

ADMS 2500 - Introduction to Financial Accounting

Equity

1. Basics of Equity
2. Retained Earnings
3. Contributed Capital
 - a. Common Equity
 - b. Preferred Equity
4. Shares in Detail
5. Dividends
 - a. Cash Dividend
 - b. Stock Dividend
 - c. Stock Split
6. Repurchase of Shares
7. Textbook for Theory
8. Practice

Equity

- Represents the claims of the owners to the business
- Ownership can be valued at the ***Residual Amount of Net Assets*** (Assets-Liabilities)

Equity - Retained Earnings

- Represents the value of all accumulated profits less any dividends declared

Equity - Capital Contributions (Share Capital)

- When Owners and Investors contribute funds, also called capital, they in return receive ownership interest in the form of 'shares' or 'stocks'

Classes of Shares

- Common Shares
- Preferred Shares

Summary of Important Characteristics:

Common Equity	Preferred Equity
Voting Privileges - One Vote Per Share	Generally No Voting Rights
Dividends Not Guaranteed (Paid After Preferred Shareholders)	Guaranteed & Defined Dividend: <i>Cumulative</i> : Any dividends not paid in past years must be paid in addition to the current year's dividend <i>Non - Cumulative</i> : Dividends not paid in past years are not carried forward
Pre-Emptive Rights (Protect Against Dilution)	Priority Over Common Shareholders In Liquidation
Last Priority In Case of Liquidation	

Equity - Shares

- *IPO - Initial Public Offering*: The first time shares are sold on the public market
 - Costs: Capitalized under "Organizational Costs" or Reduction in the Proceeds from Sale

- Initial Value:
 - Par Value: When a value is assigned to each share by the company. The value is printed on the share.
 - No Par Value: No value is printed on the share.
 - Recorded on the balance sheet at historical cost.
 - *Example: XYZ Inc. sells 50 shares to investors at \$100/share. One week later the shares are valued on the market at \$125/share.*

Balance Sheet Presentation

ABC Inc.
Balance Sheet - Shareholders Equity Section Only
Year Ended Dec 31s, 2020

Retained Earnings	\$x
Contributed Capital/Share Capital:	
Common Shares (1,000 shares authorized, 500 issued)	\$x
Preferred Shares (200, 5% Cumulative shares authorized and issued)	\$x
Total Shareholders' Equity	\$x

Dividends

- A dividend is a payment made by a corporation to its shareholders
- You can think of dividends as a way to reward our investors
- As company's earns profits, it can either re-invest it in the business, or it can distribute it to shareholders
- Dividends can be distributed in multiple forms: *Cash Dividend & Stock Dividend*
- All dividends are debited to Retained Earnings. Therefore, the maximum dividend will be limited to the balance of the Retained Earnings

Cash Dividend

- Cash dividends are the most common form of payment and are paid out in currency, usually via electronic funds transfer or a printed paper check.
- Such dividends are a form of investment income and are usually taxable to the recipient in the year they are paid.
- This is the most common method of sharing corporate profits with the shareholders of the company. For each share owned, a declared amount of money is distributed.

Example Cash Dividend: Recording the declaration of dividends

XYZ Company has a beginning Retained Earnings balance of \$115,000 and the Company earns a profit of \$85,000 for the year. After careful examination of the books, the Board of Directors of XYZ Company declared a cash dividend of \$2/share for the 10,000 shares currently issued.

Prepare the journal entry for the cash dividend and determine the ending balance of the retained earnings account.

Stock (Share) Dividend

- The BOD can elect to pay out additional shares, instead of cash, as a dividend
- Each new share issued as a result of the stock dividend, is valued at the current market value of the shares
- Where do these shares come from?
 - Remaining shares that have been authorized but not as yet issued
 - The company can repurchase shares
 - Authorize and distribute new shares
- They are usually issued in proportion to shares owned (for example, for every 100 shares of stock owned, a 5% stock dividend will yield 5 extra shares).

Example Stock Dividend: Recording the declaration of dividends

XYZ Company has a beginning Retained Earnings balance of \$115,000 and the Company earns a profit of \$85,000 for the year. After careful examination of the books, the Board of Directors of XYZ Company declared a 5% stock dividend on the 10,000 shares currently issued. The shares currently trade for 12/share.

Prepare the journal entry for the stock dividend and determine the ending balance of the retained earnings account.

Stock Splits

- Similar to stock dividends, both result in more shares being issued.
- Issue more shares in proportion to the current share ownership
- One major reason for a stock split, is to help reduce the price per share. This can make the share attractive to a wider investor market
- Does not result in a journal entry!

Example: Stock Split

The current market price of XYZ Company shares are \$120 and there are currently 10,000 shares issued. After careful examination of the books, the Board of Directors declared a the following stock split:

I.2-for-1 Split

II.3-for-2 Split

Repurchase of Shares

- Repurchased shares are recorded as Treasury Shares (Contra-Equity Account - Debit Balance)
- Can be resold at *cost*, *above cost*, *below cost*.

Example: Repurchase of Shares

ABC Company issued shares in 2020 at **\$40** per share. In 2021, ABC Company repurchased these same shares at **\$50** per share. In 2022, ABC Company resold the shares at **\$60** per share. Assume the number of shares included in the above transactions is 100 shares.

Example: Balance Sheet Presentation

ABC Company showed the following shareholders' equity as at December 31, 2020. In addition, the following information was known:

- The preferred shares have a market value of \$22 & had sold for an average price of \$15.
- The common shares have a market value of \$12 & had sold for an average price of \$8.
- Retained earnings at December 31, 2019, was \$450,000. During 2020, net income earned was \$600,000. The Board of Directors declared a total cash dividend of \$315,000.

ABC Company	
Balance Sheet - Shareholders Equity Section Only	
Year Ended Dec 31st, 2020	
Contributed Capital:	
Common Shares; unlimited shares authorized; ___ ??? ___ shares issued and outstanding	???
Preferred shares, \$1.50 non-cumulative; 250,000 shares authorized; 190,000 shares issued and outstanding	???
Total Contributed Capital	???
Retained Earnings	???
Total Shareholders' Equity	\$ 5,625,000.00

Required: Calculate the missing information