Chapter 18: Acquiring Capital for Growth and Development: Chapter Overview

Learning Objectives

After studying Chapter 18, in addition to defining key terms, you will be able to:

- LO1 Identify available sources of debt financing.
- LO2 Journalize transactions related to short-term debt financing.
- LO3 Identify the components of a loan application.
- LO4 Journalize transactions related to long-term financing.
- LO5 Journalize transactions related to equity financing.
- LO6 Identify factors influencing financing decisions.
- LO7 Analyze the impact of financial leverage.

Acquiring Capital for Growth and Development: Accounting in the Real World
DreamWorks Animation SKG
He's crude, loud, and green. Yet the lovable ogre, Shrek, has taken his place among widely recognized animated characters. The creative minds at DreamWorks Animation SKG (DreamWorks) have entertained both young and old with over 20 animated feature films, including Madagascar, Bee Movie, and Kung Fu Panda.

DreamWorks was once a division of Old DreamWorks Studios. The studios were created in 1994 through a partnership of Steven Spielberg, Jeffrey Katzenberg, and David Geffen. In 2004, the animation division was spun off to form a new company, DreamWorks Animation SKG, with Katzenberg serving as its chief executive officer. The new corporation raised additional capital by issuing common stock on the New York Stock Exchange. Its Class A stock trades under the stock symbol DWA and has over 70 million shares outstanding. The stock now trades on the NASDAQ exchange.

A second class of common stock, Class B, is owned entirely by Katzenberg and Geffen. Class B stock has different voting rights than the Class A stock available to independent investors. Each share of Class A stock has a single vote. Each share of Class B stock has 15 votes. Class B stock represents 13% of DreamWorks' total stockholders' equity and 69% of its voting rights. As a result, Katzenberg and Geffen can control all issues brought to a vote by the stockholders.

DreamWorks' capital structure is not uncommon. Individuals who start a business often maintain control of the corporation after stock is sold to the public.

Potential investors should understand the capital structure of a corporation before investing in its common stock.

Critical Thinking

As a potential investor, what are the pros and cons of investing in a corporation controlled by its founders?

Suppose the corporation you created intends to issue stock to the public. Why would you want to maintain control?

Acquiring Capital for Growth and Development: Accounting in the Real World

Acquiring Capital for Growth and Development: Key Terms

- revenue expenditure
- debt financing
- line of credit
- prime interest rate
- interest expense
- non-operating expenses
- capital expenditures
- collateral
- bond
- bond issue

- stated interest rate
- equity financing
- par value
- issue date
-
- preferred stock
- cost of capital
- financial leverage

Chapter 18: Acquiring Capital for Growth and Development: Lesson 18-1: Short-Term Debt Financing

Lesson 18-1: Short-Term Debt Financing

- Short-Term Debt Financing Options LO1
- Drawing on a Line of Credit LO2

Every business needs cash to pay its operating expenses. Purchasing inventory and paying the payroll are examples of daily activities that require a business to earn revenue. The payment of an operating expense necessary to earn revenue is called a revenue expenditure . Over an extended period of time, a business must generate enough cash from sales to pay these expenses. However, from time to time, a business may find itself short of cash. When this happens, the business may need to borrow money for a short period of time.

Many business events and decisions make it necessary for a business to borrow money. For example, a garden center has its peak season in the spring. Extra cash may be required to purchase an adequate supply of merchandise to meet customer needs. Additional employees are usually hired to service a larger number of customers, so extra cash may be needed for higher payroll expenses.

A business might experience an emergency. For example, a storm can damage plant assets and destroy merchandise inventory. The business must quickly pay for repairs and restock its merchandise inventory to avoid lost sales.

Obtaining capital by borrowing money for a period of time is called debt financing . There are several ways for a business to borrow money from a bank or other financial institution. A bank loan agreement that provides immediate short-term access to cash is called a line of credit , or credit line. There are different kinds of credit lines. The loan agreement sets the maximum amount that can be borrowed and the repayment terms. It will also set the interest rate and the length of time the agreement will be in effect. The business can draw any amount it needs within the terms of the loan agreement.

The interest rate charged on a line of credit can change based on market interest rates. The interest rate charged to a bank's most creditworthy customers is called the prime interest rate . Interest rates are often based on the prime interest rate. For example, a line of credit may have an interest rate of 2% over the prime interest rate. This rate would be stated as prime plus 2%.

A business needing to borrow money might elect to sign a promissory note, which it would record as a note payable. The note would state the principal, interest rate, and repayment terms. Unlike a line of credit, a note is signed for a specific number of months and the interest rate is fixed for the term of the note.

Sun Treasures has arranged a line of credit with First National Bank that provides the company with immediate access to a maximum of $50,000.00. Sun Treasures can transfer money from its line of credit to its checking account using an Internet site or by calling a bank loan officer. Sun Treasures pays an annual interest rate of prime plus 2.5% on its daily outstanding balance. The line of credit requires Sun Treasures to pay monthly interest and at least 10% of its outstanding balance at the end of every month.

Sun Treasures draws on its line of credit to prepare for its peak selling season. The company regularly maintains an inventory of about $150,000.00. However, prior to its peak selling season, the company increases its inventory to over $200,000.00. Sun Treasures plans to repay the borrowed funds as it collects cash from the sale of this extra inventory.

November 14. Drew $15,800.00 on its line of credit. Receipt No. 912.

A receipt is prepared to document the amount of funds drawn on the credit line. [CONCEPT: Objective Evidence]

Journalizing the Receipt of Cash from a Line of Credit

1. Write the date, 14, in the Date column.
2. Write the account name, Line of Credit, in the Account Title column.
3. Write the cash receipt number, R912, in the Doc. No. column.
4. Write the total amount borrowed, $15,800.00, in the General Credit column.
5. Write the cash deposited, $15,800.00, in the Cash Debit column.

The journals and ledgers illustrated in Parts 1 and 2 of this textbook included detailed steps for recording the date, source document, and other information about the transactions. Because you now know these standard steps, future illustrations will focus on the account titles and amounts of the transactions.

Signing a Promissory Note for an Extension of Time

A business that is unable to pay its account when due might ask the vendor for an extension of time. The vendor may ask the business to sign a promissory note. The note does not pay the amount owed to the vendor. However, the form of the liability is changed from an account payable to a note payable. When this entry is posted, the balance of the Accounts Payable account for Hass, Inc., will be zero. One liability, Accounts Payable, is replaced by another liability, Notes Payable.

September 30. Sun Treasures signed a 60-day, 12% note to Hass, Inc., for an extension of time on its account payable, $4,200.00. Memorandum No. 142.

The interest rate on promissory notes signed with a vendor may be rather high. A business should avoid signing a note for an extension of time. Instead, the business should consider borrowing funds against a line of credit or obtaining a loan from its bank.

Journalizing Signing a Promissory Note for an Extension of Time

1. Record a debit, $4,200.00, to Accounts Payable/Hass, Inc., in the general journal.
2. Record a credit, $4,200.00, to Notes Payable.

For transactions to Accounts Payable or Accounts Receivable, draw a diagonal in the Post. Ref. column. The line allows for the posting of the transaction to the general ledger and subsidiary ledger account.

Paying Principal and Interest on a Promissory Note

When a promissory note reaches its maturity date, the maker of the note pays the maturity value to the payee. Interest incurred on borrowed funds is called interest expense. The interest incurred on a note is debited to an expense account titled Interest Expense.

