividend Dividend**

Regular dividend to preferred (2000xBr7) Br 14,000 ------------ Br 14,000

Regular dividend to common (10,000xBr10) --------- Br 30,000 Br 30,000

Remainder to 12,000 shares totaling (Br 1.5

per share) 3,000 Br 15,000 Br 18,000

Total  **Br 17,000 Br 45,000 Br 62,000**

Dividends per share **Br 8.50 Br4.50**

**6.4.1 Issuing Capital Stock**

The entries to record investments of stockholders in a corporation are like those for investments by owners of other types of business organizations, in that cash and other assets received are debited and any liabilities assumed are credited. The credit to stockholders' equity differs, however, in that there are accounts for each class of stock.

A share of capital stock is either par or no par stock. If the capital stock is par stock the corporation charter states the par value, and this value must be printed on each share of stock. Par value can be Br 10, Br 1, Br 5, Br 100 etc of any amount.

Par value is the amount per share that is entered into the corporation's capital stock accounts and that makes up the legal capital of the corporation. When par value stock is issued, the appropriate capital stock account is credited for the par value regardless of whether the proceeds are more or less than the par value.

**Example:** Super Corporation is to issue 30,000 shares of Br 50 par value common stock and 15,000 shares of Br 100 preferred stock, issued half of the common and 20% of the preferred stock at par for cash as of January 1, 1991.

The entry to record the stockholders' investment and the receipt of cash is as follows:

Preferred stock = 3000 x Br 100 = Br 300,000

Common stock = 15,000 x Br 500 = Br 750,000

**Jan 1, 1991:** Cash …………………………………. 1,050,000

Preferred stock ………………. 300,000

Common stock ………………. 750,000

**Note:** *Cash is debited for Br 1,050,000 (Br 300,000 + Br 750,000), preferred stock is credited for Br 300,000 and common stock is also credited for Br 750,000.*

**Premium and Discount on Stock**

When capital stock is issued at a price greater than par (premium) the proceeds in excess of par would be credited to a capital account called ***Paid – in Capital In Excess of Par value, common stock or preferred stock.***

**Example**: assume that 5000 shares of Br 50 par of Saron Corporation common stock is sold for Br 55 per share on January 1, 1992. The entry to record the issuance of the stock at the price in excess of par would be as follows:

**Jan 1, 1992:** Cash ………………………………………. 275,000

Common stock (5,000 x Br 50)…… 250,000

Paid in capital in excess of par common stock 25,000

Paid – in capital in excess of par common stock = 5,000 x Br 5 (Br 55 – Br 50) = Br 25,000.

**Note:***the premium Br 25,000 is a part of the investment of the stockholders and is therefore a part of paid – in capital. It is distinguished from the capital stock because usually it is not a part of legal capital.*

Most states do not permit the issuance of stock at a discount. When stock is issued at less than its par, it is considered to be fully paid as between the corporation and the stockholders. In some states, however, the stockholders are contingently liable to creditors for the amount of the discount.

If a corporation issued stocks for less than par, an account called ***discount on capital stock*** is debited, and cash or other assets received are debited for the amount received. The discount on capital stock is deducted from the par amount of capital stock in the paid in capital subsection of stockholders' equity.

**Presentation of Premium on Capital Stock on the Balance Sheet**

The manner in which premiums on capital stock may be presented in the stockholders' equity section of the balance sheet is illustrated as follows:

**Stockholders’ Equity:**

Paid in Capital/ Contributed Capital:

**Preferred stock** – Br 100 par value, (15,000 shares

authorized, 4,000 shares issued and outstanding) …………… Br 400,000

Paid in capital in excess of par, Preferred Stock………………… 15,000 415,000

**Common Stock** – 20,000 shares issued and outstanding)……… Br 1,000,000

Paid in capital in excess of par, Common Stock……………….. 25,000 1,025,000

Total Paid in Capital……………………………………………. Br 1,440,000

Retained earnings……………………………………………….. 175,000

Total Stockholders' Equity --------------------------------------------- **Br 1,615,000**

1. On March 10, Alemu Company, with an authorization of 20,000 shares of common stock of Br 15 par and 8,000 shares of preferred stock of Br 20 par, issued one-fourth of each authorization for cash.

**Required:**

1. Prepare journal entries to record the issuance of capital stock, assume the selling price per share and par values are same.
2. Prepare journal entry to record the issuance of capital stock if their selling prices are Br 18 per share for common stock and Br 22 for preferred stock.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Issuing Stock for Assets Other than Cash**

Stock can be issued for assets or services other than cash. In such cases, the transactions is recorded either at the fair market price of the assets or at the fair market price of the stock issued, whichever is more objectively determinable. The determinable of the values to be assigned to the assets is the responsibility of the board of directors.

