

BACHELOR of ECONOMICS



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

AC201 Fundamental Accounting

Semester 1/2012

Course Materials

Topic:

Chapters 11 Reporting and Interpreting
Owner's Equity

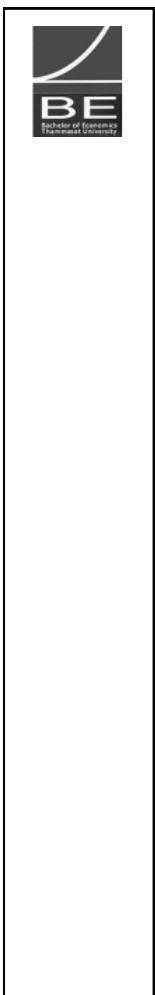
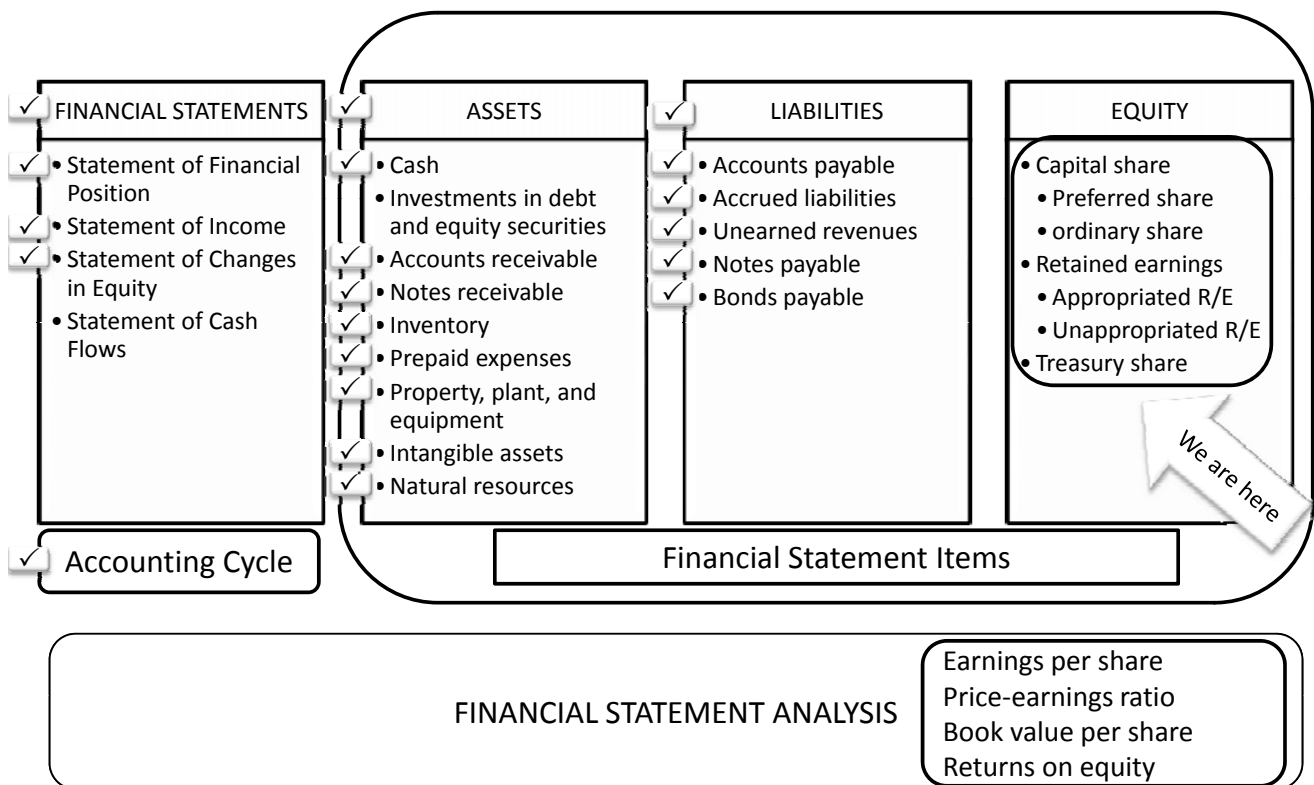
Session:

