Chapter 11

Reporting and Interpreting Stockholders' Equity

Learning Objectives

After studying this chapter, you should be able to:

- 11-1 Explain the role of stock in the capital structure of a corporation.
- 11-2 Compute and analyze the earnings per share ratio.
- 11-3 Describe the characteristics of common stock and report common stock transactions.
- 11-4 Discuss and report dividends.
- 11-5 Compute and analyze the dividend yield ratio.
- 11-6 Discuss and report stock dividends and stock splits.
- 11-7 Describe the information reported on the statement of stockholders' equity.
- 11-8 Describe the characteristics of preferred stock and report preferred stock transactions.
- 11-9 Discuss the impact of stock transactions on cash flows.

Advantages of a Corporation

The corporate form of business has the primary advantage of ease of participation in ownership, as compared to a sole proprietorship or a partnership. Ease of ownership exists in three forms.

+ Shares of stock may be purchased in small amounts.
+ Ownership interests can be transferred easily through the sale of shares on established markets.
+ Stock ownership provides investors with limited liability.

11-3

Ownership of a Corporation

Corporations enjoy a continuous existence separate and apart from its owners. A corporation can . . .

- Own assets
- Incur liabilities
- Sue others and be sued
- Expand and contract in size
- Enter into contracts independently of its owners

Corporations are created by application to a state government (not the federal government). Corporations are governed by a board of directors elected by the stockholders.

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Shareholder Structure of Tsinghua Tongfang

国务院国资委

↓ 100%

中国核工业集团有限公司

↓ 100%

中国核工业集团资本控股有限公司

↓ 30.11%

同方股份有限公司

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Benefits of Stock Ownership

Owners of common stock (known as stockholders or shareholders) receive a number of benefits:

❶ A voice in management.

❷ Dividends: Proportional share of the distribution of profits.

❸ Residual claim: Proportional share of the distribution of remaining assets upon the liquidation of the company.

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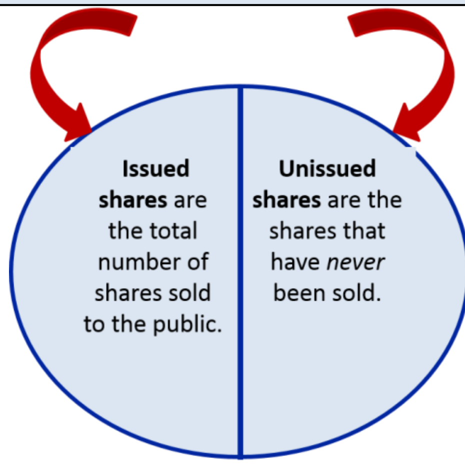
Authorized, Issued, and Outstanding Shares (1 of 3)

The authorized number of shares is the maximum number of shares of stock a corporation can issue as specified in its charter.



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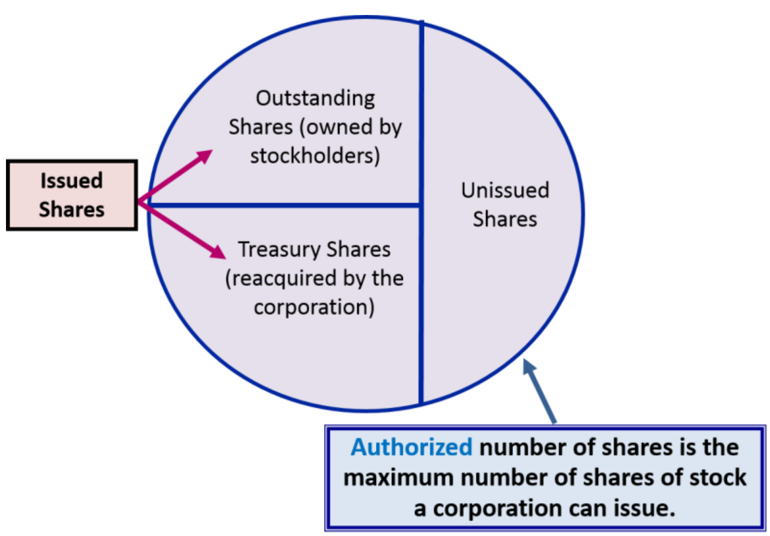
Authorized, Issued, and Outstanding Shares (2 of 3)



