

Topic 10



Company Accounts

COMPANY ACCOUNTS

Limited Companies → Business with separate legal identity

↓
• Artificial juristic person

Limited Liability

Forms of Business Organisation

Sole Trader
• unlimited liability

Partnership Firm
• unlimited liability

Limited Company
• limited liability

limited liability: It means that the owners or shareholders of the company are only liable for the amount of money they have invested in the company. In case if the business goes bankrupt or insolvent, the owners are not required to settle the debts from their personal possessions.

Registered Companies

Private limited (Pvt)

- Family controlled business where shares are issued only to friends, family and close relatives
- Maximum number of shareholders cannot exceed 50.
- Shares are not easily transferable, consent of other members is required to transfer the shares.
- It is not mandatory to follow International Accounting Standards (IAS)
- It is not required to publicly publish their financial statements

Public limited Company (Plc)

- Large scale business where shares are offered to general public through an invitation offered through prospectus.
- There is no restriction on the number of shareholders.
- Shares are easily transferable as the shares are listed or quoted on stock exchange
- It is mandatory to follow International Accounting Standards (IAS)
- It is mandatory to publish audited financial statements

Capital / Finance

Equity

- equity capital represent ownership
- includes shares
- permanent source of finance
- Reward is in form dividends
- Dividend is distribution/share of profit
- Equityholders are the owners/shareholder of the company

Debt (NCL)

- debt capital represent borrowings
- includes loans, bank loans, debentures, loanstock bonds
- temporary source of finance
- Reward is in form of fixed rate of interest
- Interest is expense of the business (Finance cost)
- Debtholders are the lenders/creditors of the company.

Debentures:

- It is a part of the debt capital of business.
- It is not a permanent source of finance and the principal amount needs to be repaid upon maturity.
- Debentureholders receive fixed rate of interest irrespective of profit or loss made by the company.

Note:• Debentures are included as non current liabilities in statement of financial position but if debentures are repayable within 1 financial year, they are shown as current liability.

- If debentures are secured on company's non current assets then they are called secured or mortgaged debentures.
- If the holder of the debentures have an option to convert debentures into shares at a future later date, then such type of debentures are called convertible debentures.

Shares

Preference Shares

- These shares are given preference or priority over ordinary shares in 2 conditions
 1. in receiving dividend
 2. in share of liquidation
- Preference shareholders receive fixed rate of dividend i.e.: their dividend rates are predetermined
- Preference shareholders do not have any voting rights therefore they cannot participate in annual general meeting of the company (AGM).

Ordinary Shares

- Ordinary shareholders are the actual owners of the company as they bear maximum risk and are also entitled for maximum reward.
- Ordinary shareholders receive dividends as deemed fit by directors.
- Ordinary shareholders have voting rights therefore they can participate and vote in the annual general meeting of the company.

Types of preference shares

1. Cumulative Preference Shares: Where the right of dividend is carried forward to following year in case the company is unable to declare or pay dividend.
2. Redeemable Preference Shares: The preference shares which can be redeemed, repurchased or bought back by the company at a future later date.
Note: Redeemable preference shares is part of non current liability rather than equity.
3. Participant Preference Shares: The preference shares which apart from their fixed rate of dividend also participates in extra profit sharing.

Memorandum of Association

1. Name Clause → Paperwala limited
2. Registered Office Clause → Harbour Front Clifton
3. Objective Clause → Construction Company
4. Liability Clause → Shareholders have Limited Liability
5. Capital Clause → Registered Capital - \$1,000,000

Authorised Share Capital

It is the maximum amount of share capital which a company is allowed to issue. This maximum limit is mentioned in company's memorandum of association. This is also called registered capital/nominal capital.

Issued Share Capital

Out of the total authorised share capital the amount of share capital currently issued by the company or currently subscribed by the shareholders.

- Note:
1. Issued share capital can be lower than or equal to authorised capital, it can never be higher than authorised capital.
 2. Dividends are always paid on issued share capital.

Par value/Face Value/Nominal Value/Registered Value:

Registered Capital : \$1,000,000

E.g.: $\frac{\$1,000,000}{\$1000} = 1000$ shares

$\frac{\$1,000,000}{\$500} = 2000$ shares

$\frac{\$1,000,000}{\$2} = 500,000$ shares

$\frac{\$1,000,000}{\$0.5} = 2,000,000$ shares

Face / Par Value

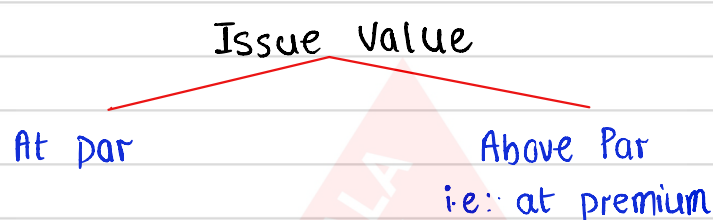
The value at which the registered or authorised capital is spread into smaller fraction of capital is called the par or face value of shares.

