LIUC
Università Cattaneo

Management & Principles of Accounting
Dates 08 – 22 November 2019
Recording owner’s contribution and financing operations

Patrizia Tettamanzi
Sophie Goodman

Source: E-Book: (Basic accounting - how to prepare and analyze financial statements) edited by Patrizia Tettamanzi, Gaia Blandano, Sophie Goodman, Ipsoa Gruppo Wolters Kluwer and Kimmel/Weygandt/Kieso “Financial Accounting”
Seventh Edition Wiley and Google

E-Book

LIUC

After this lesson you should be able to:

- Identify and discuss the major characteristic of a corporation
- Explain the recording of owner’s contribution
- Explain the recording of financing operations (factoring, discount of Notes receivable, Note payable, bank loans, bonds capital leasing)

LIUC

The Corporate form of organization

- Corporation are classified in a variety of ways. Two common classifications are by purpose and by ownership

A corporation may be organized for the purpose of making a profit (such as Facebook or General Motors)	non profit charitable, medical, or educational corporation (such as the Salvation Army or the American Cancer Society

The Corporate form of organization

- Classifications by ownership differentiates publicly held and privately held

A publicly held corporation may have thousands of stockholders, and its stock is traded on a national securities market such as the New York Stock Exchange. Example are IBM, Caterpillar, and General Electric.

A privately held corporation, often referred to as closely held corporation, usually has only a few stockholders and does not offer its stock for sale to the general public. Privately held companies are generally much smaller than publicly held companies although some notable exception exist. Before going public, Facebook was one example

LIUC

The Corporate form of organization

- Many businesses start a partnership or sole proprietorships but eventually convert to the corporate form (i.e. Nike).

- A number of characteristics distinguish a **corporation** from **sole proprietorships and partnerships.** The most important of these characteristics are explained below:

  - **Separate Legal Existence** (the corporation acts under its own name rather than in the name of its stockholders)
  - **Limited Liability of Stockholders** (creditors ordinarily have recourse only to corporate assets to satisfy their claims)
  - **Transferable Ownership Rights** (Ownership of a corporation is held in shares of capital stock, which are transferable units)
  - **Ability to Acquire Capital** (It is relatively easy for a corporation to obtain capital through the issuance of stock)
  - **Continuous Life** (The life of a corporation is stated in its charter. The life may be perpetual or it may be limited to a specific numbers of years).

Recording owner's contribution

- In order to start a business, owners have to contribute some assets (resources) to the company

- Therefore, owners' initial contribution is the first transaction a company has to record. Without such a contribution the business cannot even start living

- There are different kinds of assets the owners can contribute:
  - Cash
  - Buildings or land
  - Furniture
  - Supplies
  - …….

Recording common stock

- Let’s now look at how to start a business and account the issue of common stock. The primary objectives in accounting for the issuance of common stock are to identify the specific sources of paid-in capital (i.e. cash, building, furniture, land).

- The issuance of common stock affects the paid-in capital account

In case of corporations instead of **paid-in capital** we use the account “**common stock**

Recording owner's contribution

- We record a cash contribution as follows:

Date	Cash (A)	1.000	
	Paid-in capital (OE)		1.000
	Stockholder's initial contribution in cash		

- In case of corporations instead of **paid-in capital** we use the account "**common stock**". A **stock** is a certificate representing a number of shares of the corporation's ownership
- There are different kinds of stocks. The most basic one is called *common stock*, which gives the owner the right to vote and to collect dividends, if declared

Recording owner's contribution

- In some cases the stockholders pay for the stocks they purchase some time after they buy the stocks (very common in Italy)
- In this case, we first have to record the receivable and then the collection of money from the stockholders

Date	Owners' contribution receivable (A)	1.000	
	Common stock (OE)		1.000
	Issued and subscribed 1.000 euros of new shares		

Date	Cash (A)	1.000	
	Owners' contribution receivable(A)		1.000
	The shareholders pay cash for the shares they subscribed		

Recording owner's contribution

- If shareholders contribute other kinds of assets we make the following entry:

Buildings (A)	5.000	
Furniture (A)	1.000	
Land (A)	4.000	
Common stock (OE)		10.000

Issued 10.000 euros of shares. Contributed Buildings for 5.000 euros, furniture for 1.000 euros, land for 4.000 euros

Financing Operations

Companies need money to buy assets and to pay for expenses.

