

Equity Transactions

Equity Transactions

In this video, we will discuss three main types of equity transactions: issuing of common stock, payment of cash dividends, and purchase of treasury stock.

Before we begin let's take a moment to review the concept of stockholder's equity. Stockholders equity refers to the owners claims on the corporations' assets.

And is made of two parts: capital stock and retained earnings.

There are two forms of capital stock: common stock and preferred stock, with preferred stock usually carrying a preference for dividends.

Before we can begin learning the journal entries for issuing common stock, we must understand a couple of key terms. Authorized stock is the number of shares a corporation is allowed to sell while outstanding stock is the number of shares a corporation has actually sold. The par value of capital stock is the dollar amount assigned by the corporate charter.

We will begin by learning the transactions involving common stock. Let's look at this example: Sylvia's Tea Room issued 20,000 shares of \$10 par value stock for \$200,000 cash on January 1.

To record this journal entry, we will debit cash for \$200,000 and record a credit to Common Stock, \$10 Par Value for \$200,000. This is referred to as issuing par-value stock at par.

We can also issue common stock at a premium, or for more than the par value. Let's look at another transaction from Sylvia's Tea Room. On January 5, Sylvia's Tea Room issued 20,000 shares of \$10 par value stock for \$15 per share.

To record this journal entry, we first need to calculate the amount of cash received as number of shares issued * issued price or 20,000 shares times \$15/share. The cash will be recorded as a debit of \$300,000.

The common stock is always recorded at it's par value. So, we issued 20,000 shares at a par-value of \$10 per shares, or \$200,000. We will record a credit to common stock, \$10 par value.

The difference between the cash and common stock of \$100,000 is credited to the paid in capital in excess of par, common stock. The paid in capital in excess of par account is reported as part of equity and represents the amount paid by stockholders over par.

Let's look at the equity section of the balance sheet in regards to the last transaction. The common stock is recorded first, 20,000 shares issued and outstanding at \$10 par value, or \$200,000.

Next, the paid in capital in excess of par value, of \$100,000 is added to equity and also the retained earnings of \$60,000. Sylvia's Tea Room has a total of \$360,000 in stockholders' equity.

We can also issue common stock for noncash assets. Sylvia's Tea Room issues 10,000 shares of \$10 par value stock in exchange for Equipment valued \$250,000.

We will first record a debit for the equipment that was received by the company in exchange for the common stock. Just like in the previous examples, the common stock is always recorded at its par value. So, we issued 10,000 shares at a par-value of \$10 per shares, or \$100,000. We will record a credit to common stock, \$10 par value. The remaining difference of \$150,000 will be recorded as a credit to paid in capital in excess of par, common stock.

Issuing preferred stock is recorded very much like how we record common stock. Using this example, let's look at how we record preferred stock. Sylvia's Tea Room issued 20 shares of \$50 par value preferred stock for \$1,500 cash.

To record this journal entry, we will debit cash for \$1,500. Preferred stock, like common stock is always recorded at par. So \$50 par value times 20 shares equals a credit to preferred stock of \$1,000. The remaining difference is recorded to paid in capital in excess of par, preferred stock.

Cash dividends involve cash payments to stockholders. When a company pays cash dividends it causes a decrease in retained earnings. It's important to remember that cash dividends is not an expense of the company. Cash dividends are recorded on the statement of retained earnings.

There are three important dates to learn for a cash dividend. The first is the date of declaration. This is the day the company decides to declare that they will pay a cash dividend. The date of record is the date specified by the company to identify stockholders that will receive the dividend. And the date of payment is the day that the dividends are paid to stockholders of record.

Let's look at this example. On June 1, Sylvia's Tea Room declared a dividend on \$2 per share on 5,000 shares. The dividend will be paid on June 30. The date of record is June 15.

On the date of declaration, a journal entry must be recorded. The debit will be recorded to Retained Earnings to record a decrease to the retained earnings account. The credit will be recorded to dividends payable. The dividends payable account is credited because the company has not yet paid the dividend.

On the date of record, June 15, no entry is needed. On this day, the company simply notes the shareholders that will receive the dividend.

On June 30, the date of payment, the company must record a journal entry. The entry would involve a debit to Dividends Payable to record settlement of the liability and a credit to cash.

There is one other kind of stock that we need to learn about and that's treasury stock. Treasury stock is created when the company purchases its own stock and removes it from the market. The corporation is reacquiring stock that has already been issued. The purchase of treasury stock decreases a company's assets and equity.

Here's an example of how to record treasury stock. On August 1, Sylvia's Tea Room purchases 2,000 shares of its own stock for \$10,000.

To record this entry the company will record a debit to treasury stock and a credit to cash of \$10,000. Notice that the per share price is \$5 per share. \$10,000 divided by 2,000 shares. By crediting Treasury Stock, the equity of Sylvia's Tea Room is decreased. Let's look at how this transaction affects the equity section of the balance sheet.

The first change is in the common stock section. Notice now that it includes the statement that 2,000 shares are in treasury. Also notice that the cost of treasury stock is subtracted from equity at the bottom of the section. Remember that the purchase of treasury stock always decreases equity.

A company can decide to reissue treasury stock. In other words, the company sells the stock back to the open market. Treasury stock can be reissued by selling it at cost, above cost or below cost. We will look at the journal entry required to reissue stock at above cost. Let's assume that on September 1, Sylvia's Tea Room sold 1,000 shares of treasury stock for \$7 per share that was acquired at \$5 per share.

To record this entry, Sylvia's Tea Room would debit cash for the amount received. 1,000 shares at \$7 per share or \$7,000. Treasury Stock when reissued is always record at its purchase price. So the credit to Treasury Stock is calculated as a \$5,000 or 1,000 shares times \$5 per share. The difference is recorded as a credit to paid in capital, treasury stock. This account is also included on the equity section of the balance sheet.

In this video we have discussed three common transactions that involve equity: issuance of common stock, payment of cash dividend, and acquisition and reissue of treasury stock. Remember that all of these transactions that we discussed today are reflected in the stockholders' equity section of the balance sheet.