

# BACHELOR of ECONOMICS



**Thammasat University  
Faculty of Economics  
Bachelor of Economics (International Program)**

## AC201 Fundamental Accounting

Semester 2/2013

### Course Materials

**Topic:**

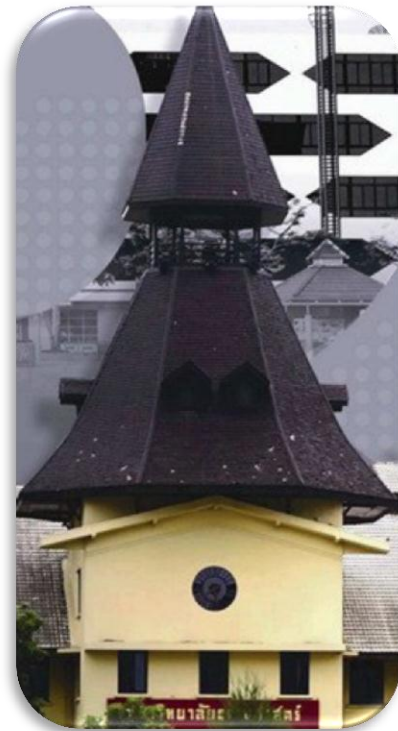
Chapter 11: Reporting and Interpreting  
Shareholders' Equity

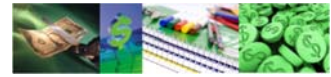
**Session:**

Session #10

**Instructor:**

Assistant Professor Dr. Orapan Yolrabil





## CHAPTER 11: REPORTING AND INTERPRETING SHAREHOLDERS' EQUITY

Assistant Professor Dr. Orapan Yolrabil  
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Thammasat Business School  
Thammasat University

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## Corporate Form of Organization

- ◆ **A Corporation is an entity created by law that is separate from its owners.**
  - ◆ Owners of corporations are called shareholders or shareholders.



### Advantages of Corporate Characteristics

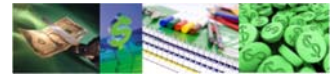
- Separate legal entity
- Limited liability of shareholders
- Transferable ownership rights
- Continuous life
- Lack of mutual agency for shareholders
- Ease of capital accumulation



### Disadvantages of Corporate Characteristics

- Government regulation
- Corporate taxation

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## Shareholders of Corporations

### ◆ Rights of shareholders:

- ◆ Vote at the shareholders' meetings.
- ◆ Sell or otherwise dispose of their share.
- ◆ Purchase their proportionate of any ordinary share later issued by the corporation. This preemptive right protects shareholders' proportionate interest in the corporation.
- ◆ Receive dividends.
- ◆ Share in any asset remaining after creditors are paid when the corporation is liquidated.



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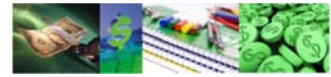


## Basics of Capital share

### ◆ Number of shares:

- ◆ Authorized shares – Total amount of share that a corporation is authorized to issue.
  - ◆ Authorized shares are the maximum number of shares that a corporation is allowed to issue.
- ◆ Issued shares – Shares that are sold to shareholders.
  - ◆ Issued shares are those that a corporation sells or otherwise transfers to shareholders. Unissued shares have no right or privileges until they are issued.
- ◆ Outstanding shares – Corporation's share held by its shareholders.
  - ◆ Outstanding shares are shares that a corporation has issued and that are still in circulation.
- ◆ Treasury shares – Corporation's own share that it reacquired and still holds.
  - ◆ Treasury share is not outstanding because it consist of shares that a corporation has issued but that it has bought back and there by put out of circulation.

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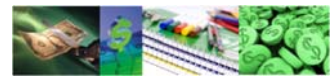
## Basics of Capital share

### Classes of share:

- Preferred share– share with a priority status over ordinary shareholders.
  - Preferred share gives its owners preference over ordinary shareholders, usually in terms of receiving dividends and in terms of claims to assets if the corporation is liquidated.
- Ordinary share– Corporation’s basic ownership share.
  - Ordinary share is also called residual equity, which means that if the corporation is liquidated, the claims of all creditors and usually those of preferred shareholders rank ahead of the claims of ordinary shareholders

### Par Value of share:

- Par value is an amount assigned per share by the corporation when the share is authorized.



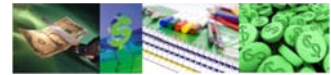
## Basics of Share Capital

### Shareholders’ Equity:

- Shareholders’ equity consists of (1) paid-in (or contributed capital) and (2) retained earnings.
  - Paid-in capital is the total amount of cash and other assets the corporation receives from its shareholders in exchange for share.
  - Retained earnings is the cumulative profit and loss retained by a corporation.