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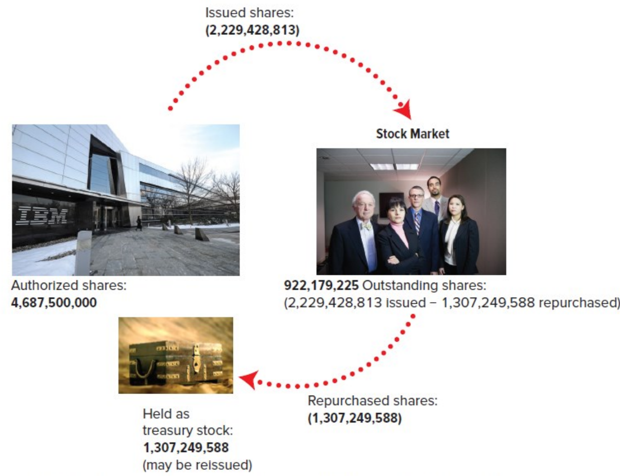
Authorized, Issued, and Outstanding Shares (3 of 3)



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Exercise 11-1

Boynton Corporation was issued a charter by the state of Illinois on January 15 of this year. The charter authorized the following:

Common stock, $20 par value, 206,000 shares
Preferred stock, 9 percent, par value $16 per share, 8,000 shares authorized

During Year 1, the following selected transactions were completed in the order given:

a. Sold and issued 40,000 shares of common stock at $32 cash per share.
b. Sold and issued 6,000 shares of preferred stock at $48 cash per share.
c. At the end of Year 1, the accounts showed net income of $80,000. No dividends were declared.

Required:
Prepare the stockholders’ equity section of the balance sheet at the end of the year.

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Boynton Corporation
Balance Sheets (Partial)

Stockholders' Equity	
Common stock ($20 par value; 206,000 shares authorized, 40,000 shares issued and outstanding)	$ 800,000
Preferred stock, 9% ($16 par value, 8,000 shares authorized, 6,000 shares issued and outstanding)	96,000
Additional paid-in capital, common stock	480,000
Additional paid-in capital, preferred stock	192,000
Retained earnings	80,000
Total stockholders' equity	$1,648,000

	Common Stock	Preferred Stock
Proceeds from sale	$1,280,000	$288,000
Par value	800,000	96,000
Remainder	$ 480,000	$192,000

Earnings per Share (EPS) (1 of 2)

KEY RATIO ANALYSIS

$$\text{Earnings per share} = \frac{\text{Net income}}{\text{Weighted average number of common shares outstanding}}$$

* Preferred dividends, if any, should be subtracted from net income.

Companies are required to report EPS on their income statements. IBM's income for 2017 was $5,753 million, and the average number of shares outstanding was 932.8 million.

Earnings per Share (EPS) (2 of 2)

KEY RATIO ANALYSIS

$$$

COMPARISONS OVER TIME		
IBM		
2015	2016	2017
$13.48	$12.43	$6.17

COMPARISONS WITH COMPETITORS	
Microsoft	Intel
2017	2017
$2.74	$2.04

Exercise 11-2

The financial statements for Gensen Corporation included the following selected information:

Common stock	$2,000,000
Retained earnings	$1,000,000
Net income	$1,100,000
Shares issued	100,000
Shares outstanding	80,000
Dividends declared and paid	$800,000

The common stock was sold at a price of $40 per share.

Required:

1. What is the amount of additional paid-in capital?
2. What was the amount of retained earnings at the beginning of the year?
3. How many shares are in treasury stock?
4. Compute earnings per share (assume the weighted average shares outstanding is equal to the shares outstanding).

1. What is the amount of additional paid-in capital?

Cash received from share issue (100,000 shares x $40 per share)	$4,000,000
Less: Common stock	(2,000,000)
Additional paid-in capital	$2,000,000

2. What was the amount of retained earnings at the beginning of the year?

Retained earnings at the year-end	$1,000,000
Add: Dividends declared and paid	800,000
Less: Net income	(1,100,000)
Retained earnings at the beginning	$ 700,000

3. How many shares are in treasury stock?

Issued shares	100,000
Less: Outstanding shares	80,000
Treasury stock shares	20,000

4. Compute earnings per share (assume the weighted average shares outstanding is equal to the shares outstanding).

$$\text{Earnings per Share} = \frac{\text{Net Income}}{\text{Weighted Average Number of Common Shares Outstanding}}$$

$$= \frac{\$1{,}100{,}000}{80{,}000}$$

$$= \$13.75$$

Common Stock Transactions (1 of 2)

Common stock is held by investors who are the **owners** of a corporation.

Stockholders have the right to:

- Vote
- Share in profits of the business
- Elect the board of directors who hire and monitor the executives who manage a company's activities on a day-to-day basis

Common Stock Transactions (2 of 2)

Par value is the nominal value per share, established in the corporate charter.*

Par Value ≠ Market Value

Legal capital is the amount of capital, required by the state, that must remain invested in the business.

***Some states do not require a par value to be stated in the charter.**

Initial Sale of Stock

An **initial public offering,** or IPO, involves the very first sale of a company's stock to the public (i.e., when the company first "goes public").