**Example:** Suppose Alemu Corporation issue 1,000 shares of its Br 50 par value of common stock in exchange for a piece of land. At the time of the exchange, the stock was selling on the market for Br 56 per share. The entry to record this exchange is as follows;

January 1, 1992:

Land……………………………………… 6,000

Common stock…………………… 50,000

Paid-in capital in excess of par common stock 6,000

**No Par Stock:**

As explained earlier, stock can be issued without a par value. When no par stock is issued the entire proceeds from the issuance of no par stock may be credited to the capital stock account, even through the issuance price varies from time to time.

**Example:** At the time of its establishment of Silashi Corporation issue 5,000 shares of no- par common stock at Br 52 a share and at a later date issues 2,000 additional share at Br 46, the entries to record no- par stock would be as follows;

Cash………………………………………. 260,000

Common stock……………………. 260,000

***To record original issuance of 5,000 shares of no par common stock at Br 52.***

Cash……………………………………….. 92,000

Common stock…………………….. 92,000

***To record subsequent issuance of 2,000 shares of no par common stock at Br 46.***

**Subscriptions and Stock Issuance**

A corporation may sell its stock directly to investors or others, such as employees, under stock purchase plans. In such cases the buyer may enter into an agreement with a corporation to subscribe to shares at a certain price per share.

When stock is subscribed for at par, the subscription price is debited to the asset account *Stock Subscription Receivable* and credited to the capital stock account *Stock Subscribed*. When stock is subscribed for at a price above par, the stock subscriptions receivable account is debited for the subscription price. The stock subscribed account is credited at par amount, and the difference between the subscription price and par is credited to the *Paid – In Capital in Excess of Par*. After a subscriber has completed the agreed payments, the corporation issues the ***stock certificate***. At this point, the subscribed account is debited for the total par of the shares issued, and the capital stock account is credited for the same amount.

**Example:** On January 8, 2002, Haleta Corporation received subscriptions to 20,000 shares of Br 30 par common stock from subscribers at Br 32 per share with a down payment of 25% of the subscription price. The journal entries would be presented below:

**Jan 8, 2002:** Cash…………………………………………. 160,000

Common Stock Subscription Receivable…… 480,000

Common stock subscribed…………… 600,000

Paid-In Capital in Excess of Par, Common Stock 40,000

On March 20, 2002, Haleta Corporation received 40% of the balance of subscription receivable from the subscribers.

**March 20, 2002:** Cash…………………………………….. 192,000

Common Stock Subscription Receivable 92,000

On June 21, 2002 Haleta Corporation received the remaining balance of subscription receivable from the subscriber and issued stock certificate as evidence of ownership right over assets of the corporation.

**June 21, 2002**: Cash………………………………………… 288,000

Common Stock Subscription Receivable… 288,000

Stock subscribed …………………………….. 600,000

Common Stock………………………….. 600,000

The Common Stock Subscription Receivable account is reported among the current asset section of the balance sheet. Whereas the Stock Subscribed and the Paid-In Capital in Excess of Par, are listed in the stockholders' equity section as contributed capital/ paid in capital. After all the subscriptions have been collected, the Common Stock Subscriptions Receivable and the Common Stock Subscribed accounts will have a zero balance.

**Check Your Progress: Exercise 9.5**

1. Assume that , Silashi Corporation acquired Land in exchange for 10,000 shares of common stock of Br 10, par (market value of the share is Br 15) . The book value of the land is Br 120,000, and the current market value is Br 140,000.

**Required:** Prepare journal entry to record the above transaction.

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

2. Assume that on January 3, 2003 the company received a stock subscription of Br 20 par common stock of 9,000 shares. The subscription price is Br 24 and the company received 20% of the subscriptions price as down payment. On February 28, 2003, the company received 30% of the subscription price. Finally, it collected the remaining on April 7 and issued stock certificate.

**Required:** Prepare the necessary entries related to the case on

a) January 3, 2003

b) February 28, 2003

c) April 7, 2003.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**9.5 TreasuryStock**

Treasury stock refers to capital stock, either common or preferred, that has been issued and reacquired (or repurchased) by the issuing company but has not been sold or retired. There are several reasons that the corporation purchases its own stock, some of these are:

1. It may want to have stock available to distribute to employees through stock option plans.
2. It may be trying to maintain a favorable market for the company's stock, i.e., to support the market price of the stock.
3. It may want to increase the company's earnings per share.
4. In payment of debt owed by a shareholder.