In most cases money contributed by owners is not enough. It's therefore necessary to look for other sources of money to finance the operating activity.

Actually, the very first way to finance operating activity comes from the operating activity itself. It's made of:

-postponing **the payment of purchases**;

-speeding-up **the collection of sales**.

To speed-up their cash receipts, businesses can use the following strategies:

-credit-card sales;

-factoring;

-discount of notes receivable.

Recording current financing operations

When we sell a service (or a good) on credit cards or bank cards, we record:

Cash (A)	1.930	
Financing expense (E)	70	
Sales revenue (R)		2.000

The company may sell its receivables to a *factor*. The factor immediately gives the company an amount corresponding to the amount of the receivables minus some financing expenses and waits until maturity to collect the credit from the customers:

Cash (A)	1.800	
Financing expense (E)	200	
Accounts receivable (A)		2.000

Recording current financing operations

Another way to speed-up cash collection is to discount notes receivable with a bank. Similarly to factoring, the bank gives the company a discounted amount of the notes receivable.

Cash (A)	1.800	
Financing expense (E)	200	
Notes receivable (A)		2.000

Note that both factoring and discount of notes receivable may require the company to keep the risk of not collecting the receivables. In that case the company may be asked for a repayment of the amount of the receivables not paid at the due date to the factor or the bank, and we record:

Notes receivable (A)	2.000	
Cash (A)		2.000

Note Receivable - Example

$50,000 Loss, Angeles, California March 12, 2015

Six months AFTER DATE Western Products Inc. PROMISES TO PAY

TO THE HOLDER Southern Company

---- Fifty thousand ---- DOLLARS

PLUS INTERST COMPUTED AT THE RATE OF 6% per annum

SIGNED A.B. Smith

TITLE Treasurer

Recording current financing operations

Companies may also issue promissory notes (notes payable) to get money from a bank or other financing institution. Accounting for such notes is not different from notes payable issued to suppliers, taking into account the interests paid

Cash (A)	1.850	
Financing expense (E)	150	
Notes payable (L)		2.000

Promissory Note - Example

Promissory Note Template

Promissory Note

Amount: ______________________ Date: ________________

Place: ____________________________

I Mr. ABC, make commitment to pay XYZ Company, the Sum of $ ____________________.
Repayment is to be made in the form of 200 equal payments at the interest rate of 7.2% of $ ___________ payable on the 1oth of each month, beginning 10/01/2011 until the total amount of debt is paid.

IN WITNESS WHEREOF, I set my hand under seal this ____ [the day] of ________________ [month], 20___ and I acknowledge receipt of a completed copy of this instrument.

____

Sign: [Signature of borrower]

Notary Public - SEAL

My Commission Expire

______/______/______

____

Name & Address: [Party name]

Recording long-term financing operations

Companies may need to borrow large amounts of money for a long period of time to finance some of their operations (e.g. the purchase of large amounts of long-lived assets).

In such cases, companies make long-term financing operations, the most common of which are the following:

- bank loans;
- bonds;
- capital leasing.

Recording bank loans

If the bank grants us a loan, we make the following entry:

Cash (A)		4.000	
	Bank loan (L)		4.000

Periodically, we pay interests to the bank, recording the following entry:

Interest expense (E)		200	
	Cash (A)		200

When we repay the loan:

