

## Equity Financing

### Comparison between debt financing and equity financing:

	Debt financing	Equity financing
Classification	Liability	Equity
Sources of funds	Creditors	Owners
Cost of funds	Interest [EXP+, PL-, RE-, E-]	Dividend [DIV+, RE-, E-]
Tax benefits	Tax shield	No
Maturity dates	Yes	No
Dilutive effects	No	Yes
		[if shareholders do not exercise <u>preemptive rights.</u> ]

### Types of business organization:

	Sole proprietorship	Partnership	Corporation
Owner(s)	1 owner	2 or more partners	many shareholders
Business life	limited	limited	unlimited
Responsibility for business liability	unlimited liability	unlimited liability	limited liability
Risk burden	unlimited risk	unlimited risk	limited risk
Type		(1) General partnership	(1) Company Limited
		(2) Limited partnership	(2) Public Company Limited

**Share capital:**

**1. Number of shares**

Authorized   Registered shares	<b>1,000,000</b>	shares	<i>max no. of shares</i>
Issued shares	<b>700,000</b>	shares	<i>sold</i>
Unissued shares	<b>300,000</b>	shares	<i>unsold</i>
Treasury shares	<b>150,000</b>	shares	<i>buy back</i>
Outstanding shares	<b>550,000</b>	shares	<i>dividend payment</i>

**2. Types of shares**

	Preference shares   Preferred stock	Ordinary shares   Common stock
<b>Preference</b>	(1) Priority in dividend distribution	No preference
	(2) Priority in asset distribution in the case of liquidation	No preference
<b>Dividend rate</b>	Fixed rate	No fixed rate
	PS dividend per year = PS DIV RATE [10%] x PS PAR [₱100 per share] x No. of PS outstanding [2,000 shares] = ₱20,000 per year	OS dividend per year = Remaining amount
<b>Voting right</b>	Usually none	Yes
<b>Type</b>	(1) Cumulative PS  (2) Noncumulative PS	N/A
<b>Required</b>	optional	required -- A MUST

### 3. Journal entries

#### 3.1. Share issuance

Date	General Journal	Debit	Credit
CASE 1: At par	Dr. Cash (A+)	7,000,000	
	Cr. Ordinary shares, at par (E+)		7,000,000
	<i>Issued 700,000 shares with ₱10 par at a price of ₱10 per share</i>		
CASE 2: At premium	Dr. Cash (A+)	8,400,000	
	Cr. Ordinary shares, at par (E+)		7,000,000
	Share premium (Adjunct E+, E+)		1,400,000
	<i>Issued 700,000 shares with ₱10 par at a price of ₱12 per share</i>		
CASE 3: At discount <i>(It is allowed only for PCL.)</i>	Dr. Cash (A+)	5,600,000	
	Share discount (Contra E+, E-)	1,400,000	
	Cr. Ordinary shares, at par (E+)		7,000,000
	<i>Issued 700,000 shares with ₱10 par at a price of ₱8 per share</i>		

#### 3.2. Dividend distribution

Date	General Journal	Debit	Credit
Date of declaration	Dr. Dividend (E-)	700,000	
	Cr. Dividend payable (L+)		700,000
	<i>Declared ₱1 cash dividend to 700,000 ordinary shares outstanding.</i>		
Date of record	No entry		
	<i>Recorded the list of shareholders who are entitled to receive dividend.</i>		
Date of payment	Dr. Dividend payable (L-)	700,000	
	Cr. Cash (A-)		700,000
	<i>Paid cash dividend declared to the shareholders who are in the list at the date of record.</i>		

## Dividend allocation

### Example #1:

Company A has the following shares outstanding:

(1) 10%, \$100-par preferred shares. There are 2,000 shares outstanding.

---  $PS \text{ Div per year} = 10\% \text{ dividend rate} \times \$100 \text{ par} \times 2,000 \text{ shares} = \$20,000$

(2) \$10-par ordinary shares. There are 10,000 shares outstanding.

### CASE 1: Cumulative preferred shares

Year	Dividend declared	Cumulative preferred shares	Ordinary shares
20X1	35,000	20,000	15,000
20X2	8,000	8,000	-
20X3	50,000	32,000	18,000
		Dividend in arrears 12,000	

### CASE 2: Noncumulative preferred shares

Year	Dividend declared	Noncumulative preferred shares	Ordinary shares
20X1	35,000	20,000	15,000
20X2	8,000	8,000	-
20X3	50,000	20,000	30,000

### Priority in dividend distribution

- (1) Dividend in arrears to **CUMULATIVE PREFERRED SHARES**.
- (2) Current year dividend to **CUMULATIVE PREFERRED SHARES**.
- (3) Current year dividend to **NONCUMULATIVE PREFERRED SHARES**.
- (4) Remaining amount of dividend to **ORDINARY SHARES**.

