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RECORDING DIVIDENDS AND OTHER OWNERS’ EQUITY TRANSACTIONS

Owners’ equity

As we saw earlier, owners’ equity is divided into two main parts:

- **paid-in capital**, that is the amount of capital contributions made by the owners to buy the company’s stock. The paid-in capital, as we’ll see later, includes both the stock accounts and the so called “additional paid-in capital”;
- **earnings (or income)**, that is the amount earned by the company through its profitable operations and that was not given back to the owners in form of dividends. If the earnings are negative they are called “losses”.

Retained earnings

In most countries, like in Italy, earnings of the last period are reported separately from retained earnings coming from previous periods.

In other countries, after earnings are determined and recorded at the end of each accounting period, they are directly accumulated into the account **retained earnings**.

If we use a separate account like **earnings of the period** or **net income** in the Income Statement, during the following period we need to move its balance to the **retained earnings account**:

Earnings (or Net Income) (OE)	2.000	
Retained Earnings (OE)		2.000

In some countries, moreover, law requires that a part of net income of the period be retained and accumulated in some **reserves**.

Dividends

Companies may decide to pay **dividends** to stockholders instead of retaining earnings inside.

Dividends are first declared by the Board of Directors and then paid.

When **declared**, we record:

Retained Earnings (OE)	200	
Dividends payable (L)		200

When **paid**, we record:

Dividends payable (L)	200	
Cash (A)		200

Statement of retained earnings

The changes in retained earnings from the end of the previous period to the end of the closing one are usually represented in a statement called **Statement of retained earnings**.

In some countries, like U.S., it's always included by large companies in their financial statements.

Issuing shares (stocks)

The price that an investor pays to acquire shares from the corporation is called the **issue price**.

The issue price can be equal to **par value** of shares or higher.

Par value is an arbitrary amount assigned by the company to a share. It's just symbolic and in most cases it's very low. It's reported on the stock certificate.

If we issue shares at par value we record:

Cash (A)		**10.000**	
	Common Stock (OE)		**10.000**

Issuing shares (stocks)

If the issue price is higher than par value we record:

Cash (A)	30.000	
Common Stock (OE)		10.000
Additional paid-in capital (OE)		20.000

If we issue "preferred stock" we keep it separate from common stock, since it gives the holders special rights:

Cash (A)	30.000	
Preferred Stock (OE)		10.000
Additional paid-in capital (OE)		20.000

Treasury stocks

When a company buys its own shares, these are called “treasury shares/stocks”. When bought, they are recorded at cost (let’s suppose this is 10.000):

Treasury stocks (-OE)	10.000	
Cash (OE)		10.000

The treasury stock is a “contra-account” of the owners’ equity since when the company buys its own shares it’s like reimbursing a part of the investment made by the owners.

If we sell the treasury stocks later, for example for a higher price, we record:

Cash (A)	10.200	
Treasury stocks (-OE)		10.000
Additional paid-in capital (OE)		200

Treasury stocks

A company may also buy treasury stocks to retire (i.e. to cancel) them.

In such a case, when the retirement takes place, we record:

Common stock (OE)	4.000	
Additional paid-in capital (OE)	6.000	
Treasury stocks (OE)		10.000

The common stock t-account is reduced by the par value of the retired shares (in our example we assume it to be 4.000). All the rest is recorded in the additional paid-in capital account.