Expenses that are not related to a business's normal operations are called non-operating expenses. Interest expense is a financing expense rather than an operating expense. Non-operating expense accounts such as Interest Expense are listed in a section of the chart of accounts titled Other Expenses.

Sun Treasures paid the 60-day note it signed on September 30.

November 29. Paid cash for the maturity value of the August 30 note: principal, $4,200.00, plus interest, $84.00; total, $4,284.00. Check No. 751.

Sun Treasures also makes monthly interest payments on its line of credit. On November 30, Sun Treasures paid $1,000.00 on its outstanding balance plus $72.00 of interest. This transaction is also recorded in the cash payments journal. The debit reduces the balance of Line of Credit and increases Interest Expense.

Journalizing the Payment of Principal and Interest on a Promissory Note

1. Write the account name, Notes Payable, in the Account Title column.
2. Write the note's principal amount, $4,200.00, in the General Debit column.
3. Write the account title, Interest Expense, in the Account Title column on the next line.
4. Write the interest expense amount, $84.00, in the General Debit column.
5. Write the amount of cash paid, $4,284.00, in the Cash Credit column on the first line of the entry.

End of Lesson Review

LO1 Identify available sources of debt financing.

LO2 Journalize transactions related to short-term debt financing.

Terms Review

- revenue expenditure
- debt financing
- line of credit
- prime interest rate
- interest expense
- non-operating expenses

Audit Your Understanding

1. What information is specified in the loan agreement for a line of credit?
2. On a line of credit, how would an interest rate of 3% over the prime rate be stated?
3. Is interest expense an operating or a non-operating expense?
4. Where is interest expense listed in a chart of accounts?

Work Together 18-1

Journalizing entries for short-term debt

The journals for Klein, Inc., are given in the Working Papers. Your instructor will guide you through the following examples.

Using the current year, journalize the following transactions on page 5 of a cash receipts journal, page 8 of a cash payments journal, and page 4 of a general journal. Source documents are abbreviated as: check, C; receipt, R; memorandum, M.

Transaction:

Mar. 3. Drew $6,500.00 on its line of credit. R146.

26. Signed a 90-day, 10% note to MVT Supply for an extension of time on its account payable, $2,400.00. M92.

June 24. Paid cash for the maturity value of the March 26 note: principal, $2,400.00, plus interest. C362.

30. Paid cash for the monthly payment on its line of credit: principal, $1,500.00, plus interest, $64.20. C369.

On Your Own 18-1

Journalizing entries for short-term debt

The journals for Placid Stores are given in the Working Papers. Work this problem independently.

Using the current year, journalize the following transactions on page 7 of a cash receipts journal, page10 of a cash payments journal, and page 5 of a general journal. Source documents are abbreviated as: check, C; receipt, R; memorandum, M.

Transactions:

Apr. 16. Drew $2,250.00 on its line of credit. R206.

May 28. Signed a 60-day, 12% note to Gates Supply for an extension of time on its account payable, $3,660.00. M85.

July 27. Paid cash for the maturity value of the May 28 note: principal, $3,660.00, plus interest. C421.

31. Paid cash for the monthly payment on its line of credit: principal, $800.00, plus interest, $24.10. C426.

Chapter 18: Acquiring Capital for Growth and Development: Ethics in Action: The Newspaper Test

Ethics in Action: The Newspaper Test

A code of conduct should provide employees with a guide for making an ethical decision. The ethical model presented in Chapter 2 provides employees with a structured method of evaluating all the implications of an action. Yet, even with these aids, employees can still find it difficult to make a decision.

Some companies provide their employees with a simple set of questions. One popular question is: “Would I be comfortable if my actions were reported in the newspaper?” If employees are uncomfortable with their actions becoming public knowledge, chances are their actions are unethical. At the very least, employees should know that, if they are in doubt about an ethical question, they should consult their company's ethics officer or legal department.

Instructions

Use the Internet to access the code of conduct for Lockheed Martin Corporation, Yahoo! Inc., and Royal Dutch Shell plc. Prepare a list of questions that could help you determine if an action is ethical.

Chapter 18: Acquiring Capital for Growth and Development: Forensic Accounting: Executive Abuses at Adelphia and Tyco—Two Corporations, Two Industries, One Common Story

Forensic Accounting: Executive Abuses at Adelphia and Tyco—Two Corporations, Two Industries, One Common Story

At its peak, Adelphia Communication Corporation was one of the largest cable television providers in the United States. Adelphia was founded in 1952 by John Rigas and headquartered in Pennsylvania. Adelphia's stock was traded on NASDAQ. In 2003, its revenues exceeded $3.6 billion.

Tyco International was a diversified business that specialized in security, fire protection, and flow control equipment. Tyco was founded in 1960 and headquartered in New York. Its stock traded on the New York Stock Exchange (NYSE). In 2007, its revenues exceeded $17 billion.

What could these corporations possibly have in common? Each chief executive officer was charged and convicted of using corporation funds to support a lavish personal lifestyle.

John Rigas and two of his sons were accused of spending $100 million of Adelphia funds on personal assets and expenses. For example, Rigas used $26 million to purchase land surrounding his estate to ensure that his view would not be obstructed. They spent $12.8 million to construct a golf course on land they controlled. They had sole use of several luxurious condominiums and private jets. At the age of 80, John Rigas was sentenced to 15 years in prison.

Dennis Kozlowski became the chief executive officer of Tyco in 1992. In 2002, it was learned that he illegally avoided $1 million of New York sales taxes on the purchase of paintings for his apartment. That accusation prompted an investigation which revealed that Kozlowski had used $600 million of Tyco funds on personal assets and expenses. Some of those purchases included a $30 million Fifth Avenue apartment, a $29 million vacation home, and a $5 million diamond ring. Tyco even paid for half of his wife's $2 million birthday party featuring entertainment by Jimmy Buffett. Kozlowski was sentenced to a minimum of eight years and four months in prison.

In each case, the abuse of corporate funds was the tip of the iceberg. Adelphia used fraudulent accounting entries to hide over $3 billion in loans to the Rigas family. Tyco used questionable methods in accounting for its acquisition of over 1,000 companies. Both Adelphia and Tyco were forced to restate some prior-year financial statements.

There the similarities end. Adelphia declared bankruptcy in 2002 and soon went out of business. Its assets were sold to Time Warner and Comcast. In contrast, Tyco survived its scandal and continues to be a profitable business.

Activity

PlyCorp Industries has hired you to search for any signs of fraudulent accounting entries. One of your standard tests is to search for entries contrary to the normal balance of income statement accounts.

Instructions

Open the spreadsheet FA_CH18 and complete the steps on the Instructions tab.

Sources: http://en.wikipedia.org ; Cecil W. Jackson, Business Fairy Tales (Thomson, 2006); Jerry W. Markham and M. E. Sharpe, A Financial History of Modern U.S. Corporate Scandals (Armonk, New York and London, England, 2006).

Chapter 18: Acquiring Capital for Growth and Development: Lesson 18-2: Long-Term Debt Financing

Lesson 18-2: Long-Term Debt Financing

As a business expands, it must purchase more equipment and other plant assets. The assets or other financial resources available to a business are called capital. Purchases of plant assets used in the operation of a business are called capital expenditures . These plant assets will be used for many years to support the operations of the business.