Market Value:

The value at which the share is trading in the stock market is called the market value of shares.

Issue Value:

The value at which the shares are issued to shareholders.



Share Premium:

Whenever a company issues its share capital over and above the par value the extra amount it receives is called share premium.

It is a reserve of a company and also part of company's equity.

Equity = Issue Share Capital + Reserves

Assets (-) Liabilities = Issue Share Capital + Reserves

P.S.C O.S.C

Note: Ordinary share capital is always credited with par value.
 • Bank is always debited with issue value

	dr	cr
bank [shares x issue value] ↑	x	
Ordinary share capital [shares x par value] ↑		x
Share premium [shares x premium] ↑		x

Example 1

1. A company issued 90000 shares of £ each at par.

	dr	cr
bank ↑ [90000 shares x £1]	90000	
Ordinary share capital [90000 shares x £1]		90000

2. A company issued 80000 shares of \$1 each at \$1.5 per share.

	dr	cr
bank ↑ [80000 shares x \$1.5]	120000	
Ordinary share capital [80000 shares x \$1]		80000
Share premium [80000 shares x \$0.5]		40000

3. A company issued 150000 shares of \$0.25 each at \$1 per share.

	dr	cr
bank [150000 x \$1] ↑	150000	
Ordinary share capital [150000 x \$0.25] ↑		37500
Share premium [150000 x 0.25] ↑		112500

4. A company issued 45000 shares of \$0.5 each at a premium of \$2.5 per share

	dr	cr
bank [45000 x \$3] ↑	135000	
Ordinary share capital [45000 x \$0.5] ↑		22500
Share premium [45000 x 2.5] ↑		112500

Dividends : • Distribution/Appropriation of profit.

- Rewards to shareholders against their investment in company.
- Preference shares → Fixed rate of dividend
- Ordinary shares → As seems fit by directors

Final/Proposed Dividend :

Dividends declared after the financial year end paid in the following year.

Proposed dividends are not adjusted in the current set of financial statements rather they are adjusted in the next set of financial statements.

Example : Proposed dividends of year 2021 will not be adjusted in 2021 financial statement rather they will be adjusted in 2022 financial statements.

Interim Dividend :

Any dividend declared and paid during the year is called interim dividend

Note : Dividends which should be adjusted in current year's financial statement should be dividends paid which are 'interim dividend of current year and final/proposed dividend of previous year'

- Per share : Directors declared dividend of 5 cents per share → number of shares
- % : Directors declared dividend of 5% → on value of shares

2021

- interim - 2021
- final - 2020

Share Premium::

Whenever a company issues its share capital over and above the par value, the extra amount it receives is called share premium.

It is part of company's capital reserve.

Company's Act of 1985 UK imposes strict regulation on use of share premium account and can only be legally used for following purposes:

1. To issue bonus shares (shares issued to existing shareholders without cash consideration).
2. To write off preliminary expenses (expenses incurred on formation of a company).
3. To write off discounts and costs of issuing shares.

RESERVES

distributable
as dividend

← Revenue Reserve

• All those reserves which arise from trading activities of the company are defined as revenue reserve.

• Examples include::

- General Reserve
- Specific Reserve
 - ~~inflation crises~~
 - ~~asset replacement~~
 - ~~dividend maintenance~~
- Retained Earnings

not distributable
as dividend

Capital Reserve →

• All those reserves which arise from non-trading activities of the company are defined as capital reserve.

• Examples include::

- Share Premium
- Revaluation Reserve
- ~~DRR (Debenture Redemption Reserve)~~
- ~~CR (Capital Redemption Reserve)~~

All reserves belong to ordinary shareholders and are part of Ordinary shareholders' Fund.

Ordinary Shareholders' Fund = Issued Ordinary Share Capital + Reserves.

Revenue Reserves are called distributable reserves because all revenue reserves can be used for distribution as dividend.

Capital Reserves are undistributable reserves because they arise from non trading activities of the company, therefore no capital can be used for distribution as dividend.

Capital Reserves can be used to finance bonus issue, if the company wants to use the reserves in the most flexible form, useful form, or to maximise dividends for Shareholders.