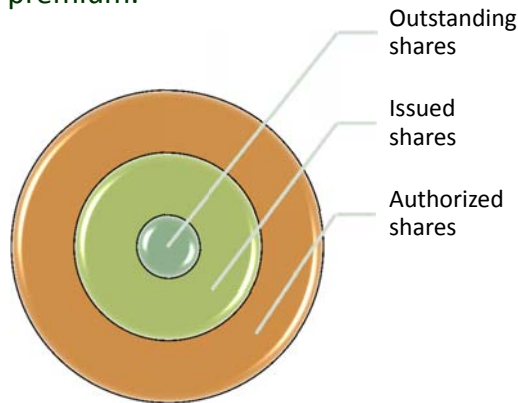
Note:  
Paid-in capital comes from share-related transactions, whereas retained earnings comes from operations.

Paid-in Capital	
Ordinary share	<i>Normal Balance</i>
Share premium	<i>Normal Balance</i>
Retained Earnings	
	<i>Normal Balance</i>



## Issuance of share

- When a corporation issues par value share, the appropriate share capital account (usually ordinary share or preferred share) is credited for the par value regardless of whether the proceeds are more or less than the par value.
  - When a corporation issues share at a price greater than par value, as is usually the case, the proceeds in excess of par are credited to an account called share premium.



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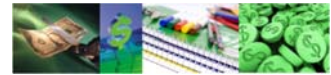


## Ordinary Share

### Share Issuance:

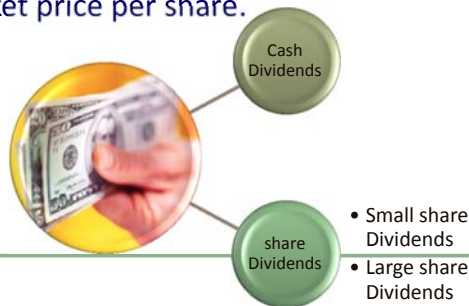
Case #1	Dr. Cash [A+]	300,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
Issued 30,000 shares of 10 Baht par value ordinary share at par			
Case #2	Dr. Cash [A+]	360,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
	Share premium [E+]		60,000
Issued 30,000 shares of 10 Baht par value ordinary share at 12 Baht per share			
Case #3	Dr. Cash [A+]	240,000	
	Share discount [E-]	60,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
Issued 30,000 shares of 10 Baht par value ordinary share at 8 Baht per share			

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## Dividend Policies

- ◆ **A dividend is a distribution among shareholders of the assets that a corporation's earnings have generated.**
  - ◆ Shareholders receive these assets, usually cash, in proportion to the number of shares they own.
    - ◆ The corporation's board of directors has sole authority to declare dividends.
- ◆ **Evaluating dividend policies:**
  - ◆ To evaluate the amount of dividends they receive, investors use the dividend yield ratio.
    - ◆ Dividend yield is computed by dividing the dividends per share by the market price per share.



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## Cash Dividends

- ◆ **Dividend payment involves three important dates:**
  - ◆ Declaration date – Date the board of directors vote to declare and pay a dividend.

Date of declaration	Dr. Cash dividend [E-]	30,000	
	Cr. Dividend payable [L+]		30,000
Declared 1 Baht per ordinary share cash dividend			

- ◆ Date of record – Future date specified by the directors for identifying those shareholders listed in the corporation's records to receive dividends – NO ENTRY
- ◆ Date of payment – Date when the corporation makes payment.

Date of payment	Dr. Dividend payable [L-]	30,000	
	Cr. Cash [A-]		30,000
Paid cash dividend on ordinary shares			

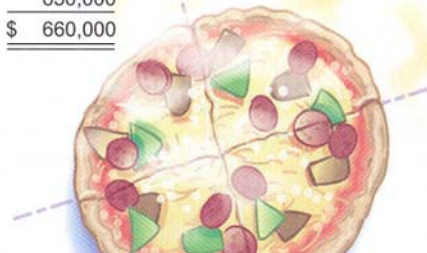
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## Stock Split and Stock Reverse

- ◆ **A stock split is the distribution of additional shares to shareholders according to their percent ownership.**
  - ◆ Stock split reduces par value, but increases number of shares.
- ◆ **A stock reverse is the opposite of a share split.**
  - ◆ It increases both the price per share and the par value per share, but reduces number of shares.