Corporations often require large amounts of capital to finance capital expenditures. A business can obtain this capital from both internal and external sources. The portion of net income not paid as a dividend is an internal source of capital. But internal capital may not be adequate. Thus, a corporation must acquire additional capital from external sources. These might include borrowing money or selling stock.

Banks are a convenient source of external capital. The first step in obtaining a loan is completing the bank's loan application. The application collects basic information about the business and its primary owners. Before approving the loan, the bank must be confident that the business is capable of repaying the funds. The business must convince the

bank to approve the loan. Thus, the business should submit a business plan describing how the borrowed funds will be used and how they will be repaid.

With each loan, the bank takes a risk that the borrower will not repay it. Banks only earn money if borrowers repay borrowed funds with interest. Banks will often require a business to pledge certain assets to secure a loan. Assets pledged to a creditor to guarantee repayment of a loan are called collateral . If the borrower is unable to repay the loan, the creditor can take the collateral and sell it to pay off the debt.

Sun Treasures has a goal of opening two new stores on the west Florida coast. It estimates it will need $400,000.00 to fund the expansion. Of this amount, $300,000.00 must come from external sources. A summary of the primary sections of Sun Treasures' business plan follows. Each section addresses common questions that will be asked by the bank's loan officers.

Section Title	Questions of Interest to Bank Officers	Summary of Sun Treasures' Business Plan
Use of funds	What portion of the funds will be used for revenue expenditures and capital expenditures?	Sun Treasures expects to use $150,000.00 for equipment at each location. Another $50,000.00 per store will be used to purchase inventory.
Business experience	What experience do the primary owners and managers have in the industry? Do the decision makers understand how to operate the business? Can they anticipate problems and react to ensure success?	Sun Treasures has been in this business for 15 years. The primary owner and chief operating officer have a combined 40 years of experience in the industry. The manager of the west coast stores has been in a management position with Sun Treasures for nine years.
Market demand	Is there a proven consumer demand for the product or service? What competition does the business face?	Sun Treasures contracted Delson Marketing to perform a market survey. The survey indicated that opportunities exist for souvenir stores in Venice and Fort Myers Beach.
Financial projections	When will the project become profitable? What assumptions is the business using to make its projections?	The new locations are expected to lose $50,000.00 over the first 18 months of operation. A loss is common while new stores develop a loyal customer base. This loss will be funded with profits from the existing stores. Based on a conservative 6% per year growth in sales, the new stores will be able to repay the loan in five years.
Collateral	What assets will be offered as collateral that could be claimed if the business is unable to pay the loan? How easy will it be to resell those assets?	All store equipment from the existing and new stores will be offered as collateral. This equipment will be purchased from vendors that also actively repurchase equipment.
Capital profile	What is the business risking in the project? Does the business have an	Sun Treasures plans to issue common and preferred stock to fund at least

	adequate stake in the project to ensure management is motivated to succeed?	10% of the project.

Other financial institutions include insurance companies, investment firms, and mutual funds.

Signing a Long-Term Note Payable LO4

Lesson 18-2: Long-Term Debt Financing

A note payable is signed as evidence of the debt when receiving a bank loan. Notes payable signed to fund revenue expenditures usually have terms of 12 months or less. However, long-term notes are common when the borrowed funds are used to purchase plant assets. That's because plant assets are useable as collateral for the notes that are issued to fund them. When a note payable is signed for a period greater than one year, it is usually recorded to an account titled Long-term Notes Payable.

In response to Sun Treasures' loan application, the bank agreed to provide only a portion of the funds needed to open the new stores. After Sun Treasures signs the note, the bank deposits the principal amount of the note in Sun Treasures' checking account.

April 1. Signed a 5-year, 8.0% note for $120,000.00. Receipt No. 628.

A receipt is prepared as evidence of the deposit of the principal amount in Sun Treasures' bank account. [CONCEPT: Objective Evidence] No entry is made for interest until a later date when interest is paid.

Journalizing the Signing of a Long-Term Note Payable

1. Write the account name, Long-term Notes Payable, in the Account Title column.

2. Write the total amount borrowed, $120,000.00, in the General Credit column.

3. Write the cash received, $120,000.00, in the Cash Debit column.

Making a Monthly Payment on a Long-Term Note Payable

Amount Borrowed $120,000.00

Term of Note (Months) 60

Annual Interest Rate 8%

Monthly Payment $2,433.17

Payment Number	Payable 1st day of	Beginning Balance	Interest	Principal	Ending Balance
1	May	$120,000.00	$800.00	$1,633.17	$118,366.83
2	June	$118,366.83	$789.11	$1,644.06	$116,722.77
3	July	$116,722.77	$778.15	$1,655.02	$115,067.75
4	August	$115,067.75	$767.12	$1,666.05	$113,401.70
5	September	$113,401.70	$756.01	$1,677.16	$111,724.54
6	October	$111,724.54	$744.83	$1,688.34	$110,036.20
7	November	$110,036.20	$733.57	$1,699.60	$108,336.60
8	December	$108,336.60	$722.24	$1,710.93	$106,625.67

Sun Treasures' note agreement requires that it make a payment on the first of every month. Upon signing the note, the bank provided Sun Treasures with a schedule of monthly payments.

August 1. Paid cash for monthly loan payment, $1,666.05, interest, $767.12; total, $2,433.17. Check No. 673.

Sun Treasures is required to pay $2,433.17 each month. A portion of the payment is interest on the outstanding balance of the loan. The remaining amount reduces the outstanding loan principal. The interest and principal portions of the August payment are highlighted in the payment schedule. The monthly payment will enable Sun Treasures to fully repay the loan by the end of the five years (60 months).

Journalizing the Monthly Payment on a Long-Term Note Payable

1. Write the account name, Long-term Notes Payable, in the Account Title column.
2. Write the principal portion of the August payment, $1,666.05, in the General Debit column.
3. 3 Write the account title, Interest Expense, in the Account Title column on the next line.
4. Write the interest portion of the August payment, $767.12, in the General Debit column.
5. Write the amount of cash paid, $2,433.17, in the Cash Credit column on the first line of the entry.

Issuing Bonds

Large loans can be difficult to obtain from a single bank. An alternative to borrowing money from a bank is to borrow money from individual investors. A long-term promise to pay a specified amount on a specified date and to pay interest at stated intervals is called a bond . Like notes payable, bonds are written promises to pay. Bonds generally have extended terms such as 5, 10, or 20 years. Also, bonds payable tend to be issued for larger amounts than notes payable.

All bonds representing the total amount of a loan are called a bond issue. A corporation usually sells an entire bond issue to a securities dealer who sells individual bonds to individual investors. The process of selling bonds is commonly referred to as issuing bonds.

Each bond states the face value, interest rate, and due date. The face value is the amount to be repaid at the end of the bond term. The interest rate used to calculate periodic interest payments on a bond is called the stated interest rate . The face value is multiplied by the stated interest rate to calculate periodic interest payments to investors. Many bonds pay interest semiannually.

July 1. Issued 20-year, 6.5%, $5,000.00 bonds, $180,000.00. Receipt No. 766.

Journalizing the Issuance of Bonds Payable

1. Write the account name, Bonds Payable, in the Account Title column.
2. Write the bonds' total face value, $180,000.00, in the General Credit column.
3. Write the amount of cash received, $180,000.00, in the Cash Debit column.

