

REVIEW FOR EXAM NO. 4, ACCT-2301 (SAC)
(Chapters 11-13)

A. Chapter 11 (Corporate Reporting & Analysis):

1. Corporate Organization. (Page 418)

a. Formation.

- (1) Application for incorporation.
- (2) State grants Charter or Articles of Incorporation.
- (3) By-laws: rules and procedures of the corporation.
- (4) Organization costs - expenses of forming a corporation.

2. Stockholders Equity.

a. Paid-In Capital (Contributed Capital): (Page 420)

- (1) Common or Preferred Stock (Par Value)
- (2) Paid-In Capital in Excess of Par

b. Rights of Common Stockholders. (Page 418)

- (1) Vote (may be by proxy)
- (2) Preemptive right (first opportunity to purchase additional shares offered to the public)
- (3) Share in distribution of earnings - Dividends
- (4) Right to share residual assets upon liquidation

c. Retained Earnings. (Page 420)

- (1) Accumulated earnings from operations (less any dividends), retained in the corporation since it's inception.
- (2) Deficit - Negative retained earnings (account debit balance).

3. Stock.

a. Authorized Stock. (Page 419)

- (1) Contained in Corporation Charter
- (2) Usually more shares authorized than number anticipated for first issue.

b. Classes of Stock: (Page 419)

- (1) Common (basic corporate stock - required)
- (2) Preferred

c. Accounting for Issuance. (Page 420)

- (1) Stock may be issued for cash or other assets.

(2) Minimum Legal Capital:

- (a) Par or stated value of the shares issued.
- (b) Does not establish stock worth or price.
- (c) Amount that must be left invested in a corporation to protect it's creditors.

- (3) Journal Entries: (Pages 420-421)
 - (a) Issues at Par
 - (b) Issues above Par (Premium)
 - (c) Issues of No-Par (Unstated or Stated Values)
 - (d) Issues for other assets (use the fair market value of asset or the fair market value of the stock, whichever can be determined more objectively)

- d. Preferred Stock Characteristics. (Page 426)
 - (1) Preferences - Granted to owners (commonly for dividends)
 - (2) Voting Rights - Usually none
 - (3) Convertible - Provides for exchange of preferred stock for common stock at a specific ratio (i.e., 1:10), at the option of the shareholder.
 - (4) Callable - Gives issuing corporation the option to retire shares at a specific price.
- e. Preferred Stock Dividends. (Page 427)
 - (1) Receive dividends before Common Stock does.
 - (2) Cumulative - Undeclared dividends accumulate until paid.
 - (3) Non-Cumulative - Right to receive dividends is forfeited for any year not declared.

4. Stock Values.

- a. Market Value - Price at which a share can be bought or sold on the market.
- b. Book Value - Equity represented by one share of common stock in corporation assets.

$$\frac{\text{Total Stockholders Equity} - \text{Preferred Dividends}}{\text{Outstanding Common Shares}}$$

- c. Par Value - Arbitrary value selected by the corporation and included in the corporate charter or articles of incorporation. Establishes corporate minimum legal capital.

5. Cash Dividends. (Page 422)

- a. Requirements for declaration of Dividends.
 - (1) Sufficient cash must be available.
 - (2) Sufficient retained earnings must be available.
 - (3) Requires formal action by the Board of Directors.
- b. Cash Dividend Dates:
 - (1) Declaration Date (formal Board action)
 - (2) Date of Record (establishes dividend ownership)
 - (3) Date of Payment (payment to shareholders)
- c. Dividends are not paid on Treasury Stock (only outstanding shares).
- d. Reduces Retained Earnings
- e. Journal Entries. (Pages 422-423)

6. Stock Dividends (Page 423)

- a. Proportional distribution to existing stockholders (based on shares issued/outstanding).
 - (1) Small stock dividend (25% or less of outstanding shares). Capitalize retained earnings based on current market price of the stock.
 - (2) Large stock dividend (more than 25% of outstanding shares) Capitalize retained earnings based on the par value of the stock.
- b. No assets are transferred from corporation to stockholders.
- c. Recorded by a Transfer of Retained Earnings:
For public corporations, normally the amount transferred to paid-in capital is the fair market value of the shares issued in the stock dividend.
- d. Stock Dividends Distributable (Stockholders Equity Account).
- e. Journal Entries (Pages 424-425)
- f. Stock Dividend Dates:
 - (1) Declaration Date (formal Board action)
 - (2) Date of Record (establishes ownership of shares of stock dividend)
 - (3) Date of Distribution (issuance of the stock dividend shares)