Stockholders' Equity	Before a 2-for-1 Stock Split	After a 2-for-1 Stock Split
Number of shares outstanding	1,000,000	2,000,000
Par value per share	\$ 0.01	\$ 0.005
Total par value outstanding	\$ 10,000	\$ 10,000
Retained earnings	650,000	650,000
Total stockholders' equity	\$ 660,000	\$ 660,000



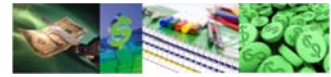
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## Preferred Share

- ◆ **Share Issuance:**
  - ◆ The preferred share issuance is recorded in a similar fashion as ordinary share issuance.
    - ◆ Preferred share differs from ordinary share based on a number of rights granted to the shareholders. The most significant differences are:
      - ◆ Preferred share does not grant voting rights.
        - » The main reason for preferred share issuance is to raise capital. Preferred share permits the company to raise funds without diluting ordinary shareholders' control.
      - ◆ Lower risk for preferred share.
        - » Generally, preferred share is less risky than ordinary share because holders receive priority payment of dividends and distribution of assets if the corporation goes out of business. Usually a specified amount per share must be paid to preferred shareholders upon dissolution, before any remaining assets can be distributed to the ordinary share.
      - ◆ Preferred share typically has a fixed dividend rate.
        - » The fixed dividend is attractive to certain investors who want a stable income from their investments.

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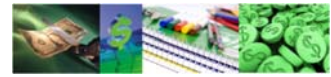
## Dividends on Preferred Share

### ◆ Dividend preference of preferred share:

#### ◆ Cumulative VS Noncumulative Dividend

- ◆ **Cumulative preferred share** has a right to be paid both the current and all prior periods' unpaid dividends (dividend in arrears) before any dividend is paid to ordinary shareholders.
  - ◆ If the share is cumulative preferred share, the dividend amount per share accumulates from year to year, and the company must pay the whole amount before it pays any dividends on ordinary share.
- ◆ **Noncumulative preferred share** confers no right to prior periods' unpaid dividends if they were not declared in those prior periods.
  - ◆ If the share is noncumulative preferred share and the board of directors fails to declare a dividend on it in any given year, the company is under no obligation to make up the missed dividend in future years.

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## Dividends on Preferred Share (Cont.)

### ◆ Cash dividend on preferred share:

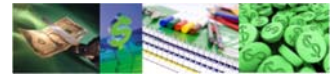
- ◆ Dividend per year = Dividend rate x Par value x Number of shares outstanding

	Dividend Declared	Cumulative Preferred Share	Ordinary Share
		<i>(6% x 100 Baht par x 2,000 shares outstanding)</i>	
Year 1	12,000	12,000	0
Year 2	0	0	0
Year 3	40,000	24,000	16,000

	Dividend Declared	Noncumulative Preferred Share	Ordinary Share
		<i>(6% x 100 Baht par x 2,000 shares outstanding)</i>	
Year 1	12,000	12,000	0
Year 2	0	0	0
Year 3	40,000	12,000	28,000

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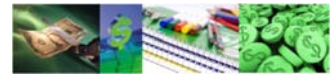
## Example on dividend distribution

- ◆ **Company A has the following shares outstanding:**
  - ◆ Cumulative Preferred Shares: 5%, 100 Baht par, 2,000 shares outstanding
  - ◆ Noncumulative Preferred Shares: 6%, 100 Baht par, 5,000 shares outstanding
  - ◆ Ordinary Shares: 10 Baht par, 10,000 shares outstanding
- ◆ **The company declared the following amount of dividend in Year 20X1-20X3**
  - ◆ Year 20X1 – 8,000 Baht
  - ◆ Year 20X2 – 30,000 Baht
  - ◆ Year 20X3 – 100,000 Baht

Priority in Dividend Distribution:

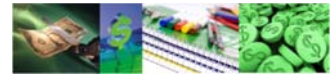
1. Dividend in arrears → Cumulative PS
2. Current year dividend → Cumulative PS
3. Current year dividend → Noncumulative PS
4. Remaining amount → Ordinary share

	Cumulative PS	Noncumulative PS	Ordinary share
Year 20X1			
Year 20X2			
Year 20X3			



## Treasury Share

- ◆ **Treasury share:**
  - ◆ A corporation's reacquired shares are called treasury share.
    - ◆ It is, in fact, shares of its own that the corporation has bought back on the open market. The cost of these shares is treated not as an investment, but as a reduction in shareholders' equity. By buying back the shares, the corporation reduces the ownership of the business.
  - ◆ Among the reasons a company may want to buy back its own share are the following:
    - ◆ It may want share to distribute to employees through share option plans.
    - ◆ It may be trying to maintain a favorable market for its share.
    - ◆ It may want to increase its earnings per share or share price per share.
    - ◆ It may want to have additional shares of share available for purchasing other companies.
    - ◆ It may want to prevent a hostile takeover.