Paying Interest on Bonds

Similar to stock, bonds are securities that can be bought and sold. Sales between investors have no impact on the corporation. However, the corporation does need to maintain current records of who owns each bond in order to make proper interest payments. Corporations issue one check for the amount of interest to be paid, usually to an agent such as a bank. The agent then handles the details of sending interest checks to individual bondholders.

Sun Treasures' bonds require that interest be paid semiannually on June 30 and December 31. Interest on the bond is calculated as the face value multiplied by the stated interest rate.

December 31. Paid cash for semiannual interest on bonds, $5,850.00. Check No. 892.

Sun Treasures writes a single check to its agent who then writes individual checks to the bondholders. The investors who own the bonds on the payment date receive the interest payments. Thus, an investor who purchases a bond from another investor on December 29 would receive a check for $162.50 ($5,000.00 × 6.5% × 180/360 = $162.50 per bond).

Journalizing the Payment of Interest on Bonds Payable

1. Write the account name, Interest Expense, in the Account Title column.
2. Write the interest expense amount, $5,850.00, in the General Debit column.
3. Write the amount of cash paid, $5,850.00, in the Cash Credit column.

End of Lesson Review

- LO3 Identify the components of a loan application.
- LO4 Journalize transactions related to long-term financing.

Terms Review

- capital expenditures
- collateral
- bond
- bond issue
- stated interest rate

Audit Your Understanding

1. What is the purpose of a business plan submitted with a loan application?
2. What can happen to collateral if a borrower is unable to repay a bank loan?
3. Identify the primary sections of a business plan.
4. Investor A sells a bond to investor B just days before the interest payment is made. Which investor receives the interest payment?
5. What are two common differences between notes payable and bonds? stated interest rate

Work Together 18-2

Journalizing entries for long-term debt

The journals and a loan payment schedule for Lambers Stores are given in the Working Papers. Your instructor will guide you through the following examples.

Using the current year, journalize the following transactions on page 6 of a cash receipts journal and page12 of a cash payments journal. Refer to the loan payment schedule when journalizing the December 1 transaction. Source documents are abbreviated as: check, C; receipt, R.

Transactions:

June 1. Signed a five-year, 9.0% note, $25,000.00. R337.

July 1. Issued 20-year, 6%, $5,000.00 bonds, $200,000.00. R345.

Dec. 1. Paid cash for the December payment on the June 1 note payable, $518.96. C842.

31. Paid cash for the semiannual interest on bonds. C861.

On Your Own 18-2

Journalizing entries for long-term debt

The journals and a loan payment schedule for Belmar Co. are given in the Working Papers. Work this problem independently.

Using the current year, journalize the following transactions on page 8 of a cash receipts journal and page 15 of a cash payments journal. Refer to the loan payment schedule when journalizing the November 1 transaction. Source documents are abbreviated as: check, C; receipt, R.

Transactions:

July 1. Issued 20-year, 5.5%, $10,000.00 bonds, $300,000.00. R621.

1. Signed a four-year, 7.5% note, $32,000.00. R622.

Nov. 1. Paid cash for the November payment on the August 1 note payable, $773.72. C902.

Dec. 31. Paid cash for the semiannual interest on bonds. C928.

Chapter 18: Acquiring Capital for Growth and Development: Think Like an Accountant: Authorizing a Dividend

Think Like an Accountant: Authorizing a Dividend

At each November meeting, the board of directors of Natchez Finance Corporation reviews the company's financial performance. The information is used to determine the dividend per share for the next four quarters. For the past 24 years, the board has authorized an increase in the quarterly dividend.

Board members are aware that many stockholders are retirees who rely on the income provided by the quarterly dividend. However, the corporation cannot afford to pay out all of its earnings in dividends. The business must retain some of its earnings to finance future growth.

The board considers two financial ratios in making its decision:

Payout Ratio: The board attempts to pay out between 60%–70% of its earnings. The board believes stockholders deserve to receive a dividend of at least 60% of company earnings. However, the board needs to retain at least 30% of company earnings to finance future growth.

Dividend Yield: The board wants the financial markets to view the corporation's stock as an income stock that yields at least a 5.0% dividend.

During 20X4, Natchez Finance Corporation was negatively impacted by a severe economic downturn. To obtain the funds needed to operate, the corporation was forced to issue more stock than usual. Further complicating the situation was a decline in the market price of the common stock. Although the board believes the economy is recovering, it is seeking your recommendation on the amount of the dividend for the next year.

Open the Spreadsheet TLA_CH18

The worksheet contains the relevant data for 20X1–20X4. Analyze the data to suggest an amount for the new quarterly dividend. Answer the following questions:

1. How often has the corporation achieved the payout ratio target?
2. How often has the corporation achieved the dividend yield target?
3. What dividend per share do you recommend? Support your answer.

Chapter 18: Acquiring Capital for Growth and Development: Why Accounting?: Costs Determine Pricing

Why Accounting?: Costs Determine Pricing

Have you ever thought that the price you paid for a product was too high? Did you think about all the costs that went into making the product available to you? Manufacturers and retailers must charge enough to cover all their costs plus make a reasonable profit.

You can probably imagine most of the retailer's costs, but consider the manufacturer's costs. Calculating the manufacturing cost is not as easy as it may seem. Take a bicycle for example. Besides the actual materials used in the bike, there are many other costs that must be included such as:

Machines used, as well as the parts and supplies required to maintain the machines.

Labor, including factory supervisors.

Utilities for the factory.

Labor and supplies to keep the factory clean.

Employee benefits, vacations, and training.

The price charged for the bike must also include all the administrative costs of the company and produce a profit for the company's stockholders. It is the job of the company's accountants to make sure all of these costs are identified and measured accurately. If any costs are missed, the company will make less profit on each bicycle it sells. If enough costs are missed, the company might actually lose money on every bike it sells. The field of accounting that identifies and measures costs is called cost accounting.

Critical Thinking

Select a product of your choice and make a list of all the costs that went into the making of the product. Be prepared to defend your list in class.

Chapter 18: Acquiring Capital for Growth and Development: Lesson 18-3: Capital Stock

Lesson 18-3: Capital Stock

- Issuing Capital Stock LO5

A corporation may elect to raise capital by selling stock. Obtaining capital by issuing stock in a corporation is called equity financing . Selling stock increases the stockholders' equity in the business.

An advantage of selling stock is that the capital becomes a part of a corporation's permanent capital. Permanent capital does not have to be returned to stockholders as long as the business continues to operate. Another advantage is that dividends do not have to be paid to stockholders unless the earnings are sufficient to warrant such payments. A disadvantage of selling more stock is that the ownership is spread over more shares and more owners.

Shares of stock are often assigned a value. A value assigned to a share of stock is called the par value . The par value has nothing to do with the market value of the stock. State laws use the par value to determine the minimum amount of equity that must be retained in the corporation.

Several years ago, Sun Treasures issued stock to raise the capital required to open its first store.

February 25. Sold 10,000 shares of $10.00 par value common stock at par value, $100,000.00. Receipt No. 16.

The date on which a business issues a note, bond, or stock is called the issue date . The issue date is required to determine the proper payments of interest or dividends.

Journalizing the Sale of Common Stock at Par Value

1. Write the account name, Capital Stock—Common, in the Account Title column.
2. Write the stocks' total par value, $100,000.00, in the General Credit column.
3. Write the amount of cash received, $100,000.00, in the Cash Debit column.

Over time, the common stock of a profitable corporation will increase in value. Investors will be willing to pay more than the par value of the stock.