Sessions #11 & 12

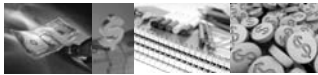
Instructor:

Assistant Professor Dr. Orapan Yolrabil





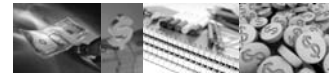
AC201 Fundamental Accounting



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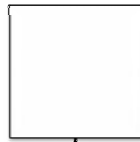
**CHAPTER 11:
REPORTING AND INTERPRETING
OWNERS' EQUITY**

**Assistant Professor Dr. Orapan Yolrabil
Department of Accounting
Thammasat Business School
Thammasat University**



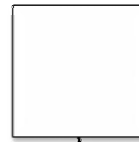
Corporate Form of Organization

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



Advantages of Corporate Characteristics

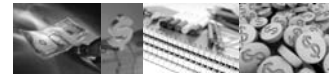
- Separate legal entity
- Limited liability of shareholders
- Transferable ownership rights
- Continuous life
- Lack of mutual agency for shareholders
- Ease of capital accumulation



Disadvantages of Corporate Characteristics

- Government regulation
- Corporate taxation

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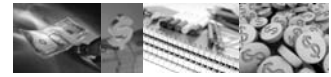


Shareholders of Corporations

- **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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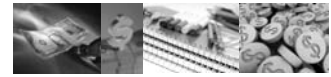


Basics of Capital share

• 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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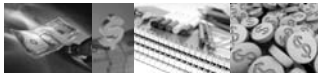


Basics of Capital share

• 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.

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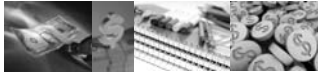
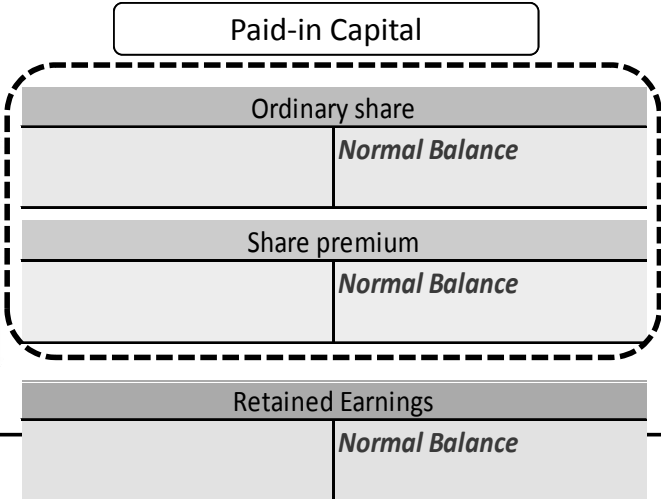


Basics of Share Capital

Shareholders' Equity:

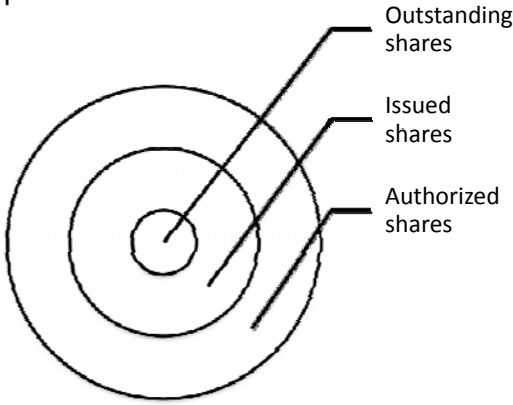
- Shareholders' equity consists of (1) paid-in (or contributed capital) and (2) retained earnings.
 - Paid-in capital is the total amount of cash and other assets the corporation receives from its shareholders in exchange for share.
 - Retained earnings is the cumulative profit and loss retained by a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

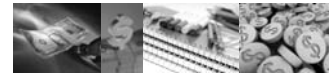
Note:
Paid-in capital comes from share-related transactions, whereas retained earnings comes from operations.