Example #2:

Company A has the following shares outstanding:

(1) 10%, \$100-par noncumulative preferred shares. There are 2,000 shares outstanding.

--- *NonPS Div per year = 10% x \$100 x 2,000 shares = \$20,000*

(2) 5%, \$50-par cumulative preferred shares. There are 10,000 shares outstanding.

--- *CumPS Div per year = 5% x \$50 x 10,000 shares = \$25,000*

(3) \$10-par ordinary shares. There are 10,000 shares outstanding.

Year	Dividend declared	Cumulative preferred shares	Non-cumulative preferred shares	Ordinary shares
20X1	30,000	25,000	5,000	-
20X2	10,000	10,000	-	-
20X3	85,000	40,000	20,000	25,000
<b>Dividend in arrears 15,000</b>				

**3.3. Treasury shares**

Date	General Journal	Debit	Credit
Date of reacquisition	Dr. Treasury shares (Contra E+, E-)	3,000,000	
	Cr. Cash (A-)		3,000,000
	<i>Reacquired 150,000 treasury shares at price of \$20 per share. ==&gt; Cost of treasury shares is \$20 per share</i>		
Date of reissuance #1	Dr. Cash (A+)	600,000	
	Cr. Treasury shares (Contra E-, E+)		600,000
	<i>Reissued 30,000 treasury shares at a price of \$20 per share.</i>		
Date of reissuance #2	Dr. Cash (A+)	1,320,000	
	Cr. Treasury shares (Contra E-, E+)		1,200,000
	Paid in capital -- Treasury shares (E+)		120,000
	<i>Reissued 60,000 treasury shares at a price of \$22 per share.</i>		
Date of reissuance #3	Dr. Cash (A+)	750,000	
	[1] Paid in capital -- Treasury shares (E-)	120,000	
	[2] Retained earnings (E-)	130,000	
	Cr. Treasury shares (Contra E-, E+)		1,000,000
	<i>Reissued 50,000 treasury shares at a price of \$15 per share.</i>		

## Retained earnings:

The retained earnings consist of 2 components:

1. **Appropriated** retained earnings -- legal reserve and others
2. **Unappropriated** retained earnings

	Year 20X1	Year 20X2	Year 20X3
Beginning balance of retained earnings	0	350,000	950,000
+ Profit for the period	500,000	800,000	1,200,000
- Dividend declared	(150,000)	(200,000)	(350,000)
= Ending balance of retained earnings	<b>350,000</b>	<b>950,000</b>	<b>1,800,000</b>

## Appropriated Retained Earnings -- Legal 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 profit 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.

Example:

Registered Capital  
Required legal reserve (10%)

฿ 1,000

฿ 100

Authorized shares 1,000 shares and  
the par value is ฿1 per share.

	Profit or loss	Legal reserve
Year 1	100	5
Year 2	200	10
Year 3	(300)	-
Year 4	400	5
Year 5	500	25
Year 6	600	30
Year 7	700	25
Year 8	800	-
Year 9	900	-
Year 10	1,000	-
<b>Total</b>		<b>100</b>

## Financial Statement Presentation:

### Information:

Company A issued 700,000 ordinary shares with a par value of ₪10 per share at a price of ₪12 per share on Jan. 1, 20X1.

Later, the Company reacquired 10,000 shares of treasury shares at a cost of ₪20 per share.

Note that this is the first year of operations and the company reported profit for the year of ₪800,000 and declared dividend ₪50,000.

Statement of Financial Position [PARTIAL]				
<b>Shareholders' equity</b>				
Share capital				
Ordinary shares	[700,000 x 10]	7,000,000		
Share premium - Ordinary shares	[700,000 x 2]	1,400,000		
Total				8,400,000
Retained earnings				
Appropriated retained earnings - Statutory reserve		40,000	If Company A is public company limited [800,000 x 5%]	
Unappropriated retained earnings		710,000	[0+800,000-40,000-50,000]	
Total				750,000
<u>Less:</u> Treasury shares			[10,000 x 20]	(200,000)
<b>Total shareholders' equity</b>				<b>8,950,000</b>

Statement of Changes in Equity						
	Share capital		Retained earnings		Treasury shares	Total
	Ordinary shares	Share premium	Appropriated -- Legal reserve	Un-appropriated		
<b>Beginning balance</b>	0	0	0	0	0	0
+ Share issuance	7,000,000	1,400,000				8,400,000
- Treasury shares reacquisition					(200,000)	(200,000)
+ Profit for the year				800,000		800,000
+ - Legal reserve appropriation			40,000	(40,000)		0
- Dividend declared				(50,000)		(50,000)
<b>Ending balance</b>	<b>7,000,000</b>	<b>1,400,000</b>	<b>40,000</b>	<b>710,000</b>	<b>(200,000)</b>	<b>8,950,000</b>