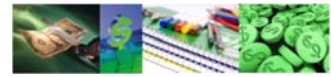
## Purchasing Treasury Share

### Purchasing Treasury Share

- Purchasing treasury share reduces the corporation's assets and equity by equal amounts. The treasury share will be recorded at cost.

Dr. Treasury share [E-]	11,500	
Cr. Cash [A-]		11,500
Purchased 1,000 treasury shares at 11.50 Baht per share		

- The shareholders' equity section of the Company's balance sheet shows the cost of the treasury share as a deduction from the total contributed capital and retained earnings.
  - Note that the number of shares issued has not changed. However, the number of shares outstanding has decreased as a result of the transaction.

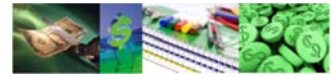


## Reissuing Treasury Share

### Sale of treasury share:

- Treasury shares can be sold at cost, above cost, or below cost.
  - When treasury shares are sold for an amount greater than their cost, the excess of the sales price over cost should be credited to paid-in capital, treasury share. No gain should be recorded.
  - When treasury shares are sold below their cost, the difference is deducted from paid-in capital, treasury share. If this account does not exist or if its balance is insufficient to cover the excess of cost over the reissue price, retained earnings absorbs the excess. No loss is recorded.

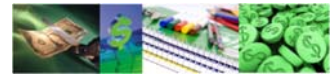




## Reissuing Treasury share (Cont.)

◆ **Reissuing Treasury share:**

<b>Reissue @ cost</b>	Dr. Cash [A+]	1,150	
	Cr. Treasury share [E+]		1,150
Received 11.50 Baht per share for 100 treasury shares costing 11.50 Baht			
<b>Reissue above cost</b>	Dr. Cash [A+]	4,800	
	Cr. Treasury share [E+]		4,600
	Paid-in capital -- Treasury stock [E+]		200
Received 12 Baht per share for 400 treasury shares costing 11.50 Baht			
<b>Reissue below cost</b>	Dr. Cash [A+]	5,000	
	Paid-in capital -- Treasury share [E-]	200	
	Retained earnings [E-]	550	
	Cr. Treasury share [E+]		5,750
Received 10 Baht per share for 500 treasury shares costing 11.50 Baht			



## Example on Treasury Share

- ◆ **1. Company A acquired the treasury shares on Jan. 1, 20X1 at 50 baht per share for 10,000 shares.**
- ◆ **2. On Jun. 1, 20X2, the company reissued 2,000 shares for 45 baht price.**
- ◆ **3. On Dec. 15, 20X2, the company reissued 5,000 shares for 52 baht price.**

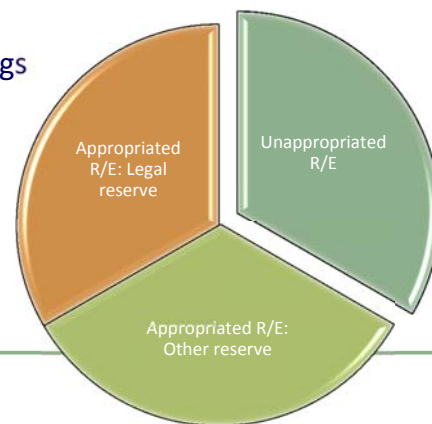
Date	General Journal	Debit	Credit
Jan. 1, 20X1	Dr. Treasury share	500,000	
	Cr. Cash		500,000
Jun. 1, 20X2	Dr. Cash	90,000	
	Retained earnings	10,000	
	Cr. Treasury share		100,000
Dec. 15, 20X2	Dr. Cash	260,000	
	Cr. Treasury share		250,000
	Paid-in capital – Treasury share		10,000



## Retained Earnings

### Retained earnings:

- The earnings of the corporation since its inception, less any losses, dividends, or transfers to contributed capital. Retained earnings are reinvested in the business. They are not a pool of funds to be distributed to the shareholders; instead, they represent the shareholders' claim to assets resulting from profitable operations.
  - Appropriated (or Restricted) retained earnings
    - Legal reserve
    - Other reserve
  - Unappropriated retained earnings



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## Financial Ratios: Equity Financing

### Earnings per share

$$\text{Earnings per share} = \frac{\text{Net income} - \text{Preferred dividend}}{\text{Weighted average common shares outstanding}}$$