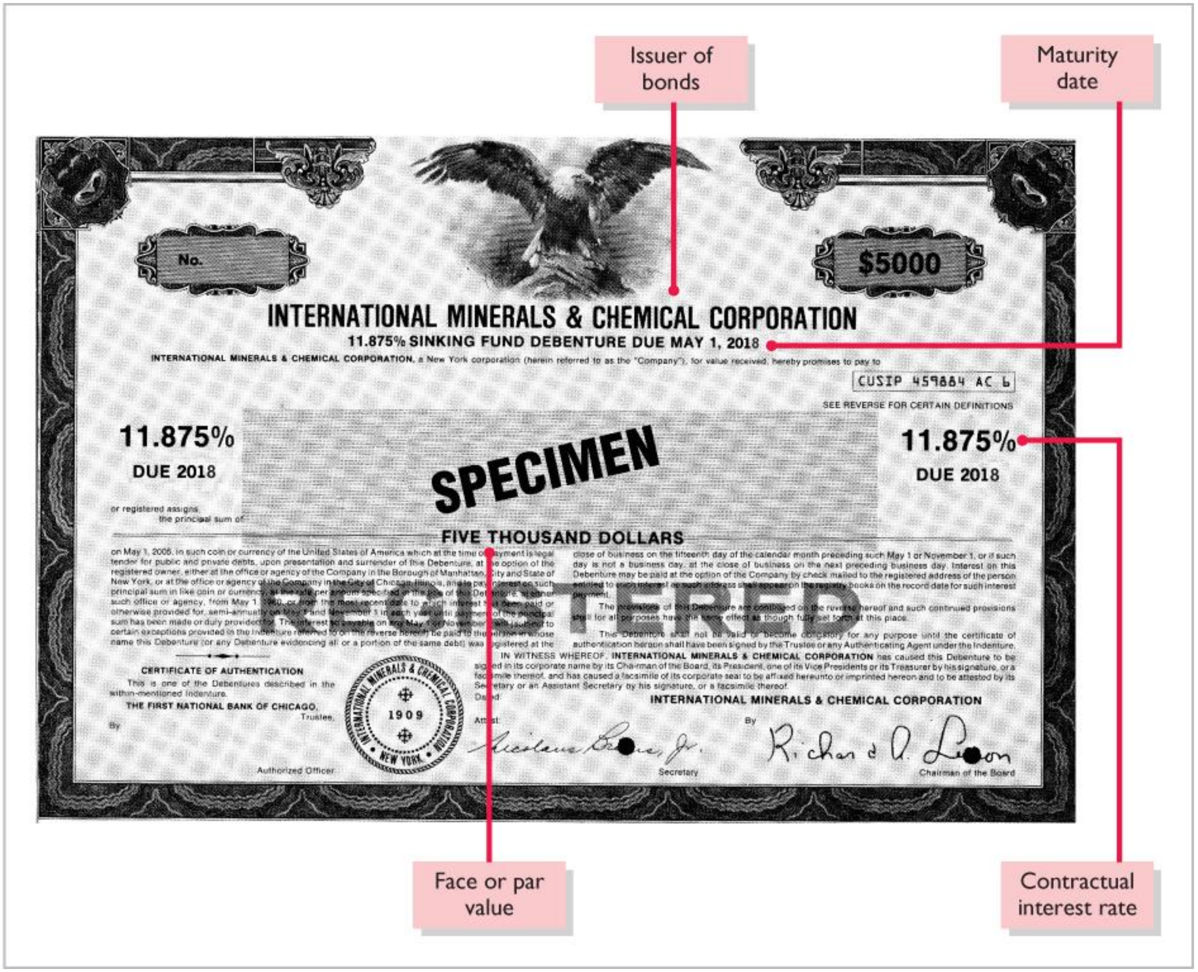
Bank Loan (L)		4.000	
	Cash (A)		4.000

Bond - example

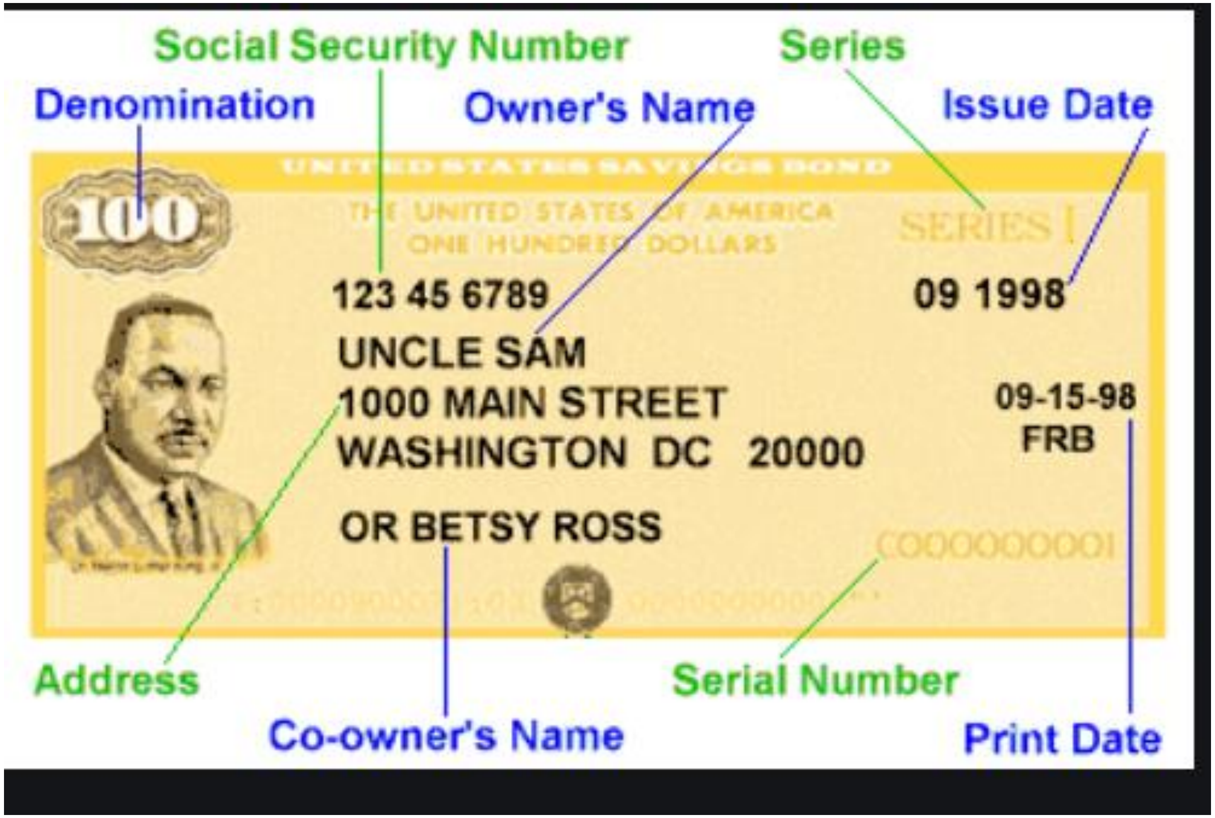
Bonds are notes payable issued to a large number of lenders called *bondholders*. Therefore, bonds are debts of the issuing company.

Purchasers of bonds receive a **bond certificate** carrying the following information:

- **issuing company's name**
- **face** (or par) value of the bond, also called the principal, that is the amount that the bondholder will receive at maturity;
- **maturity date**, when the bondholder will be paid back;
- **interest rate** that the issuer will pay and the dates when the interests are due.



Bond - example



Recording bonds

When we issue bonds a par value:

Cash (A)	30.000	
Bonds payable (L)		30.000

At due dates (for example each 6 months), we pay interests, making the following entry:

Interest expense (E)	900	
Cash (A)		900

When companies retire their bonds at maturity, they pay back the face amounts of their bonds:

Bonds payable (L)	30.000	
Cash (A)		30.000

Recording capital lease

Capital lease may be used to finance the acquisition of some long-lived assets. It’s a long-term non cancelable agreement related to the use of an asset. Usually the lessee becomes the legal owner of the asset at the end of the lease term.

Capital leasing is recorded as follows:

the lessee enters the asset into his own accounts;

at the same time the lessee records a liability.

Let’s consider the following simple example.

Recording capital lease

The lessee has a total obligation of 120 for a capital leasing of a plant. Interest included in the total obligation is 20. Each 6 months the lessee has to pay 24 to the lessor.

At the beginning of the lease term we record:

Plant and equipment (A)	100	
Capital lease payable (L)		100

Each 6 months we'll record:

Capital lease payable (L)	20	
Interest expense (E)	4	
Cash (A)		24

Review Questions

Review Question

How do current liabilities differ from long-term liabilities?

Review Question

On January 3 Evergreen Market borrowed $10,000 from a bank.

Its cash therefore (increased/decreased/did not change).

A liability (increased/decreased/did not change)