Additional sales of new stock to the public are called **seasoned offerings.**

Assume IBM sold 100,000 shares of its $0.20 par value common stock for $150 per share. The company would record the following journal entry:

	Debit	**Credit**
Cash (+A) (100,000 × $150)	15,000,000	
Common stock (+SE) (100,000 × $0.20)		20,000
Additional paid-in capital (+SE)		14,980,000

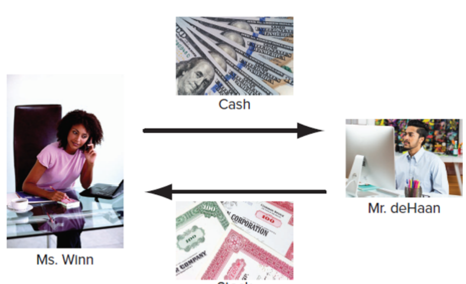
Assets		=	**Liabilities**	+	**Stockholders' Equity**	
Cash	+15,000,000				Common stock	+20,000
					Additional paid-in capital	+14,980,000

Sale of Stock in Secondary Markets

When a company sells stock to the public, the transaction is between the issuing corporation and the investor.

Subsequent to the initial sale, investors can sell shares to other investors without directly affecting the corporation.

- The corporation is not a part of the transaction and therefore does not receive or pay anything.



Stock Issued for Employee Compensation

Managers may be offered stock options, a common form of compensation, which permit them to buy stock at a fixed price.

Options specify that shares may be bought at the then-current market price.

If the stock price increases, you can exercise your option at the low grant price and sell the stock at the higher price for a profit.

- If you hold a stock option and the stock price declines, you have lost nothing. They are a risk-free investment.

Companies must estimate and report compensation expense associated with stock options.

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Stock Options(期权)

The right to purchase common stock at a fixed price over a specified period of time. As the stock's price rises above the fixed option price, the value of the option increases.

Option purchase price $30 per share.

Market price of stock $75 per share.

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Repurchase of Stock

A corporation repurchase its stock from existing stockholders for a number of reasons:

- When employee bonus plans provide workers with shares of company's stock, the company can give employees repurchased shares rather than issue new ones.
  - If a company were to pay bonuses with newly issued shares each period, it would increase the number of shares in the market, which would decrease the company's stock price.
  - Increasing the number of shares also would dilute existing stockholders' investments, as each share of stock they own would be worth less.
  - By repurchasing shares to fulfill bonus obligations, companies avoid this dilutive effect.

Stock that has been repurchased and is held by the issuing corporation is called **treasury stock**.

Treasury shares have no voting, dividend, or other stockholder rights while they are held as treasury stock.

Repurchase and Reissuance of Stock (1 of 2)

IBM reacquired 100,000 shares of its common stock when it was selling for $140 per share.

	Debit	Credit
Treasury stock (+XSE, −SE) (100,000 × $140)	14,000,000	
Cash (−A)		14,000,000

Treasury Stock is a contra-equity account, not an asset!

IBM reissued 10,000 shares of treasury stock at $150 per share.

	Debit	Credit
Cash (+A) (10,000 × $150)	1,500,000	
Treasury stock (−XSE, +SE) (10,000 × $140)		1,400,000
Additional paid-in capital (+SE)		100,000

Repurchase and Reissuance of Stock (2 of 2)

IBM reissued 10,000 shares
of treasury stock at $130 per share.

	Debit	Credit
Cash (+A) (10,000 × $130)	1,300,000	
Additional paid-in capital (−SE)	100,000	
Treasury stock (−XSE, +SE) (10,000 × $140)		1,400,000

Exercise 11-3

During Year 1 the following selected transactions affecting stockholders' equity occurred for Disney Corporation:

a. Apr. 1 Repurchased 400 shares of the company's own common stock at $40 per share.
b. Jun. 14 Sold 80 shares of the shares purchased on April 1 for $50 cash per share.
c. Sept. 1 Sold 60 shares of the shares purchased on April 1 for $30 cash per share.

Required:
Provide journal entries to record each of the transactions in (a) through (c).

Requirement

	Debit	Credit
a. Treasury Stock (+XSE, −SE) (400 shares × $40)	16,000	
Cash (−A)		16,000
Bought treasury stock for $40 per share.		
b. Cash (+A) (80 shares × $50)	4,000	
Treasury Stock (−XSE, +SE) (80 shares × $40)		3,200
Additional Paid-in Capital (+SE) (80 shares × $10)		800
Sold treasury stock at $50 per share.		
c. Cash (+A) (60 shares × $30)	1,800	
Additional Paid-in Capital (−SE)	600	
Treasury Stock (−XSE,+SE) (60 shares × $40)		2,400
Sold treasury stock at $30 per share.		

Dividends on Common Stock

The return from investing in a company's common stock can come from two sources: stock price appreciation and dividends.

