The Company as a form of business enterprise:
- Created by an association of persons with a common profit motive, called **promotors**.
- Collect its capital by selling shares to the public.
- The owners are called shareholders.
- Large amounts of capital may be raised.

Legal entity

In the eyes of the law, a company is regarded as a person. It can own assets, enter into contracts in its own name, institute legal proceedings in its own name, sue and be sued.

The company as a legal entity implies the following:

- The company has its own rights and responsibilities and operates independent from its shareholders.
- The company owns the assets in its own right. The shareholders have no claim on the assets of the company. Only on liquidation (cash flow problems), they might share in the assets.
- The income generated belongs to the company – companies pay income tax on their profits (Companies tax). Shareholders pay separate tax on the dividends they receive. This means that we work with so-called double taxation.
- The company is liable for all debts of the company.
- A company has limited liability, therefore the name will end with the abbreviation Ltd.

Independent contractual ability

The company can do business with other legal personalities, including business with its shareholders. There is complete segregation of management from ownership.

Advantages:
1. A **legal existence** separates from its management and shareholders – a company may incur debt and enter into legal agreements and assume legal rights and obligations.
2. **Limited liability** – The company is liable for its own debts, because the shareholders and the company are regarded as separate legal personalities. The shareholders will lose only the value of their shares.
3. **Continuity** – The company has its own rights and duties and an indefinite existence apart from the shareholders. The company's life continues even after the withdrawal or death of one of the shareholders.

Disadvantages:
1. Costly and complex to administer.
2. Regulated by complex Corporation laws and regulations – to protect the shareholders.
3. Statutory audit of Financial Statements are required.

Companies Act

A company may be registered with or without a company name. When a company is registered without a reserved name, its registration number automatically becomes the company name.

Companies must be registered at the **Companies and Intellectual Properties Commission (CIPC).** In the past this task was performed by the Registrar of Companies, which was appointed by the Minister of Finance (currently Tito Mboweni).

Name

The company has a unique name which must be registered with the CIPC.

Promoters

The initial group of people who decide to start the company.

The main **differences** between a public company and a private company:

Public company	Private company
One person may incorporate a public company.	One person may incorporate a private company.
The company name ends in "Limited" or "Ltd".	The company name ends in "Proprietary Limited" or "(Pty) Ltd".
The minimum number of directors is three.	The minimum number of directors is one.
The public is invited to buy shares.	The public is not invited to buy shares.
Shares can be transferred freely.	Shares can only be transferred after approval by the Board of Directors.
Public companies must appoint an auditor, audit committee and company secretary.	Private companies appoint an audit committee only to the extent provided for in the MOI.
All public companies must have audited financial statements that should be presented to shareholders at the AGM within six months after financial year-end.	Private companies only need to be audited if: - It has assets exceeding a value of R5 million. - Their public interest score exceeds 750 points. - The financial statements were internally compiled.
Public companies must appoint a Social and Ethics Committee.	Private companies only need to appoint a Social and Ethics Committee if their public interest score exceeds 750 points.
They raise capital by issuing shares to the public.	They raise capital by issuing shares to the owners.

In the school syllabus we only deal with the public company.

<u>Assets</u>
The company acquires assets under its own name and in its own right. The assets are the exclusive property of the company and do not belong to the shareholders.

<u>Profits and losses</u>
The profits and losses belong to the company. The shareholders are entitled to the dividends that the company declares.

<u>Company secretary</u>
Ensures the Board remains aware of its duties and responsibilities and attends all meetings to the Board and its sub-committees.

<u>Formation of a Company</u>

When registering and founding a company, the Companies Act stipulates the following:

- A **Memorandum of Incorporation (MOI)** must be drawn up and submitted at the CIPC.
- The Commission will approve the name of the company, enter the prescribed information in the Companies Register and endorse the Notice of Incorporation and the MOI.
- When the Commission allocates a **Registration number** to the company and then issues a **Certificate of Incorporation**, the company is in existence for the first time. The certificate signifies that the requirements in the Act have been met and that the company has been legally registered.
- The company may now invite the general public to purchase shares in the company by issuing a **Prospectus**. The first issue of shares to the public is better known as the **Initial Public Offering (IPO)**.
- Usually a merchant bank or stockbroker will manage the issue of shares to the public. After the allotment of the shares the **share certificates** will be issued to the shareholders.

SHAREHOLDERS

These are the people who buy shares and therefore are the “owners” of the company.

Shareholders have certain rights, but they **do not** have the right to **manage the company**.

1. They have the right to **attend the Annual General Meeting** (AGM).

2. They have the right to elect the **Board of Directors**,
   → who appoint the **Managing Director** (CEO).

3. They **approve the appointment of the external auditor**.
   The external auditor is paid by the company, but he reports to the shareholders on whether the financial statements give a true reflection of the books of the company and whether he has found any fraud or suspicious transactions.

4. They **approve the Annual Financial Statements** presented to them.
   They have the right to ask directors questions about the information given so that they are quite sure the company is being run for their benefit and that there is no collusion between the directors and the auditor to hide fraud.

5. They also **approve the final dividend** proposed by the directors.

Separation of ownership from control – To separate ownership from control means that one group of people (the directors) is responsible to manage the money contributed by another group of people (the shareholders).

