Unit 3 Financing a Business With Equity

IX. The Balance Sheet

A. A balance sheet is based on the accounting equation.

B. This view of the **accounting equation** is used to show how assets of **Quick Company** were financed.

> **Assets = Liability + Owner's Equity**
> $15, 000, 000 = $7,000,000 + $8,000,000

1. **Assets** are items of value. **Quick Company** has items with a value worth $15,000,000.
2. **Liabilities** are amounts owed. Quick Company used liabilities (debt) to finance assets worth $7,000,000.
3. **Owner's equity** is the net worth of a business. Quick Company owners have invested $8,000,000 to finance assets.

C. This view of the **accounting equation** is used to show the value of a company.

> **Assets - Liability = Owner's Equity**
> $15, 000, 000 - $ 7,000,000 = $8,000,000
> Quick Company has **net worth** of $8,000,000

D. The balance sheet is a **statement of financial position** because it shows where the company is financially at a point in time.

E. The balance sheet is also a **statement of financial condition** because it shows the financial health of a company at a point in time.

X. Types of Balance Sheets

A. The **account form** of balance sheet depicts categories horizontally. →

B. The **report form** of balance sheet, shown below, depicts categories vertically.

Quick Company
Opening Balance Sheet
January 1,1997

Assets		**Liabilities**	
Cash	$ 1,000,000	Notes Payable	$ 7,000,000
Land	9,000,000	**Owner's Equity**	
Fixed Assets	5,000,000	Mr. C, Capital	8,000,000
Total Assets	$15,000,000	**Total Liabilities and Owner's Equity**	$15,000,000

← Sole Proprietorship

Partnership →

Quick Company
Opening Balance Sheet

Assets		
Cash	$1,000,000	
Land	9,000,000	
Fixed Assets	5,000,000	
Total Assets		$15,000,000
Liabilities		
Notes Payable		$ 7,000,000
Partners' Equity		
Mr. C, Capital	$4,000,000	
Mr. A, Capital	4,000,000	8,000,000
Total Liabilities		$15,000,000

III. The Corporate Balance Sheet

A. People wishing to form a corporation must obtain a **state corporate charter**.
   1. States also require **articles of incorporation** containing basic information on ownership and purpose.
   2. **Corporate bylaws**, defining how the corporation will be governed, are also required.

B. Ownership shares called **stocks** are then sold to interested parties. Owners are called **stockholders**.

C. A **board of directors** and **corporate officers** manage a corporation.
   1. The **president**, often called the **chief executive officer (CEO)**, is appointed by the board of directors and is responsible for all company activity.
   2. The **controller** manages accounting activity.
   3. The **treasurer** manages cash.

D. Owner's equity of a corporation is called **stockholders' equity**.
   1. **Authorized shares** are granted for issue by the state.
   2. **Issued shares** have been sold to stockholders.
   3. **Outstanding shares** are still in the hands of stockholders.
   4. **Treasury stock** has been issued and bought back by the corporation.
   A corporation buys its own shares to use in stock-option plans, to influence the stock's market price, and because they are a good buy.

E. **Types of Corporate Stock**
   1. **Common stock** is the strongest form of corporate ownership because its owners elect the board of directors.
      a. Common stock has a **par or stated value**. Par value is usually very small and does not relate to the amount received by the issuing corporation.
         1) Common stock usually sells above par value.
         2) The amount received above par value is called **contributed capital in excess of par**.
         3) One million shares of $1.00 par value common stock sold for $5.00 per share is valued as follows:
            a) **Common stock** equals $1.00 par x 1,000,000 shares = $1,000,000.
            b) **Contributed capital in excess of par** for common stock equals $4.00 x 1,000,000 shares = $4,000,00
            c) **Common stockholders' equity** equals $1,000,000 + $4,000,000 = $5,000,000.
         4) **No par stock** came into existence when some states stopped requiring stock to have a par value.
      b. Periodic payments to stockholders are called dividends.
      c. The board of directors determine the amount of a common stock dividend and whether it is paid.
   2. **Preferred stock**
      a. Preferred stock has this name because its owners receive dividends before common stockholders do.
      b. In the case of **liquidation (the closing of a business)**, preferred stockholders also have a prior claim over common stockholders in reference to return of their investment.
      c. Preferred stockholders do not vote for the board of directors.
      d. A preferred dividend is a percentage of the stock's par value. An 8% dividend paid on a $100 par value preferred stock would be .08($100) = $8.00.
      e. 25,000 shares of $100 par value preferred stock sold for $120 per share is valued as follows:
         1) **Preferred stock** equals $100 par x 25,000 shares = $2,500,000.
         2) **Contributed capital in excess of par** for preferred stock equals $20 x 25,000 shares = $500,000.
         3) **Preferred stockholders' equity** equals $2,500,000 + $500,000 = $3,000,000.

F. **Total contributed capital** is the amount received from stockholders to finance assets.

Quick Company
Opening Balance Sheet
January 1,1997

Assets		**Liabilities**		
Cash	$ 1,000,000	Notes Payable		$ 7,000,000
Land	9,000,000	**Stockholders' Equity**		
Fixed Assets	5,000,000	Preferred Stock ($100 x 25,000 shares)	$2,500,000	
Total Assets	$15,000,000	Common Stock ($1 x 1,000,000 shares)	1,000,000	
		Contributed Capital in Excess of Par		
		Preferred Stock ($20 x 25,000 shares)	500,000	
		Common Stock ($4 x 1,000,000 shares)	4,000,000	
		Total Contributed Capital		8,000,000
		Total Liabilities and Stockholders' Equity		$15,000,000