Some investors prefer to buy stocks that pay little or no dividends.

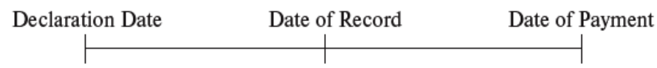
- reinvest earnings back into operations → future earnings potential and stock price.
- Wealthy investors in high tax brackets prefer higher stock prices because capital gains may be taxed at a lower rate than dividend income.

Other investors, such as retired people who need a steady income, prefer to receive their return in the form of dividends.

- Retirees seek stocks that will pay relatively high dividends, such as utility stocks.

Analysts compute the dividend yield ratio to evaluate a company's dividend policy.

Key Dividend Dates



Date of Declaration: Date on which the board of directors approves the dividend. Assume IBM declared a $1,387 million dividend on 10/31.

	Debit	Credit
Retained earnings (−SE)	1,387,000,000	
Dividends payable (+L)		1,387,000,000

Date of Record: Stockholders who own shares on this date will receive the dividend. (No journal entry)

Date of Payment: The date the cash is disbursed to stockholders.

	Debit	Credit
Dividends payable (−L)	1,387,000,000	
Cash (−A)		1,387,000,000

Note: The corporation must have sufficient retained earnings and cash to cover the amount of the dividend.

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Exercise 11-4

A recent annual report for Lawson, Inc. disclosed that the company declared and paid dividends on common stock in the amount of $4 per share. During the year, Lawson had 2,000,000,000 authorized shares of common stock and 775,028,600 issued shares. There were 83,340,000 shares of treasury stock.

Required:
Assume Lawson declared the entire dividend ($4 per share) on July 15 and subsequently paid the dividend on July 31. Provide the journal entries to record the declaration and payment of dividends.

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Requirement

Dividends paid = No. of outstanding shares × Dividend per share

Computation of shares outstanding:

Shares issued......................	775,028,600
Treasury stock......................	(83,340,000)
Shares outstanding................	691,688,600

Dividends paid:

691,668,600 shares × \$4 = \$2,766,754,400

	Debit	Credit
July 15		
Retained Earnings (−SE)..	2,766,754,400	
Dividends Payable (+L)..		2,766,754,400
Declaration of dividend.		

July 31		
Dividends Payable (−L)..	2,766,754,400	
Cash (−A)..		2,766,754,400
Payment of dividend.		

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Dividend Yield

KEY RATIO ANALYSIS

$$\text{Dividend Yield} = \frac{\text{Dividends per Share}}{\text{Market Price per Share}}$$

In 2017, IBM paid a dividend of \$5.90 per share, and the market price of a share of IBM stock was \$153.42.

$$\text{Dividend Yield} = \frac{\$5.90 \text{ per share}}{\$153.42 \text{ per share}} = 3.85\%$$

COMPARISONS OVER TIME		
IBM		
2015	2016	2017
3.63%	3.31%	3.85%

COMPARISONS WITH COMPETITORS	
Microsoft	Intel
2017	2017
1.82%	2.33%

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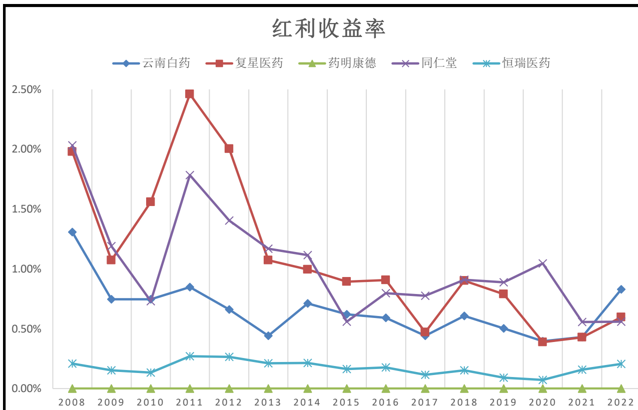
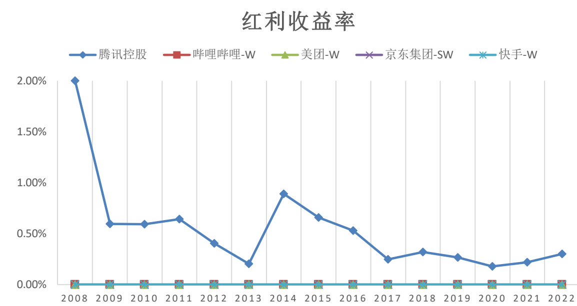
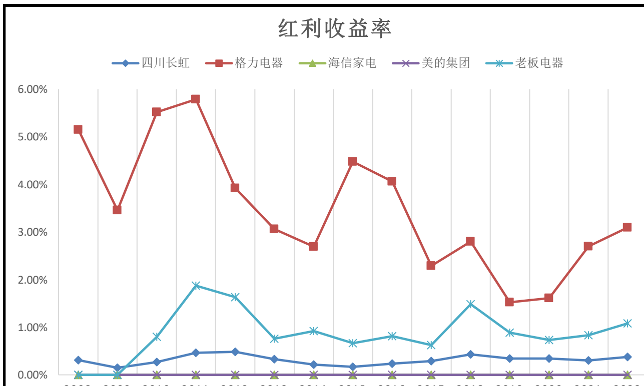