The par value of the issued stock is recorded in Capital Stock—Common. Any additional amount received is recorded to Paid-in Capital in Excess of Par—Common. The account is an equity account and appears on the statement of stockholders' equity under common stock.

August 4. Sold 600 shares of $10.00 par value common stock at $40.00 per share, $40,000.00. Receipt No. 811.

The amount credited to Capital Stock—Common is always the par value multiplied by the number of shares issued. The issue price of the stock does not have any impact on this amount. The balance of Capital Stock—Common is useful to satisfy information required by certain state laws and taxing authorities.

Journalizing the Issuance of Stock in Excess of Par Value

1. Write the account name, Capital Stock—Common, in the Account Title column.
2. Write the total par value amount, $6,000.00, in the General Credit column.
3. Write the account title, Paid-in Capital in Excess of Par—Common, in the Account Title column on the next two lines.
4. Write the difference between the total par value and the cash received, $18,000.00, in the General Credit column.
5. Write the total cash received, $24,000.00, in the Cash Debit column.

Some investors are uncomfortable with the risks of owning common stock, especially if dividends have not been paid consistently. To attract these investors, some corporations offer a different class of stock in addition to their common shares. Preferred stock is a class of stock that gives preferred shareholders preference over common shareholders in dividends along with other rights. Preferred stock is typically described by referring to the stock's dividend rate and par value. Sun Treasures plans to issue 6%, $50.00 par value preferred stock.

August 16. Issued 400 shares of 6%, $50.00 par value preferred stock at par value, $20,000.00. Receipt No. 815.

Corporations are not required to pay dividends on stock, whether common or preferred. However, when dividends are paid, all the dividends owed the preferred stockholders must be paid first. Preferred stock dividends are determined by the par value and the stated interest rate. Sun Treasures' annual preferred dividend is $3.00 (6% × $50.00) per share. Thus, Sun Treasures is expected to pay annual total dividends of $1,200.00 ($3.00 × 400 shares) to preferred stockholders. Any additional dividends declared are paid to common stockholders.

Preferred stockholders can have other preferences over common stockholders. Unpaid dividends may accumulate from one year to another. These dividends must be paid before common stockholders receive any dividends. If the corporation is dissolved, preferred stockholders receive cash for their stock before any cash is distributed to common stockholders. However, preferred stockholders do not have the same voting rights as common stockholders.

Journalizing the Sale of Preferred Stock at Par Value

1. Write the account name, Capital Stock—Preferred, in the Account Title column.
2. Write the total par value amount, $20,000.00, in the General Credit column.
3. Write the total cash received, $20,000.00, in the Cash Debit column.

End of Lesson Review

- LO5 Journalize transactions related to equity financing.

Terms Review

- equity financing
- par value
- issue date
- preferred stock

Audit Your Understanding

1. Is a corporation required to issue dividends? Explain.
2. How is preferred stock typically described?
3. In what order is cash paid to preferred and common stockholders if a corporation is dissolved?
4. What is the most common reason that investors purchase preferred stock?

Work Together 18-3

Journalizing the sale of common and preferred stock

A cash receipts journal for Center Fashion is given in the Working Papers. Your instructor will guide you through the following examples.

Using the current year, journalize the following transactions on page 6 of a cash receipts journal. Source documents are abbreviated as: receipt, R.

Transactions:

June 1. Sold 6,000 shares of $10.00 par value common stock at par value, $60,000.00. R258.

9. Sold 2,000 shares of $10.00 par value common stock at $10.50 per share, $21,000.00. R267.

22. Issued 500 shares of 5%, $60.00 par value preferred stock at par value, $30,000.00. R289.

30. Issued 500 shares of $10.00 par value common stock at $11.25 per share. R301.

On Your Own 18-3

Journalizing the sale of common and preferred stock

A cash receipts journal for Main Station is given in the Working Papers. Work this problem independently.

Using the current year, journalize the following transactions on page 8 of a cash receipts journal. Source documents are abbreviated as: receipt, R.

Transactions:

Aug. 3. Sold 40,000 shares of $1.00 par value common stock at par value, $40,000.00. R311.

14. Issued 2,000 shares of 6%, $50.00 par value preferred stock at par value, $100,000.00. R325.

21. Sold 8,000 shares of $1.00 par value common stock at $1.40 per share, $11,200.00. R330.

29. Issued 6,000 shares of $1.00 par value common stock at $1.60 per share. R338.

Chapter 18: Acquiring Capital for Growth and Development: Lesson 18-4: Acquiring Additional Capital

Most businesses need additional capital to finance a major expansion or the purchase of expensive plant assets such as buildings and machinery. How a business elects to obtain funds for expansion or development will impact its earnings. Each method has a different impact on earnings. Borrowing money increases interest expense. Issuing stock may result in dividend payments.

The ratio of interest and dividend payments to the proceeds from debt and capital financing is called the cost of capital . A business should only raise capital if the projected increase in earnings exceeds the cost of capital. A business that elects to raise capital has several options: a line of credit, notes payable, bonds, common stock, and preferred stock. Each option can have positive and negative effects on a business and its owners. The following factors should be considered in deciding how a business should raise capital.

Interest Rate. A business seeks to minimize its interest expense. The interest rate of a loan or bond is dependent on several factors. Short-term interest rates are usually less than long-term interest rates. Interest rates can change from events in the regional or global economy. Creditors demand higher interest rates if they loan money to a business with a less than perfect credit history.

Impact on Earnings. Interest on debt financing is an expense that reduces net income before federal income taxes. But interest payments also reduce federal income taxes. For a company with a marginal tax rate of 25%, a $1,000.00 interest payment reduces its federal income taxes by $250.00. Thus, the net cash outlay is only $750.00. In contrast, dividends are not an expense and do not reduce federal income taxes. The primary benefit of dividends is that the payments are made to the stockholders rather than creditors and bondholders.

Repayment Terms. A business must decide how quickly it wants to repay borrowed funds. Debt financing is often extended for a term similar to the useful life of the assets purchased. Funds used to purchase extra merchandise for a busy season should be repaid quickly. Funds used to purchase plant assets are often repaid over several years. Bonds usually provide the longest repayment terms. In contrast, equity financing is typically never repaid.

Ownership Control. The existing owners of a business maintain full control of a business when expansion is achieved with debt financing. If funding is obtained through equity financing, a proportional share in the control of the business goes with each new share of stock. This spreading of the control over the business is known as dilution of control.

Debt Ratio. A business may not have total control over which financing method it selects. Creditors may be unwilling to lend money to a business with a high debt ratio. Such a business is perceived to be a high credit risk. The business may have no choice but to issue additional stock. In contrast, lenders are more willing to lend money to a business with a low debt ratio. Creditors perceive such a business to be a low credit risk.

Suppose a business wants to purchase $50,000.00 of equipment. The equipment will enable the business to serve more customers and earn more income. The company only has $10,000.00 it can afford to invest in the equipment. Should the company borrow the $40,000.00 needed to complete the purchase? If so, how should the company raise the necessary cash?

The ability of a business to use borrowed funds to increase its earnings is called financial leverage . For financial leverage to be a benefit, the borrowed funds must be invested in the business and increase income by more than the interest paid. The following table presents three possible outcomes of borrowing $40,000.00 at 8.0%.