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.

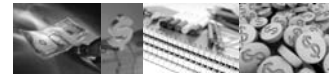




Ordinary Share

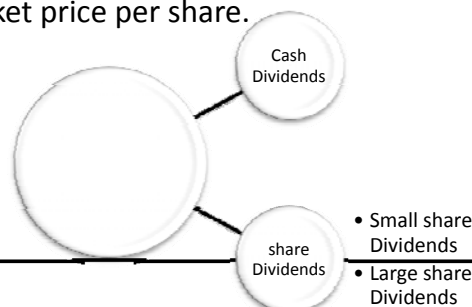
Share Issuance:

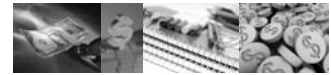
Case #1	Dr. Cash [A+]	300,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
Issued 30,000 shares of 10 Baht par value ordinary share at par			
Case #2	Dr. Cash [A+]	360,000	
	Cr. Ordinary share, 10 Baht par [E+]		300,000
	Share premium [E+]		60,000
Issued 30,000 shares of 10 Baht par value ordinary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



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.





Cash Dividends

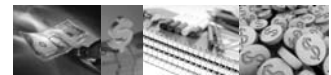
• **Dividend payment involves three important dates:**

- 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.

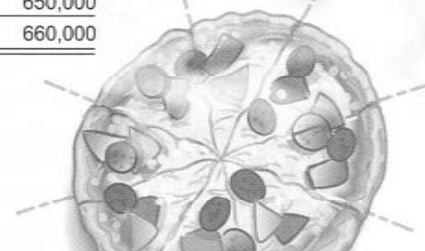
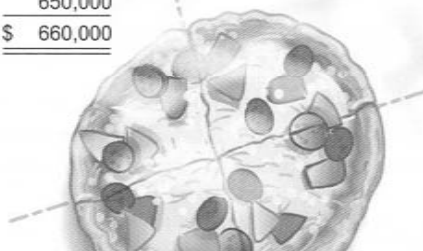
Date of payment	Dr. Dividend payable [L-]	30,000	
	Cr. Cash [A-]		30,000
Paid cash dividend on ordinary shares			

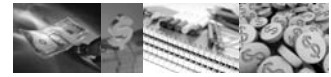


Stock Split and Stock Reverse

- **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	<u>\$ 660,000</u>	<u>\$ 660,000</u>



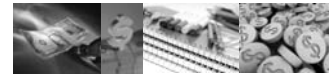


Preferred Share

• 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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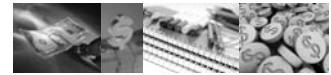


Dividends on Preferred Share

• 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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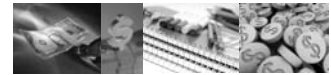
Dividends on Preferred Share (Cont.)

- **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

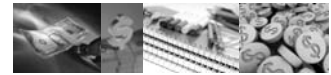
	Dividend Declared	Noncumulative Preferred Share	Ordinary Share
		<i>(6% x 100 Baht par x 2,000 shares outstanding)</i>	
Year 1	12,000	12,000	0
Year 2	0	0	0
Year 3	40,000	12,000	28,000



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.



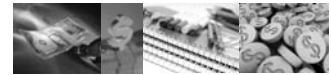
Purchasing Treasury Share

• 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.

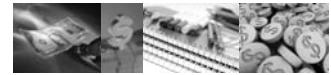


Reissuing Treasury Share

• 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.

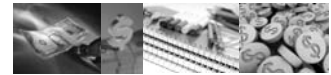




Reissuing Treasury share (Cont.)