### Price-earnings ratio

$$\text{Price-earnings ratio} = \frac{\text{Price per share}}{\text{Earnings per share}}$$

### Dividend yield

$$\text{Dividend yield} = \frac{\text{Cash dividend per share}}{\text{Price per share}}$$

### Book value per share

$$\text{Book value per share} = \frac{\text{Stockholders' equity}}{\text{Weighted average number of shares outstanding}}$$

### Return on equity

$$\text{Return on Equity} = \frac{\text{Net income}}{\text{Average Stockholders' Equity}}$$

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# STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

## Example of Financial Statement Presentation & Disclosure: Share Capital

[Source: www.farmhouse.co.th]

President Bakery Public Company Limited  
For the years ended 31 December 2010 and 2009

(Unit : Baht)

	Note	Separate financial statements				Total
		Issued and paid-up share capital	Share premium	Retained earnings		
				Appropriated - statutory reserve	Unappropriated	
<b>Balance as at 31 December 2008</b>		450,000,000	674,379,513	45,000,000	931,097,004	2,100,476,517
Net income for the year		-	-	-	507,727,852	507,727,852
Dividend payments	21	-	-	-	(241,650,000)	(241,650,000)
<b>Balance as at 31 December 2009</b>		450,000,000	674,379,513	45,000,000	1,197,174,856	2,366,554,369
<b>Balance as at 31 December 2009</b>		450,000,000	674,379,513	45,000,000	1,197,174,856	2,366,554,369
Net income for the year		-	-	-	616,116,538	616,116,538
Dividend payments	21	-	-	-	(273,150,000)	(273,150,000)
<b>Balance as at 31 December 2010</b>		450,000,000	674,379,513	45,000,000	1,540,141,394	2,709,520,907

A **statement of changes in shareholders' equity** lists the beginning and ending balances of each equity account and describes the changes that occur during the period.

# BALANCE SHEETS (CONTINUED)

President Bakery Public Company Limited  
As at 31 December 2010 and 2009

(Unit : Baht)

	Note	Financial statements in which the equity method is applied		Separate financial statements	
		2010	2009	2010	2009
<b>Shareholders' equity</b>					
Share capital					
Registered, issued and fully paid-up					
45,000,000 ordinary shares of Baht 10 each		450,000,000	450,000,000	450,000,000	450,000,000
Share premium		674,379,513	674,379,513	674,379,513	674,379,513
Retained earnings					
Appropriated - statutory reserve	18	45,000,000	45,000,000	45,000,000	45,000,000
Unappropriated		1,542,733,677	1,199,078,351	1,540,141,394	1,197,174,856
<b>Total shareholders' equity</b>		2,712,113,190	2,368,457,864	2,709,520,907	2,366,554,369
<b>Total liabilities and shareholders' equity</b>		3,765,063,406	3,157,284,049	3,762,471,123	3,155,380,554

## 18. STATUTORY RESERVE

Pursuant to Section 116 of the Public Limited Companies Act B.E. 2535, the Company is required to set aside to a statutory reserve at least 5 percent of its net income after deducting accumulated deficit brought forward (if any), until the reserve reaches 10 percent of the registered capital. The statutory reserve is not available for dividend distribution.

## 20. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net income for the year by the weighted average number of ordinary shares in issue during the year.

## 27. CAPITAL MANAGEMENT

The primary objective of the Company's capital management is to ensure that it has an appropriate financing structure and preserves the ability to continue its business as a going concern.

According to the balance sheet as at 31 December 2010, the Company's debt-to-equity ratio was 0.4:1 (2009: 0.3:1).

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## 21. DIVIDEND PAYMENTS

During the years ended 31 December 2010 and 2009, the Company had dividend payments as follows:

	Approved by	Total dividends (Thousand Baht)	Dividend per share (Baht)	Paid on
<b>For the year 2010</b>				
Final dividend on 2009 income	Annual General Meeting of the shareholders on 26 April 2010	141,750	3.15	25 May 2010
Interim dividend on income for the six-month period ended 30 June 2010	The meeting of the Company's Board of Directors No. 8/2010 on 25 August 2010	131,400	2.92	24 September 2010
Total dividend payments for 2010		273,150		
<b>For the year 2009</b>				
Final dividend on 2008 income	Annual General Meeting of the shareholders on 24 April 2009	129,150	2.87	22 May 2009
Interim dividend on income for the six-month period ended 30 June 2009	The meeting of the Company's Board of Directors No. 9/2009 on 16 September 2009	112,500	2.50	15 October 2009
Total dividend payments for 2009		241,650		

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