In the first column, the business earns an annual operating income of $4,000.00, a return of 8.0% on its $50,000.00 purchase of equipment. After interest expense and federal income taxes, the business earns an additional $600.00. However, the business only invested $10,000.00 of internal capital. Thus, the business earns 6.0% ($600.00 ÷ $10,000.00) on its investment.

What if the company can earn $5,000.00 in operating income, a return of 10.0% on the $50,000.00 purchased equipment? The second column shows the power of financial leverage. The return on the company's investment jumps to 13.5%. The interest expense is unchanged. Thus, the $1,000.00 of additional operating income belongs to the business. Earning a 12.0% return on the purchased equipment, as shown in the third column, results in the business earning 21.0% on its investment.

It might appear that a business should always borrow money when it needs additional capital. That is not the case. Borrowing money can be risky. The fourth column shows how financial leverage can be harmful. What if an economic decline causes the company to earn only $3,000.00, or 6.0% on the purchased equipment? Interest must be paid regardless of the income earned with the borrowed funds. As a result, the business loses $150.00, a negative return of 1.5% on its investment.

A business can have too much debt. A business having a high level of debt is perceived to be a credit risk. Creditors and investors may be unwilling to loan money or invest in the business. A business having a high level of debt is said to be highly leveraged or possibly over-leveraged.

Selecting Financing Methods

A business needing to raise additional capital has many decisions to make. Does it use debt financing, equity financing, or a combination of both? What form of debt financing should be used? Should equity financing involve common or preferred stock? The best choice will be unique for each business.

A business wants to take advantage of financial leverage. At the same time, a business cannot risk having too much debt. It is very hard to determine the exact amount of capital that should be raised by debt versus equity financing.

Several years after opening its west coast stores, Sun Treasures is ready to expand again. Sun Treasures needs to raise $340,000.00 of capital to finance a third store and a distribution center. The company will need $250,000.00 to purchase equipment and $60,000.00 to purchase inventory. The remaining $30,000.00 will be required to pay expenses prior to opening.

The board of directors used the following schedule to guide its decision-making. Using current balances of the liability and equity accounts, the schedule enabled the board to examine the new balances after financing decisions were made.

The board decided to take the following actions to finance the expansion of the business:

Draw $18,000.00 on its $50,000.00 line of credit. This debt financing source has the lowest interest rate, 6.0%, of the three debt financing options. The new balance of $32,200.00 will preserve the board's target emergency balance of approximately $15,000.00.

Sign a $160,000.00, 7.5% note payable on the equipment. The interest rate on this debt is higher than the interest rate of the bonds. Sun Treasures projects that company earnings will enable the loan to be repaid within four to six years. The board elected to pay a slightly higher interest rate for a few years rather than be obligated to pay interest on additional 6.5% bonds for 20 years.

Sell 4,500 shares of common stock at the current market price of $36.00 per share. The stock will generate the remaining $162,000.00 of financing needed to fund the expansion ($178,000.00 + $162,000.00 = $340,000.00).

The debt financing alone would raise the company's debt ratio to 65.4%. This ratio exceeds the board's maximum benchmark of 60.0%. Thus, equity financing is required to raise the additional funds and bring the debt ratio down.

The total number of shares outstanding will increase to 94,500 (90,000 + 4,500). To hold onto a majority of the outstanding shares, the founding family has elected to purchase 1,000 shares. The family will then own 52.4% of the outstanding shares. A family united in its decisions can guarantee its control over the corporation by owning a majority of the common stock.

After the equity financing, the debt ratio of 50.5% will be within the benchmark range of 40.0% and 60.0%.

End of Lesson Review

- LO6 Identify factors influencing financing decisions.
- LO7 Analyze the impact of financial leverage.

Terms Review

- cost of capital
- financial leverage

Audit Your Understanding

1. Identify five options available to a business to raise capital.
2. Identify five factors that a business should consider in deciding how to raise capital.
3. What is necessary for financial leverage to increase earnings?
4. How might individuals describe a business having a high level of debt?
5. What might force a corporation to issue additional stock?

Work Together 18-4

Analyzing the impact of financial leverage

A form is given in the Working Papers. Your instructor will guide you through the following example.

KMT Stores is considering a renovation of its store. The project will cost $100,000.00. The company can issue 7%, $5,000.00 bonds to finance 90% of the project. The remaining capital will come from internal sources. The renovation should enable the business to serve more customers. Complete the form to evaluate the effect of financial leverage on the proposed renovation. Evaluate the earnings potential of the project assuming that operating income will increase by 6%, 7%, or 8% of the project cost.

Under what conditions should KMT Stores renovate the store?

On Your Own 18-4

Analyzing the impact of financial leverage

A form is given in the Working Papers. Work this problem independently.

Daniel Electric is planning to open a distribution center. The center will cost $500,000.00. The company can finance 96% of the project with 8.2%, $10,000.00 bonds. The remaining capital will come from internal sources. Complete the form to evaluate the effect of financial leverage on the proposed center. Evaluate the earnings potential of the project assuming that operating income will increase by 7.6%, 7.8%, or 8.0% of the center cost.

Under what conditions should Daniel Electric open the distribution center?

Chapter 18: Acquiring Capital for Growth and Development: Global Awareness: India—An Expanding Market

Global Awareness: India—An Expanding Market

A company that wants to expand into a foreign market should consider India. With 1.16 billion people and 240 million households, India is the fourth largest economy in the world. It is also a nation with a young population. The average age of an Indian citizen is 25.3 (compared to 36.7 in the United States). India is known for its competitive education system and large pool of highly skilled workers.

Like any nation, India has unique political and cultural practices. It is very important to be aware of these practices in order to have a successful business relationship. India is a culturally diverse country. Four factors affect the difficulty of doing business there: regionalism, religion, language, and caste. The first three factors are closely related. India is made up of several states. These states (or regions) vary greatly in religious beliefs and language. For example, Hindi is the official language of India, but states within India have their own official languages—21 in all. English is considered an associate language and is used in most business dealings.

Historically, India's social structure involved a caste system—class distinctions based on the occupation and ethnicity of the family into which a person is born. Although this system has been officially dismantled, there are still many signs of it in Indian culture. Organizations have a hierarchy which is strictly followed. A simple task can take hours because a worker at the right level must complete it. This hierarchy determines each individual's role and status. Most decisions are made by the owner of a business rather than someone in a lower-level position.

Relationships are critical in business practices. Business decisions are not based solely on financial facts and figures. A person hoping to do business with an Indian firm must be patient and allow a relationship to develop. In negotiations, being forceful might be misinterpreted as a sign of disrespect.

Many foreign businesspeople find it extremely helpful to follow two strategies when beginning an expansion into India:

Work at a local level rather than marketing to the entire country.

Form a partnership with an Indian businessperson or company instead of operating individually. A local partner can provide priceless information on local customs and practices.

Critical Thinking

Although a handshake is usually required when meeting someone in India, Namaste is also practiced. Use the Internet to research the word “Namaste” and the gesture that accompanies the greeting. In a written report, explain the meaning of the word and the gesture.

Sources: www.buyusa.gov/india ; www.export.gov/india ; Doing Business in India, Ernst & Young, India; and www.kwintessential.co.uk .

Chapter 18: Acquiring Capital for Growth and Development: End of Chapter Review

In this chapter, you learned several different ways that businesses can raise capital for growth and development. But notes payable, credit lines, bond issues, and stock issues don't provide the cash a business needs for its daily operations.