红利收益率
云南白药 复星医药 药明康德 同仁堂 恒瑞医药
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022


红利收益率
腾讯控股 哔哩哔哩-W 美团-W 京东集团-SW 快手-W
2.00%
1.50%
1.00%
0.50%
0.00%
2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022

11-33


红利收益率
四川长虹 格力电器 海信家电 美的集团 老板电器
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
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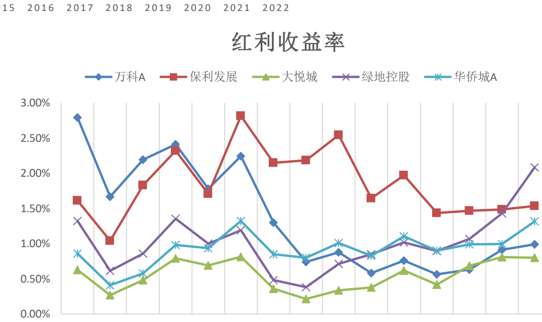
2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022


红利收益率
万科A 保利发展 大悦城 绿地控股 华侨城A
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022

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Impact of Dividends on Stock Price

FINANCIAL ANALYSIS

$$$

The **ex-dividend date** 除权日is the date two days before the date of record. This date is established by the stock exchanges to account for the fact that it takes time (typically three days) to officially transfer stock from a seller to a buyer.

If someone buys stock before the ex-dividend date, they will be listed as the owner and receive the dividend. If someone buys stock on or after the ex-dividend date, the previous owner will be listed as the owner of the dividend.

Stock prices often fall on the ex-dividend date since the stock no longer includes the right to receive the next dividend.

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Nature of Stock Dividends (1 of 2)

Stock dividends represent a distribution of additional shares of stock to shareholders.

- Stock is distributed pro rata; stockholders retain the same percentage ownership after stock dividends are distributed.
- *A stock dividend has no economic value!*

Stock dividends do not change the stock's par value or total stockholders' equity.

The stock market reacts immediately when a stock dividend is issued.

- The stock price falls.
- The lower market price may make the stock more attractive to new investors.

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Nature of Stock Dividends (2 of 2)

Small	Large
Stock dividend < 20–25%	Stock dividend > 20–25%
Record at current market value of stock.	Record at par value of stock.

The entry for a stock dividend is a transfer from the Retained Earnings account to the Common Stock account (and Additional Paid-in Capital account for small stock dividends).

Stock Dividends

Large Stock Dividend: Assume IBM issued 50 million shares of its $0.20 par value stock. On the date of declaration the following journal entry is made:

	Debit	Credit
Retained earnings (−SE) ($0.20 par value × 50,000,000)	10,000,000	
Common stock (+SE) ($0.20 par value × 50,000,000)		10,000,000

Small Stock Dividend: Assume IBM issued 5 million shares of its $0.20 par value stock when it was trading for $150 per share.

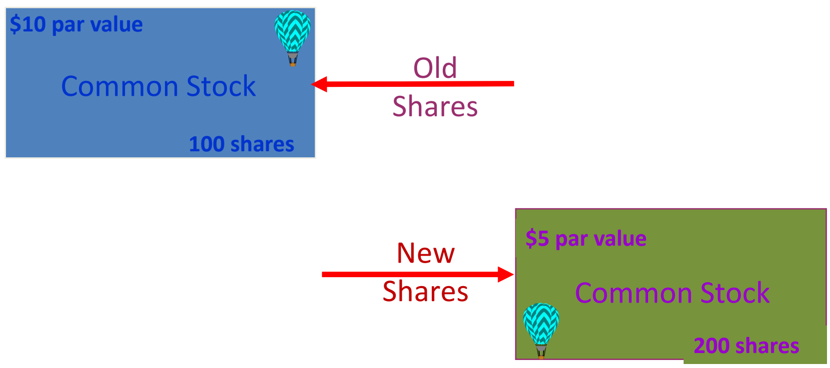
On the date of declaration the following journal entry is made:

	Debit	Credit
Retained earnings (−SE) ($150 market price × 5,000,000)	750,000,000	
Common stock (+SE) ($0.20 par value × 5,000,000)		1,000,000
Additional paid-in capital (+SE) (remainder)		749,000,000

NOTE: Regardless of whether a stock dividend is classified as large or small, there is no change in the total amount of stockholders' equity

Stock Splits(股票分割)

A distribution of additional shares of stock to stockholders according to their percent ownership.



