Shareholders' Equity Accounting

- **Characteristics of the corporate form of business**
  Ability to raise capital – through the sale of sales (advantage)
  Separate legal entity – only a small no. of publically traded on ASX
  Limited liability – No personal liability beyond their investment in shares.
  Dividend Imputation – when taxed on income, the tax paid is imputed to shareholders with dividends (cancels effect of double taxation).

- **Characteristics of equity & how it's recorded and reported**
  Contributed Capital = amount raised by issuing shares
  Shareholder rights = to vote, preemption (maintain share proportion)
  Issuing Shares = 100 shares for $5 per share

General journal

Date	Description	Debit	Credit
5 Apr.	Cash (cash trust)	500	
	Contributed capital (ordinary capital)		500

x

Instalment share issues = to receive capital over time (long term project)
On application people must pay a % of the share price
To increase the pool of shareholders affordably

1. Application - Dr trust account, Cr Application (you owe them money)
2. Allotment (become shareholders–turns application into share capital
   * Once the shares are allotted, the cash becomes the company's and the cash comes out of the trust (Dr Application, Dr allotment, Cr ordinary share capital)

General journal

Date	Description	Debit	Credit
10 Apr.	Application	200	
	Allotment	100	
	Ordinary share capital		300
	Cash	200	
	Cash trust		200

When the allotment money is received

General journal

Date	Description	Debit	Credit
15 Apr.	Cash	100	
	Allotment		100

3. Call (receivable - may require future payments as and when required)

When a call is made

General journal

Date	Description	Debit	Credit
20 Jun	Call	200	
	Share Capital		200
30 Jun	Cash at Bank	200	
	Call		200

- **Cash dividends, share dividends and share splits**
  Cash dividends reduce the cash available to pursue other strategies
  Date of declaration: returned profits become liabilities (owe shareholder)
  Dividends declared during the year reported on changes in equity FS
  Dividends paid during the year reported on cash flow statement.

Assume that a company with 1 000 000 shares declares a $0.05 per share dividend on 3 November. The dividend is payable on 30 November to shareholders of record on 21 November.

General Journal

Date	Description	Debit	Credit
3 Nov.	Retained earnings	50 000	
	Dividends payable		50 000
30 Nov.	Dividends payable	50 000	
	Cash		50 000

Note how the date of record (21 Nov) has no accounting effect…

Share dividends (stated in % terms)
No direct cash flow effect (there is still a tax effect)

Assume that Bethany Ltd declares a 15 per cent share dividend on 1 June to be distributed immediately. On 1 June, Bethany has 100 000 ordinary shares originally issued for $1 and the share is trading at $10 per share.

General journal

Date	Description	Debit	Credit
1 Jun.	Retained earnings	150 000	
	Ordinary shares		150 000

Share Splits (wants to decrease share market price-more affordable)
An increase in share according to some specified ratio
E.g. Offering 2 for 1 split doubles shares issues (price falls proportionally)

- **Characteristics of preference shares & preference dividends**
  Receives priorities over ordinary share (Dr cash, Cr Preference Shares)
  Relinquish the right to vote in exchange for preference to dividends and assets upon liquidation of the company

  Cumulative preference Shares – right to receive current year dividends and all unpaid dividends from prior years before paying ordinary shares

  Non-cumulative preferred shares – receive current year dividends only

  Recording dividend declared = preferred and ordinary shares payable

Stover, Ltd has the following types of share:
- Ordinary share, 100 000 shares
- 5%, $10 Cumulative Preference share, 20 000 shares

Stover does not pay dividends in 2011 or 2012 but declares $64 000 of dividends in 2013.

General journal

Date	Description	Debit	Credit
23 Aug.	Retained Profits	64,000	
	Ordinary Dividends Payable		34,000
	Preference Dividends Payable		30,000

- **Characteristics of share buybacks and how they're recorded**
  Way to reduce no. of shares (Dr ordinary share capital, Cr Cash)
  Tax effective way to return capital (makes company look smaller)
  They want to leverage up to increase liabilities and decrease equity to become more geared 'healthy level of debt'

Bajada Limited purchases 1 000 shares of its own ordinary share on 3 May when the share is trading for $32 per share. Bajada would record the buyback as follows:

General journal

Date	Description	Debit	Credit
3 May	Ordinary share capital	32 000	
	Cash		32 000

- **Evaluation of equity through horizontal, vertical & ratio analyses**

  → How does the company generate equity for shareholders?

  EPS = total income/no. of shares (depends on number on issue)

  ROE = income/average shareholder equity

  → How does the company reward its shareholders through dividends?

  Dividend Payout = Dividends/total income OR dividend per share/EPS
  Tells us what % of profits are paid out as dividends
  Higher is not better (if you're a growth firm, you wont pay any dividends)

  Dividend Yield = dividend per share/market price per share
  Likely to change overtime

  → How does the company's equity affect its cash flows?

  Discussion: Shareholders will always prefer a cash dividend to a share dividend.

  * Cash is given out instead of retained earnings
  * Cash dividends = profitable company
  * Share dividends = company is reinvesting their money
  * Cash dividends reduces agency problem