Just like consumers, businesses use credit cards to finance some of their day-to-day expenses.

Unlike the usual expenditures for inventory and supplies, credit card charges tend to be small and occur in large numbers. These are tedious to account for manually, but technology simplifies the process significantly.

Using the Internet, a business can link directly to its bank's accounting system. Credit card charges can be downloaded from the bank directly into the business's accounting system, where each charge can easily be posted to the proper account.

Acquiring Capital for Growth and Development: A Look at Accounting Software

1. The user clicks on the Banking button to open the Banking Center navigation pane.
2. The user clicks on the Credit Card Charges icon to open the Credit Card Charges window.
3. From the drop-down list, the user selects a credit card account. Many businesses have more than one credit card account.
4. The user clicks on the Download button and the current charges are listed in the frame below. The Internet connection data were entered when the American Express—First American Bank account was set up. The system makes that connection and does the download automatically.
5. The current charges are displayed the same as they would appear on a credit card account statement. Gulf Coast Gifts, Inc., has provided three employees with cards on this account. The Card column identifies the employee who made each charge.
6. The Acct. No. and GL Account columns are empty until the user begins to assign account numbers to the charges. As account numbers are assigned, the system automatically displays the GL account titles.
7. At any time the user chooses, he or she can access the Credit Card Charges window, select a credit card account, and click the Pay button. That opens a new dialog box in which the user will designate the bank account the funds are to be paid from and the amount of the payment. The funds are automatically drawn from the business's checking account and paid on the credit card account. The system automatically credits the Cash account and debits the American Express—First American Bank account.
8. When the user has finished assigning the charges to the proper accounts, he or she clicks Save to post the charges. The next time charges are downloaded, only charges not posted will appear in the window.
9. Clicking on Search opens a search box allowing the user to quickly find and review any individual charge that has been posted. Clicking Print gives the user a choice of reports, including a report of the charges that have been posted.

It is not uncommon for questions to arise later about specific charges. With paper records, it might be necessary to search through stacks of charge statements and charge slips to find them. In an automated system, a simple search can quickly locate any charge and make it easy to examine the details.

Acquiring Capital for Growth and Development: Chapter Summary

At some point, every business needs to raise capital. A business might need extra cash to prepare for its prime selling season. An unexpected event, such as a storm, may cause a business to need extra cash for repairs. Businesses also need capital to fund expansion plans.

A business can raise capital through internal or external sources. The portion of net income not paid as a dividend is an internal source of capital. This source is rarely adequate to fund major expansion plans. In these cases, a business must raise capital from external sources. External sources include debt and equity financing.

Several types of debt financing are available. A line of credit is a flexible, short-term bank loan. A note payable is a bank loan for a stated amount, period, and interest rate. Notes can be signed for several months or several years. The term of the note determines whether the transaction is recorded to Notes Payable, a current liability, or Long-term Notes Payable, a long-term liability. Bonds are long-term promises to pay that are sold to investors. Bonds are often issued for 5, 10, and 20 years.

A business can raise equity financing by selling common or preferred stock. Common stockholders have voting rights and the right to the earnings of the business. A business can, but is not required to, pay dividends on its common stock. Preferred stockholders expect to earn a stated dividend rate along with other preferred rights. Preferred stockholders, though, do not have voting rights. Shares of both common and preferred stock are often assigned a par value. The par

value has nothing to do with the market value of the stock. The amount of a stock sale above the par value is credited to an account titled Paid-in Capital in Excess of Par.

How a business raises needed capital is a complex decision. A business wants to reduce its obligation to pay interest to external sources. Each type of debt financing has different repayment terms. In contrast, equity financing does not have to be repaid. But equity financing may reduce the amount of control held by current stockholders by giving a share of the control to new stockholders.

The financial leverage of using debt financing can be a powerful tool to increase earnings. Whichever way a business elects to fund its operations, it must take care not to become over leveraged.

Acquiring Capital for Growth and Development: Explore Accounting

Public mistrust stemming from the 1929 stock market crash threatened the ability of corporations to obtain equity financing. In response, Congress created the Securities and Exchange Commission (SEC) in 1933 to restore public confidence in the financial markets. Corporations offering stock and bonds for sale to the public must register these securities with the SEC. Each quarter, corporations must submit financial reports containing their financial statements. The most common SEC reports include the Form 10-Q quarterly report and the Form 10-K annual report. Corporations also commonly file a Form 8-K to report significant events, such as a change in auditor, corporate mergers, and changes in the board of directors. Corporations have only four days after such an event to file Form 8-K.

The SEC has the authority to establish the accounting principles that must be used in preparing financial reports. However, the SEC has permitted the accounting profession to develop generally accepted accounting principles (GAAP). The SEC does require additional information not normally found in financial statements prepared in accordance with GAAP. For example, a corporation must describe its business and list the members of its board of directors.

Investors can obtain access to the SEC reports from many sources. Most corporations post these reports on their websites. Key search words such as investor relations or corporate governance are useful in searching for the reports. The SEC also posts reports to its Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system at http://www.sec.gov/edgar.shtml . An investor can enter a company name or stock symbol to access the reports.

Instructions

Use EDGAR or a corporate website to access the latest Form 10-K for a corporation of your choice. Prepare a list of the topics discussed in the Item 2—Properties section of the report.

Acquiring Capital for Growth and Development: Apply Your Understanding: Application Problem

INSTRUCTIONS: Download problem instructions for Excel, QuickBooks, and Peachtree from the textbook companion website at www.C21accounting.com .

<u>18-1 Application Problem: Journalizing Entries for Short-Term Debt LO2</u>

The journals for Gift Shack are given in the Working Papers.

Instructions:

Using the current year, journalize the following transactions on page 9 of a cash receipts journal, page 14 of a cash payments journal, and page 8 of a general journal. Source documents are abbreviated as: check, C; receipt, R; memorandum, M.

Transactions:

Aug. 29. Signed a 90-day, 15% note to Mann Co. for an extension of time on its account payable, $2,950.00. M153.

Sept. 24. Drew $12,900.00 on its line of credit. R337.

Nov. 27. Paid cash for the maturity value of the August 29 note: principal, $2,950.00, plus interest. C669.

30. Paid cash for the monthly payment on its line of credit: principal, $2,400.00, plus interest, $108.90. C674.

18-2 Application Problem: Journalizing Entries for Long-Term Debt LO4

The journals and a loan payment schedule for PAL Industries are given in the Working Papers.

Instructions:

Using the current year, journalize the following transactions on page 7 of a cash receipts journal and page14 of a cash payments journal. Refer to the loan payment schedule when journalizing the December 1 transaction. Source documents are abbreviated as: check, C; receipt, R.

Transactions:

Apr. 1. Signed a six-year, 7% note, $16,000.00. R552.

July 1. Issued 20-year, 5%, $5,000.00 bonds, $250,000.00. R606.

Dec. 1. Paid cash for the December payment on the April 1 note payable, $272.78. C968.

31. Paid cash for the semiannual interest on bonds. C997.

18-3 Application Problem: Journalizing the Sale of Common and Preferred Stock LO5

Journalize and post transactions related to the sale of common and preferred stock to the general journal.

Print the general journal and the trial balance.

Journalize and post transactions related to the sale of common and preferred stock to the journal.

Print the journal and the trial balance.

A cash receipts journal for Southern Supply is given in the Working Papers.