Stock Splits

Unlike stock dividends, companies do not make journal entries to record stock splits. Stock splits change the par value per share, but the total par value is unchanged. Assume that a corporation had 3,000 shares of $2 par value common stock outstanding before **a two-for-one** stock split.

	Before Split	After Split
Common Stock Shares	3,000	6,000
Par Value per Share	$ 0.02	$ 0.01
Total Par Value	$ 60	$ 60

Increase

Decrease

No Change

Exercise 11-5

On July 1, Charlotte Corporation had the following capital structure:

Common stock ($6 par value)	$1,200,000
Additional paid-in capital	1,800,000
Retained earnings	1,400,000
Treasury stock	-0-

Required:

Complete the table below for each of the two following independent cases:

Case 1: The board of directors declared and issued a 50 percent stock dividend when the stock was selling at $10 per share.

Case 2: The board of directors announced a 6-to-5 stock split (i.e., a 20 percent increase in the number of shares). The market price prior to the split was $10 per share.

Items	Before Dividend and Split	After Stock Dividend	After Stock Split
Common stock account	$	$	$
Par per share	$6	$	$
Shares outstanding	#	#	#
Additional paid-in capital	$1,800,000	$	$
Retained earnings	$1,400,000	$	$
Total stockholders' equity	$	$	$

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Comparative results:

STOCKHOLDERS' EQUITY

Items	Before Dividend and Split	After a 50% Stock Dividend	After a 6-to-5 Stock Split
Common stock account	$1,200,000	$1,800,000	$1,200,000
Par per share	$6	$6	$5
Shares outstanding	200,000	300,000	240,000
Additional paid-in capital	$1,800,000	$1,800,000	$1,800,000
Retained earnings	$1,400,000	$ 800,000	$1,400,000
Total stockholders' equity	$4,400,000	$4,400,000	$4,400,000

Comments: Neither the stock dividend nor stock split changed total stockholders' equity because neither involved the disbursement of assets.

1. The stock dividend transferred funds out of retained earnings to the common stock; it increased the number of shares outstanding but did not change the par value per share.
2. The stock split did not change any account balances; its only effects were to (1) increase the number of shares outstanding and (2) decrease the par value per share.

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Exhibit 11.2
Excerpt from Statement of Shareholders’ Equity for IBM

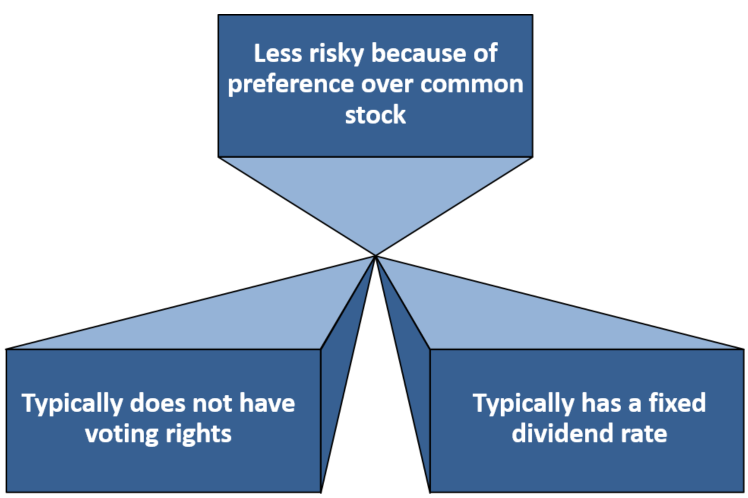
IBM CORPORATION
Consolidated Statement of Changes in Equity
($ in millions)

	Common Stock and Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders’ Equity	Non-Controlling Interests	Total Equity
Equity, January 1, 2017	$53,935	$152,759	$(159,050)	$(29,398)	$18,246	$146	$18,392
Cumulative effect of change in accounting principle*		102			102		102
Net income plus other comprehensive income/ (loss)							
Net income		5,753			5,753		5,753
Other comprehensive income/(loss)				2,806	2,806		2,806
Total comprehensive income/(loss)					$ 8,559		$ 8,559
Cash dividends paid— common stock		(5,506)			(5,506)		(5,506)
Common stock issued under employee plans (4,311,998 shares)	631				631		631
Purchases (1,226,080 shares) and sales (463,083 shares) of treasury stock under employee plans—net		18	(134)		(116)		(116)
Other treasury shares purchased, not retired (27,237,179 shares)			(4,323)		(4,323)		(4,323)
Changes in other equity		0			0		0
Changes in noncontrolling interests						(15)	(15)
Equity, December 31, 2017	$54,566	$153,126	$(163,507)	$(26,592)	$17,594	$131	$17,725

*Reflects the adoption of the FASB guidance on intra-entity transfers of assets in the first quarter of 2017.