7. Treasury Stock. (Page 429)

- a. Corporation's own stock that has been issued, reacquired by the corporation, and not canceled or reissued.
- b. Usually it is the intention of management to reissue (redistribute) treasury stock at a later date.
- c. Treasury stock is subtracted from stockholders equity on the Balance Sheet.
(Contra-Equity Account)
- d. Par value is ignored in treasury transactions. All transactions are recorded and accounted for at actual cost (Cost Method).
- e. Any gains, on the sale of treasury stock, is credited the special equity account Paid-In Capital, Treasury Stock.
- f. Any losses, on the sale of treasury stock, is first applied against the Paid-In Capital, Treasury Stock Account, with any balance charged to Retained Earnings.
- g. Journal Entries. (Pages 429-430)

8. Stock Splits. (Page 425)

- a. Calling in shares and replacing them with a larger issue (multiple shares).
- b. Total par value of shares does not change. Par or stated value per share reduces (inversely with increase in the number shares).
- c. Only memo entry required to record the stock split.
- d. Retained earnings are not capitalized.
- e. Number of shares increases and book value per share decreases. Applies to all shares (unissued, issued, and treasury).

9. Prior-Period Adjustments. (Page 431)

- a. Material errors, not discovered in the same period they occurred, are not included in the computation of net income for the current period.
- b. Such adjustments are reflected as adjustments to the Retained Earnings beginning balance in the period they are identified.
- c. Reported in the Statement of Retained Earnings.

B. Chapter 12 (Statement of Cash Flows).

1. Purposes. (Page 453)

- a. To predict future cash flows (ability to generate cash from operations).
- b. Provide information to evaluate management.
- c. To determine company's ability to meet obligations (debts, interest, and dividends).

2. Report Categories. (Page 454)

- a. Operating Activities
- b. Investing Activities
- c. Financing Activities

3. Methods for Preparing the Operating Activities Section. (Page 457)

- a. Direct Method - analyze each non-cash account and determine cash inflows and outflows.
- b. Indirect Method - starts with net income and adjusts for non-cash transactions to determine cash inflows and outflows.

4. Typical Cash Inflows and Outflows by Category.

- a. Exhibits 12.1 - 12.3 (Page 154)

5. Non-Cash Investing and Financing Activities. (Page 455)

- a. Reported on a separate schedule.
- b. Examples – Acquisition of land and a building in exchange of common stock.
 - Land acquired by issuing notes payable.

C. Chapter 13 (Analysis of Financial Statements).

1. Purpose of Analysis. (Page 497)
 - a. Internal Users - manage and operate the organization to improve effectiveness and efficiency.
 - b. External Users - not involved in running organization and uses financial analysis statements to pursue their individual goals.

2. Common Tools of Financial Analysis. (Page 498)
 - a. Horizontal analysis
 - b. Vertical analysis
 - c. Ratio analysis

3. Horizontal Analysis. (Page 498)
 - a. Comparative Statements.
Involves side-by-side presentations of two or more accounting periods, where changes in amounts are commonly shown as dollar amounts and percentages.

 - b. Trend Analysis. (Page 501)
 - (1) A form of horizontal analysis.
 - (2) Reveals patterns across successive time periods.
 - (3) Analysis periods are expressed as a percentage of a selected base year.

4. Vertical Analysis. (Page 502)
 - a. Percentage analysis showing relationship of each item to a total within the statement.
 - b. Common-Size Statements.
 - (1) Income Statement Items -- expressed as a percent of net sales.
 - (2) Balance Sheet Items -- expressed as a percent of total Assets.

5. Ratio Analysis. (building blocks of financial analysis) (Page 497)
 - a. Liquidity and Efficiency Ratios
 - b. Solvency Ratios
 - c. Profitability Ratios
 - d. Market Prospects Ratios