Instructions:

Using the current year, journalize the following transactions on page 9 of a cash receipts journal. Source documents are abbreviated as: receipt, R.

Transactions:

Sept. 2. Sold 350 shares of 7.5%, $100.00 par value preferred stock at par value. R525.

8. Issued 20,000 shares of $1.00 par value common stock at par value. R531.

10. Issued 4,000 shares of $1.00 par value common stock at $1.30 per share. R533.

21. Sold 250 shares of 7.5%, $100.00 par value preferred stock at par value. R543.

28. Sold 6,000 shares of $1.00 par value common stock at $1.40 per share. R549.

18-4 Application Problem: Analyzing the Impact of Financial Leverage LO7

A form is given in the Working Papers.

Instructions:

UpTown Café wants to begin providing live music in its dining area. The plan will require the company to invest $30,000.00 in sound equipment. The vendor maintains that other restaurants have increased their annual operating income by 8.5% to 9.5% of the cost of the equipment. The vendor has offered to finance $28,000.00 of the purchase with a 9% note. The remaining capital will come from internal sources. Complete the form to evaluate the effect of financial leverage on the proposed center. Evaluate the earnings potential of the project assuming that operating income will increase by 8.5%, 9.0%, or 9.5% of the equipment cost.

Assume the company is successful in increasing its operating income by 9.5% of the sound equipment cost. Explain the impact of financial leverage on the return on UpTown Café's investment.

Acquiring Capital for Growth and Development: Apply Your Understanding: Mastery Problem

18-M Mastery Problem: Journalizing Transactions Related to Debt and Equity Financing LO2, 4, 5

The journals for Teller Tires are given in the Working Papers.

Instructions:

Using the current year, journalize the following transactions on page 7 of a cash receipts journal, page 12 of a cash payments journal, and page 7 of a general journal. Refer to the loan payment schedule when journalizing the December 1 transaction. Source documents are abbreviated as: check, C; receipt, R; memorandum, M.

Transactions:

July 1. Issued twenty-five 20-year, 6%, $10,000.00 bonds. R359.

3. Signed a 180-day, 12% note to PTS Corp. for an extension of time on its account payable, $3,200.00. M98.

8. Issued 8,000 shares of $25.00 par value common stock at par value. R362.

12. Sold 500 shares of 6.5%, $50.00 par value preferred stock at par value. R370.

18. Drew $24,800.00 on its line of credit. R376.

23. Issued 6,000 shares of $25.00 par value common stock at $28.00 per share. R385.

31. Signed a five-year, 8% note, $45,000.00. R392.

Dec. 1. Paid cash for the December payment on the July 31 note payable, $912.44. C745.

2. Paid cash for the monthly payment on its line of credit: principal, $3,000.00, plus interest, $128.95. C746.

30. Paid cash for the maturity value of the July 3 note to PTS Corp., $3,200.00, plus interest. C762.

31. Paid cash for the semiannual interest on bonds. C763.

Journalize and post the July transactions to the general journal.

Journalize and post the December transactions in the Write Checks window.

Print the general journal, cash disbursements journal, and trial balance.

Journalize and post the July transactions to the journal.

Journalize and post the December transactions in the Write Checks window.

Print the journal, check detail, and trial balance.

Journalize and post the July transactions to the journal.

Journalize and post the December transactions to the cash payments journal.

Print the general journal and cash payments journal.

Acquiring Capital for Growth and Development: Apply Your Understanding: Challenge Problem

18-C Challenge Problem: Selecting Financing Methods LO7

Windsong Corporation needs to obtain $500,000.00 of financing for a distribution center. Using the form provided in the Working Papers, develop a financing plan to fund the project.

Instructions:

1. Use the following information to determine an appropriate amount of debt and equity funding.

    a. Current liability and equity account balances are presented on the form.

    b. The project involves the opening of a distribution center. The funds will be used to purchase $380,000.00 of equipment and $70,000.00 of additional merchandise inventory. The remaining funds will cover pre-opening expenses.

    c. The company has a $25,000.00 line of credit with a 6.5% interest rate.

    d. A bank is willing to loan up to $250,000.00 at 8% for up to ten years.

    e. The company can issue up to $200,000.00 of 7%, 20-year $5,000.00 bonds.

    f. The Windsong family currently owns 8,000 of the 12,000 outstanding shares. The Windsong family wishes to keep control of a majority of the outstanding common stock.

    g. The company can sell up to 20,000 of its $10.00 par value common stock to independent investors for $15.00 per share.

    h. The board has a target debt ratio benchmark of 30% to 50%.

    i. Windsong projects that it will earn 12% on its investment in the project.

2. What number of shares of common stock should be purchased by the Windsong family to maintain voting control?

Use the worksheet to develop a financing plan to fund the distribution center project.

Select an appropriate mixture of debt versus equity financing.

Print the worksheet.

Acquiring Capital for Growth and Development: 21st Century Skills

Acquiring Capital for Growth and Development: 21st Century Skills

Heavenly Deals

Theme: Financial, Economic, Business, and Entrepreneurial Literacy

Skills: Critical Thinking and Problem Solving, Communication and Collaboration

Many great business ideas never become reality because entrepreneurs are unable to raise the capital to get started. The types of financing that businesses normally use to raise capital are seldom available for high-risk ventures. Many of those ideas are simply left behind.

The business of raising capital is rarely considered a heavenly undertaking—unless an angel is providing the financing. The term angel originally came from Broadway in the 1900s. It described a wealthy individual who provided money for theatrical productions. Today, an angel investor is usually a successful businessperson who wants to invest in startup companies with the potential to produce huge returns on their investments. Angel investors seek startups that would be too risky for banks; and they often contribute expertise and experience in addition to capital.

Many angel investors choose to invest for reasons that go beyond a monetary return. They may choose to invest close to home in an effort to help their local community with technological or environmental advancements, or to help create jobs. It is difficult to account for the number of angel investors. Some studies indicate there may be over 12,000 of them. The angel investor might be a name you recognize, like Jeff Bezos, founder of Amazon. He was an angel investor for both Google and Twitter. Or, PayPal's cofounder, Peter Thiel, who helped Facebook get its start. There might be an angel investor in your own community willing to invest in your idea!

Application

You have created a more efficient solar panel, and you have identified potential customers who have said they would be willing to purchase a large number of panels. Unfortunately, you do not have the production capacity to manufacture the panels, which will cost $10,000,000.00. Compose a persuasive letter to a potential angel investor. Describe your business idea and state the amount of capital needed. Be sure to list at least three reasons why this would be a worthwhile investment.

Together with a classmate, brainstorm at least five characteristics of an angel investor who might be interested in investing in your Online Homework Tutoring business.

Acquiring Capital for Growth and Development: Analyzing Nike's Financial Statements

Investors use a ratio known as the dividend yield when making investment decisions. The dividend yield is calculated as follows: Dividend Yield = Dividend per Share ÷ Market Price per Share.

Companies with large dividend yields (greater than 3%) are typically considered to be income stocks, meaning that investors own the stock primarily to earn the dividend. In contrast, companies with no dividend or small dividend yields (less than 2%) are often referred to as growth stocks, meaning that investors are counting on the market value of the stock to increase over time.

Instructions

Use Nike's Selected Financial Data on page B-3 in Appendix B to answer the following questions.

For each year, calculate Nike's dividend yield using the high price of common stock. Calculate percents to one decimal place.

Would you classify Nike as an income or growth stock?