Reissuing Treasury share:

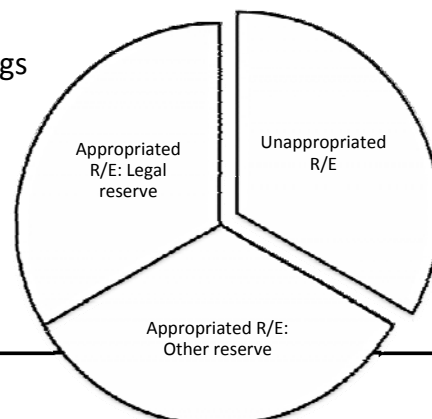
Reissue @ cost	Dr. Cash [A+]	1,150	
	Cr. Treasury share [E+]		1,150
Received 11.50 Baht per share for 100 treasury shares costing 11.50 Baht			
Reissue above cost	Dr. Cash [A+]	4,800	
	Cr. Treasury share [E+]		4,600
	Paid-in capital -- Treasury stock [E+]		200
Received 12 Baht per share for 400 treasury shares costing 11.50 Baht			
Reissue below cost	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			

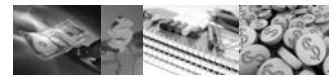


Retained Earnings

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





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	
Balance as at 31 December 2008		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)
Balance as at 31 December 2009		450,000,000	674,379,513	45,000,000	1,197,174,856	2,366,554,369
Balance as at 31 December 2009		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)
Balance as at 31 December 2010		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
Shareholders' equity					
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
Total shareholders' equity		2,712,113,190	2,368,457,864	2,709,520,907	2,366,554,369
Total liabilities and shareholders' equity		3,765,063,406	3,157,284,049	3,762,471,123	3,155,380,554

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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).

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
For the year 2010				
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		
For the year 2009				
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		

What's in a Name?



INTERNATIONAL PERSPECTIVE

It is often confusing when different words are used to describe exactly the same thing. Such is the case with International Financial Accounting Standards (IFRS) and U.S. GAAP. The following table serves as a translation guide. Remember the actual elements are exactly the same. It is only their names that differ:

GAAP		IFRS
Capital stock	=	Issued capital or share capital
Paid-in capital	=	Share premium
Treasury stock	=	Treasury shares
Preferred stock	=	Preference shares



CHAPTER 11 - EXERCISE

11-1 COMPUTING THE NUMBER OF UNISSUED SHARES

The balance sheet for Ronlad Corporation reported 177,000 shares outstanding, 283,000 shares authorized, and 25,000 shares in treasury stock. Compute the maximum number of new shares that the company could issue.

Maximum number of new shares = _____ shares

11-2 AUTHORIZED, ISSUED, AND OUTSTANDING SHARES

The charter of Vista West Corporation specifies that it may issue 207,000 shares of common stock. Since the company was incorporated, it has sold a total of 146,000 shares to the public but bought back a total of 17,000. The par value of the stock is \$4 and the stock was sold at an average price of \$13. When the stock was bought back from the public, the market price was \$27.

Authorized shares = _____ shares

Issued shares = _____ shares

Outstanding shares = _____ shares

11-7 PREFERRED STOCKS AND COMMON STOCKS

The records of Hollywood Company reflected the following balances in the stockholders' equity accounts at December 31, 2010:

- Common stock, par \$11 per share, 31,000 shares outstanding
- Preferred stock, 12 percent, par \$9 per share, 7,000 shares outstanding
- Retained earnings, \$227,000

On September 1, 2011, the board of directors was considering the distribution of a \$76,000 cash dividend. No dividends were paid during the previous two years.

Determine the total and per share amounts of dividend that would be paid to the common stockholders and to the preferred stockholders under the two independent assumptions:

- a. The preferred stock is noncumulative.

	Common Stock 31,000 shares	12% Preferred Stock 7,000 shares	Total
Total	_____	_____	_____
Per share	_____	_____	
	=====	=====	

- b. The preferred stock is cumulative.

	Common Stock 31,000 shares	12% Preferred Stock 7,000 shares	Total
Total	_____	_____	_____
Per share	_____	_____	
	=====	=====	