The effect of a purchase of treasury stock is to reduce the asset and stockholders' equity of the company. Treasury stock can be held for an indefinite period of time. Treasury stock does not have voting rights, rights to cash dividends, or stock dividends, or right to assets upon liquidation of the company.

There are several methods of accounting for the purchase and the resale of treasury stock. The ***cost basis of accounting*** for treasury stock is the most common method. Under cost method, the purchase of stock is debited to treasury stock account, and credited to cash account at the price paid for it. The par and the price at which the stock was originally issued are irrelevant to account for treasury stock under cost method. When the stock is resold, treasury stock is credited at the price paid for it, and the difference between the price paid and the selling price is debited or credited to an account entitled *Paid – in Capital from Sale of Treasury Stock.*

**Example:** Assume that on June 30, 2002 the Corporation has common stock account balance of Br 800,000 (10,000 shares at Br 80 par) and premium on common stock of Br 300,000. On the same date, the company acquired 2000 shares of its own common stock for Br 120 per share. The entry to record the acquisition of stock is made below:

Treasury stock (2000 x Br 120)…………………….. 240,000

Cash………………………………………… 240,000

Treasury stock account is reported in the stockholders' equity section as *a deduction* from paid in capital. After the reacquisition of 2,000 shares of common stock, the number of common stock outstanding is reduced to 8,000 shares (10,000 - 2000).

**Example:** Assume further that on July 31, 2003, 1500 shares (out of 200shares) were resold

Cash (1500 x Br 200)………………………………… 300,000

Treasury stock (1500 x 120)………………………….. 180,000

Paid-In Capital from Sale of Treasury Stock (300,000- 180,000) 120,000

The account Paid-In Capital from Sale of Treasury Stock is reported in the stockholders' equity section as addition if it has a credit balance. On the other hand (if it is sold less than its acquisition price), this account has a debit balance, it is presented as a deduction in the stockholders equity section.

**Check Your Progress: Exercise 9.6**

On January 1, 1993, the stockholders' equity section of Meka Corporation shows; Common stock (Br 5 par value) Br 1,500,000; Paid - in Capital in excess of par value Br 1,000,000 and retained earnings Br 1,200,000. During the year, the following treasury transactions occurred:

March.1 Purchased 50,000 shares for cash at Br 14 per share\

July 1 Sold 10,000 treasury shares for cash at Br 16 per share

Sept.1 Sold 8,000 treasury shares for cash at Br 12 per share.

**Required:**

a) Journalize the treasury transactions

b) Restate the entry for September 1, assuming the treasury shares were sold at Br 10 per share.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**9.7 Equity per Share**

The amount appearing on the balance sheet as total stockholders' equity can be stated in terms of the Equity per Share or some times called Book Value per Share of Common Stock or Preferred Stock. When there is only one class of stock, the equity per share is determined by dividing total stockholders' equity by the number of shares outstanding as

**Equity per Share = Total stockholders' Equity**

**Number of Common Stock Outstanding**

**Example:** Assume that a corporation has a balance in common stock and premium on common stock accounts of Br 200,000 and Br 100,000 respectively. Besides, it has a retained earnings balance of Br 50,000, and there are 70,000 shares of common stock outstanding.

Total stockholders equity is Br 350,000 (Br 200,000 + Br 1 00,000 + Br 50,000). Equity per share on Common Stock would be:

Equity per share = Br 350,000/ 70,000 = **Br 5 per share**.

If the corporation has both common stock and preferred stock, it is necessary first to allocate the total equity between the two classes. Allocation is first made to preferred stock based on its liquidation price and any participating and cumulative dividends features. After the total is allocated to the two classes, the equity per share of each class may then be determined by dividing the respective amounts by the related number of shares outstanding.

**Example:** Assume that on December 31, 2002, a corporation has both classes of stock, and that the preferred stock is entitled to receive Br 105 a share upon liquidation. The amounts of the stockholders' equity accounts of the corporation as follows:

**Stockholders' Equity**

Preferred Br 9 stock, cumulative, Br 100 par

(1,000 shares outstanding) ………………………………………. Br 100,000

Excess of issue price over par – Preferred stock………………… 2,000

Common stock, Br 10 par (50,000 shares outstanding)…………. 500,000

Excess of issue price over par-- Common stock………………… 50,000

Retained earnings………………………………………………... 253,000

Total Equity---------------------------------------------------------------  **Br 905,000**

**Required:** Compute equity per share on both common stock and preferred stock under the following assumptions;

a) Preferred stock is entitled only to liquidation price

b) Preferred stock is entitled to liquidation price plus two years dividend in arrears.