Amounts may not add due to rounding.
Source: IBM Corporation

Preferred Stock Transactions



What's in a Name?

International Perspective

U.S. GAAP and IFRS use different words to describe the same stockholders' equity accounts.

IBM (U.S.) GAAP		ASOS (UK) IFRS
Common stock	=	Share capital
Additional paid-in capital	=	Share premium

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Dividends on Preferred Stock (1 of 2)

Preferred stock offers a dividend preference:

Current dividend preference红利优先: Requires a company to pay current dividends to preferred stockholders before paying dividends to common stockholders. *After this is met then dividends can be paid to common stockholders.*

Cumulative dividend preference可累计优先股: Requires any unpaid dividends on preferred stock to accumulate. This amount, called **dividends in arrears**, must be paid before common dividends are paid.

*If preferred stock is **noncumulative**, any dividends not declared in previous years are permanently lost and will never be paid.*

Note: Dividends in arrears are disclosed in the notes to the financial statements. They are not a liability until the board of directors declares them.

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Dividends on Preferred Stock (2 of 2)

Wally Company has the following stock outstanding:

Preferred stock: 6%, $20 par value, 2,000 shares outstanding. *Assume current dividend preference*

Common stock: $10 par value, 5,000 shares outstanding

1) If Wally issues a $3,000 current dividend, the dividends would be allocated as follows:
   - Preferred: $20 par value × 6% × 2,000 shares = $2,400
   - Common: $3,000 − $2,400 = $600

2) If Wally issues a $30,000 dividend and the dividends were in arrears for two years (assume cumulative dividend preference) the allocation would be as follows:
   - Preferred: $2,400 current + ($2,400 in arrears × 2 years) = $7,200
   - Common: $30,000 − $7,200 = $22,800

Exercise 11-6

The records of Nashville Company reflected the following balances in the stockholders' equity accounts at December 31, Year 1:

- Common stock, $24 par value, 60,000 shares outstanding
- Preferred stock, 10 percent, $10 par value, 10,000 shares outstanding
- Retained earnings, $432,000

On September 1, Year 2, the board of directors was considering the distribution of a $130,000 cash dividend. No dividends were paid during the previous two years.

You have been asked to determine dividend amounts under two independent assumptions (show computations):

a. The preferred stock is noncumulative.
b. The preferred stock is cumulative.

Required:

Determine the total and per share amounts that would be paid to the common stockholders and the preferred stockholders under the two independent assumptions.

Requirement:

		Preferred (10,000 Shares)	Common (60,000 Shares)	Total
a.	Non-cumulative:			
	Preferred ($100,000 × 10%)...........................	$10,000		$ 10,000
	Balance to common ($130,000 – $10,000)...........		$120,000	120,000
		$10,000	$120,000	$130,000
	Dividend per share.................................	**$1.00**	**$2.00**	
b.	Cumulative:			
	Preferred, arrears ($100,000 × 10% × 2 years)....	$20,000		$ 20,000
	Preferred, current year ($100,000 × 10%)..........	10,000		10,000
	Balance to common ($130,000 – $20,000 – $10,000)		$100,000	100,000
		$30,000	$100,000	$130,000
	Dividend per share.................................	**$3.00**	**$1.67**	

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Preferred Stock and Limited Voting Rights

FINANCIAL ANALYSIS

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Although not typical, some preferred stock has special voting rights. For example, the excerpt below is from Public Storage's 2017 Annual Report:

> The holders of our Preferred Shares have general preference rights with respect to liquidation, quarterly distributions and any accumulated unpaid distributions. Except under certain conditions and as noted below, holders of the Preferred Shares will not be entitled to vote on most matters. In the event of a cumulative arrearage equal to six quarterly dividends, holders of all outstanding preferred shares will have the right to elect two additional members to serve on our board of trustees (our "Board") until the arrearage has been cured. At December 31, 2017, there were no dividends in arrears.

11-50

Financing Activities

FOCUS ON CASH FLOWS

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Transactions involving stock have a direct impact on the capital structure of a business. The cash inflows and outflows associated with these transactions are reported in the **Financing Activities** section of the statement of cash flows.

