Stockholders' Equity

(Cheat Sheet)

AccountingCoach®

Stockholders' Equity

A business corporation's owners are referred to as *stockholders* or *shareholders* because they hold stock certificates which provide evidence of their share of ownership in the corporation. Hence, the balance sheet of a business corporation will report the following:

Assets	=	Liabilities	+	*Stockholders*' Equity

Stockholders' equity (along with corporation's liabilities) can be viewed as:

1. Sources of a corporation's assets, and/or
2. Claims against the corporation's assets. (However, the claims of the liabilities come ahead of the stockholders' claims.)

The stockholders' equity section of the balance sheet will consist of the following components:

- Paid-in capital (or contributed capital)
- Retained earnings
- Accumulated other comprehensive income
- Treasury stock (however, this is a deduction/negative amount)

The changes which occurred during an accounting year are reported in the annual *statement of stockholders' equity*, which is one of the five required external financial statements.

Paid-in Capital or Contributed Capital

Paid-in capital or contributed capital is the first component listed in the stockholders' equity section of the balance sheet. It includes the amounts that the corporation received from investors when the corporation issued its shares of capital stock. (*Capital stock* is used to describe both common and preferred stock.) All corporations issue common stock, but only a relative few will also issue preferred stock. If preferred stock is issued, the amounts received will be reported separately from the amounts received for its common stock. If any of the shares of stock have *par values or stated values*, those amounts are listed separately.

Common Stock

Common stock is the capital stock that is issued by all U.S. business corporations. (Some corporations will issue preferred stock in addition to the common stock.) The holders of common stock:

- Elect the corporation's directors
- Vote on significant issues such as its acquisition by another corporation
- Receive dividends if declared by the board of directors

Depending on state laws, each share of common stock could have a par value, a stated value, or neither. If each share has a par value or a stated value, that amount for each issued share of stock is reported separately from the amounts received that were in excess of the par or stated value. When approved by a corporation's board of directors, the common stockholders will receive cash dividends based on the number of shares of common stock owned.

Preferred Stock

In addition to common stock, a few corporations will also issue *preferred stock*. These shares have a *preferential* treatment as far as dividends and liquidation. This means that stockholders of the preferred shares of stock must receive their dividends before the corporation can pay a dividend to the stockholders of the common stock.

The dividend for the preferred stock is based on its stated dividend rate and the par value of the preferred stock. For example, each share of 6% preferred stock having a par value of $100 must be paid its $6 per year dividend before the common stockholders will receive any dividend. (Only *participating preferred stock* will ever receive more than the stated dividend.)

When the stock is *cumulative preferred*, any past omitted preferred dividends plus the preferred stock's current dividend must be paid before a dividend can be given to the common stockholders. Any past omitted dividend on the cumulative preferred stock is known as a *dividend in arrears*.

Par Value or Stated Value

The par value or stated value of shares of stock is a legal amount that must be recorded and reported separately from the amounts received in excess of the par or stated value. The par value of a corporation's preferred stock (if any is issued) will determine the dividends for the preferred stockholders. For example, a 6% $100 par value preferred stock will receive a $6 per year dividend. However, the shares of common stock often have no par value or a very small par value (depending on state laws).

Retained Earnings

Generally, retained earnings are the cumulative amounts of the corporation's earnings since the corporation began minus the cumulative amounts of dividends that the corporation declared since the corporation began. The amount of *retained earnings* is reported separately in the stockholders' equity section of the balance sheet and must be a positive amount (a credit balance) in order for the corporation to declare and pay dividends to its stockholders. For successful corporations the amount of retained earnings is often many times the amount of its paid-in capital.

Comprehensive Income

Comprehensive income is the sum of 1) a corporation's net income which is reported in detail on its income statement, plus 2) *other comprehensive income* (if any), which is reported in detail on a corporation's statement of comprehensive income. The comprehensive income (or loss) is the amount earned during the accounting period shown in the heading of the statement of comprehensive income. (This is relevant for understanding *accumulated other comprehensive income*, which is part of stockholders' equity.)

Other Comprehensive Income

Other comprehensive income is one of the two components of *comprehensive income* and the details for the accounting period are reported on the financial statement entitled *Statement of Comprehensive Income*. (The other component of comprehensive income is the net income reported on the income statement.) Two examples of *other comprehensive income* include unrealized gains or losses on derivatives used in hedging and foreign currency translation adjustments. (This is relevant for understanding *accumulated other comprehensive income*, which is part of stockholders' equity.)

Accumulated Other Comprehensive Income

Accumulated other comprehensive income is a separate line within the stockholders' equity section of the balance sheet. While retained earnings reports the cumulative amounts of net income, *accumulated other comprehensive income* reports the cumulative amount of the *other comprehensive income or loss.*

Treasury Stock

Treasury stock is usually the amount that a corporation has paid to repurchase some of its own shares of stock (and has not reissued or retired the shares). The corporation's cost is debited to the general ledger account Treasury Stock. This debit balance will appear as a reduction to the amount of stockholders' equity reported on the corporation's balance sheet.

Cash Dividend

A cash dividend is a distribution of cash by a corporation to its stockholders. The dividend amount will reduce the balance in the account Retained Earnings (as well as reduce the corporation's cash). In order for a corporation's board of directors to declare a cash dividend, the Retained Earnings must have a positive, credit balance.

Stock Dividend

A stock dividend is a distribution of additional shares of a corporation's own shares of stock to its existing stockholders. For example, if a corporation declares a 5% common stock dividend and the corporation has 100,000 shares of common stock outstanding, the corporation will be issuing and distributing 5,000 additional shares of common stock. Therefore there will be 105,000 shares outstanding (instead of 100,000) but the total amount of the corporation's assets, liabilities, and stockholders' equity will not change. The journal entry to record the declaration of a stock dividend will usually debit Retained Earnings for the market value of the new shares and will credit the paid-in capital accounts for the same total amount.

Stock Split

A stock split usually is done in order to reduce the market value *per share* of common stock by increasing the number of shares outstanding. If the market value of a share of common stock was $60 before a 2-for-1 stock split, the market value per share of common stock should be approximately $30 after the stock split. If the corporation had 300,000 shares of $10 par value common stock outstanding and it declares a 2-for-1 stock split, the corporation will have 600,000 shares of $5 par value common stock after the stock split. No journal entry is necessary since the total amounts of the stockholders' equity are unchanged. A memo is entered to indicate the stock split and the new total number of common shares and the new par value per share.

Declaration Date

The declaration date is the date that the board of directors declares a dividend to the corporation's stockholders. The declaration date is used to record a credit to the liability account Dividends Payable and a debit to the account Retained Earnings (or the temporary account Dividends).