**Check Your Progress: Exercise 9.7**

The stockholders' equity accounts of Dawit Company at the end of the current fiscal year are as follows:

Preferred stock Br 10 stock, Br 100 par ----------------------Br 1,000,000

Common stock, Br 10 par, -------------------------------------- 5,000,000

Paid in capital in Excess of par-- Common stock----------- 200,000

Paid in capital in Excess of par-- Preferred stock---------- 40,000

Retained earnings-------------------------------------------------- 935,000

**Required:**

1) Determine the equity per share of each class of stock, assuming that the preferred stock is entitled to Br 120 per share upon liquidation.

2) Determined the equity per share of each class of stock, assuming that the preferred stock is entitled to receive Br 120 per share plus the dividends in arrears in the event of liquidation, and that only the dividends for the current year are in arrears.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Model Examination Questions**

1. Assume that Silashi Corporation has authorized of shares of 150,000 at the time of establishment (January 1, 2001). it has issued 110,000 shares since its establishment. on July 15, 2002, the corporation reacquired 5,000 shared for various reasons. if the par value of a share is Br.15, perform the following computations:

A) Outstanding shares a of December 31, 2002

B) The total par value of outstanding share

C) If a Share issued for Br 20, what is the legal capital?

1. **On** March 10, Alem Company issued for cash 5,000 shares of no- par common stock (with stated value of Br.10) a Br 14 and on August 7 it issued for cash 1,000 shares of Br 50 par preferred stock at Br 54.

**Required**

a) Give the entries for March 10 and August7. Assume that the common stock is to be credited with the stated value.

b) What is the total amount invested by all stockholders as of August 7?

1. On January 11 of the current year, Silashi Company reacquired 1,000 shares of its common stock at Br.30 per share. On July 2, 500 of the reacquired share were sold at Br.28 per share. The remaining 500 shares were sold at Br. 35 per share on December 19.

**Required:**

A) Record the transactions of January 11, July2, and December 19

B) What is the balance in Pain-in-Capital from sale of Treasury stock on December 31 of the current year?

C) Where will the balance in paid-in-Capital from sale of treasury stock e reported on the balance sheet?

1. The stockholders equity and related accounts of Elias Manufacturing Corporation as of November 1, 1990, the beginning of the fiscal year, are as follows:

Preferred stock subscription receivable--------------------------------- Br 120,000

Preferred 8% stock, Br 50 par (100,000 shares authorized

20,000 shares issued) ------------------------------------------------ 1000,000

Preferred stock subscribed (3,000 shares) ---------------------------- 150,000

Paid in capital in excess of pare-- Preferred stock 80,000

Common stock, Br 25 par (500,000 shares authorized,

100,000 shares issued) ---------------------------------------------- 2,500,000

Paid-in Capital in Excess of par-Common stock--------------------- 600,000

Retained earnings----- --------------------------------------------------- 3,150,000

During the fiscal year ended October 31, 1991 Elias Manufacturing Corporation completed the following transactions affecting stockholders' equity:

a) Purchased 5,000 shares of treasury common stock for Br 130,000.

b) Received balance due on preferred stock subscribed and issued to certificates

c) Sold 3,000 shares of treasury common stock for Br 81,000

d) Received subscriptions to 4,000 shares of preferred 8% stock at Br 51, collecting one third of the subscription price.

E) Issue 40,000 shares of common stock at Br 27, receiving cash.

f) Sold, 1,000 shares of treasury common for Br 24,000.

**Required:**

1. Prepare the journal entries to record the transactions listed, identifying each transaction by the appropriate letter.

2. Prepare the stockholders' equity section of Elias Manufacturing Company balance sheet as October 31, 1991. The beginning retained earning balance must be increased by the net income for the year, Br 710,000, and reduced by the dividends declared and paid, Br 280,000.

1. Addis Corporation has authorized 150,000 shares and issues 100,000 shares at the time of establishment as on January 1, 1995 at a par value of Birr 20 per share for cash. Determine the following:
2. The total par value of outstanding share.
3. The amount by which capital stock is credited
4. If, on average, one share was issue for Br 25, will the legal capita be changed? If so, what is the amount of the legal capital?