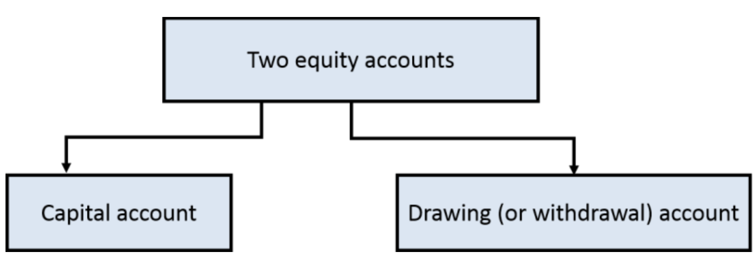
	Effect on Cash Flows
Financing activities	
Issuance of common or preferred stock	+
Purchase of treasury stock	−
Sale of treasury stock	+
Payment of cash dividends	−

11-51

Chapter Supplement: Accounting for the Equity of Sole Proprietorships

Owners' Equity for a Sole Proprietorship

A sole proprietorship is an unincorporated business owned by one person.



11-52

Exhibit 11.4: Accounting for Owner's Equity for a Sole Proprietorship (1 of 2)

Hans Solo started an aviation business by investing $150,000 of personal savings. The journal entry to record this business formation is:

	Debit	Credit
Cash (+A)	150,000	
Hans Solo, capital (+OE)		150,000

Assets		=	Liabilities	+	Owner's Equity	
Cash	+150,000				Hans Solo, capital	+150,000

Each month, Hans Solo withdrew $1,000 cash from the business for personal living expenses.

	Debit	Credit
Hans Solo, drawing (−OE)	1,000	
Cash (−A)		1,000

Assets		=	Liabilities	+	Owner's Equity	
Cash	−1,000				Hans Solo, drawing	−1,000

11-53

Exhibit 11.4: Accounting for Owner's Equity for a Sole Proprietorship (2 of 2)

At the end of Year 1, $418,000 of revenues and $400,000 of expenses were closed to the owner's capital account as follows:

	Debit	Credit
Revenue accounts (−R, closing entry)	418,000	
Expense accounts (−E, closing entry)		400,000
Hans Solo, capital (+OE)		18,000

The drawing account was closed as follows:

	Debit	Credit
Hans Solo, capital (−OE)	12,000	
Hans Solo, drawing (+OE, closing entry)		12,000

11-54

Exhibit 11.4
Accounting for Owner's Equity for a Sole Proprietorship

HANS SOLO AVIATION
Statement of Owner's Equity
For the Year Ended December 31, Year 1

Owner's Equity	
Hans Solo, capital, January 1, Year 1	$ 0
Add: Additional investments during Year 1	150,000
Add: Net income for Year 1	18,000
Total	168,000
Less: Drawings for Year 1	(12,000)
Hans Solo, capital, December 31, Year 1	$156,000

Owners' Equity for a Partnership (1 of 3)

A partnership is owned by two or more individuals. The partnership agreement specifies the division of income, management responsibilities, transfer or sale of partnership interests, disposition of assets upon liquidation, and procedures to be followed in case of the death of a partner.

Separate capital and drawing accounts are maintained for each partner.

Partnership income is divided among the partners according to the partnership agreement.

Advantages of a partnership include:

- Ease of formation
- Complete control by partners
- No income taxes on business itself

The primary disadvantage of a partnership is unlimited liability of each partner for the partnership's debts.

Partners must report their share of the partnership profits on their individual tax returns.

Owners' Equity for a Partnership (2 of 3)

Hannah and Bob formed a partnership. Hannah contributed $60,000 cash. Bob contributed $40,000 cash. The partners agreed to divide partnership income in the ratio of their contributions (60:40).

The journal entry to record this business formation is:

	Debit	Credit
Cash (+A)	100,000	
Hannah, capital (+OE)		60,000
Bob, capital (+OE)		40,000

Assets		=	Liabilities	+	Owner's Equity	
Cash	+100,000				Hannah, capital	+60,000
					Bob, capital	+40,000

Owners' Equity for a Partnership (3 of 3)

The partners agreed that each month, Hannah would withdraw $1,000 and Bob would withdraw $650. The monthly journal entry to record the withdrawal is:

	Debit	Credit
Hannah, drawing (−OE)	1,000	
Bob, drawing (−OE)	650	
Cash (−A)		1,650

Assets		=	Liabilities	+	Owner's Equity	
Cash	−1,650				Hannah, drawing	−1,000
					Bob, drawing	−650

Exhibit 11.5
Accounting for Owners' Equity for a Partnership

A separate statement of owners' equity, similar to the following, is customarily prepared to supplement the balance sheet:

MIRROR IMAGE PARTNERS
Statement of Owners' Equity
For the Year Ended December 31, Year 1

	Hannah	Bob	Total
Investment, January 1, Year 1	$ 0	$ 0	$ 0
Add: Additional investments during Year 1	60,000	40,000	100,000
Add: Net income for Year 1	18,000	12,000	30,000
Totals	78,000	52,000	130,000
Less: Drawings during Year 1	(12,000)	(7,800)	(19,800)
Owners' equity, December 31, Year 1	$66,000	$44,200	$110,200

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