DIRECTORS

As a company is a legal person (not a physical one), it has to have people (directors) to carry on business on the company’s behalf.

It may be a good idea to have a couple of directors who have special knowledge and experience in the particular industry or special legal knowledge which they can share with the company.

The duties of directors are laid down by the Companies Act. They are paid a fee, called Directors fee.

Directors of a company may be held **jointly and severally liable** for any loss, damage or costs sustained by the company.

The King III Reports defines directors as:

- **Executive directors** are involved in the day-to-day management of the company and/or full-time salaried employment of the company.

- **Non-executive directors** are independent of management on all issues including strategy, performance, transformation, and employment equity.

- **Independent directors** have not been employed by the company in any way during the previous three years and should be totally independent from any business relationship with the company.

The JSE (Johannesburg Stock Exchange) is the place where shareholders can buy and sell shares according to certain rules.

King III and the JSE recommended that the positions of **Chairperson** and **Chief Executive Officer (CEO)** of the company should be separated – to bring independence to board discussions

AUDITOR – EXTERNAL

The external auditor is appointed by the shareholders at the AGM, but his remuneration/fee is paid by the company. He has to be a qualified chartered accountant registered by SAICA.

The external auditor performs his duties annually by checking a sample of the year's work to ensure the books are written up in accordance with GAAP and IFRS. It is his duty to check the annual financial statements to ensure that they accurately present the state of affairs of the company, as he has to sign the Auditor's Report.

This report must be included with the financial statements stating his opinion on the accounting records.

An <u>unqualified report</u>, also known as a clean report, means that the external auditor finds the financial statements to be free from discrepancies and that it gives a true and fair view of the financial reporting framework used in preparing and presenting the financial statements.

The report will contain the following comment: "In our opinion, the financial statements fairly present, **in all material respects**, the financial position …"

A <u>qualified report</u> is issued when the external auditor encounters one or two situations that do not comply with the prescribed accounting standards. However, the rest of the financial statements are fairly presented.

If the external auditor found any suspicious activities or suspects there is fraud, he will "qualify" the report. This warns everybody interested in these statements that there is something wrong.

The report will contain the following comment: "In our opinion, the financial statements fairly present the financial position of the company …, **except for the effects of** …"

An <u>adverse audit report</u> is issued when the external auditor determines that the financial statements of the company being audited are materially misleading and when considered as a whole, do not conform to the prescribed accounting standards.

The report will contain the following comment: "In our opinion, **because of the significance of** …, the financial statements **DO NOT** fairly present, in all material respects, the financial position …"

SAICA – South African Institute of Chartered Accountants

In order to practice as a Chartered Accountant, one must be registered with SAICA. This body lay down the code of professional conduct expected from its members. Auditors agree to comply with a code of ethical practice and integrity. If the shareholders are not satisfied that the external auditor is carrying out his duties properly, they can report him to SAICA. It has procedures which it follows and, after investigation, it can discipline of deregister him.

IFRS – International Financing Report Standards

These are the standards laid down by an international body of chartered accountants. All financial statements must comply with these requirements and the auditor usually refers to this fact in his report. The advantage of IFRS is that shareholders can compare all financial statements, no matter in which country they were prepared.

AUDITOR – INTERNAL

He is employed by the business and does not need to be a registered accountant. His duties are decided on by management, and he reports to management. He continually tests the internal controls to ensure that they are working and recommends changes to improve the systems. He checks what the staff are doing to ensure that they are carrying out their duties properly. He checks **everything all the time** to ensure **all** information is reliable.

SHARES

A company needs funds to start and then run a business. They can get these funds in the following ways:

- Selling shares to the shareholders
- Generating profit (internal source)
- Borrowing through loans (external source)

Preference shareholders generally receive a fixed percentage dividend annually.

Ordinary shareholders are not guaranteed to receive dividends because ordinary dividends depend on the profitability of a company and its cash flow. Ordinary shares are therefore riskier from an investor's point of view.

In the school syllabus we only deal with ordinary shares.

ORDINARY SHARE CAPITAL

A public company obtains its capital by issuing a Prospectus which gives full details of the business to be carried on to enable the person reading it to decide whether to invest or not. In the prospectus is an application form which the person must fill in.

Authorised and issued share capital

The capital is divided into shares.

Authorised shares
The word authorize means *to give permission/to allow*. The MOI states the maximum number of shares the company is allowed to sell. When it starts, the company does not necessarily sell all the shares.

Issued shares
The total number of shares that have actually been sold to the public.

Unissued shares
The number of shares not yet sold.

Issue price
The price for which the shares are sold.

Ordinary share capital
The sum of all the shares sold at issue price.

Market price
The price of a share which is quoted on the stock exchange (JSE) – determined by the laws of supply and demand. Gives an indication of what the public is prepared to pay for the shares.

RETAINED INCOME / ACCUMULATED PROFITS

A company is a legal person and therefore owns its own profits. However, it usually distributes some of the after-tax profits to shareholders in the form of dividends, but not all. It will retain (keep/accumulate) some of the profit to strengthen the company for the future. This means the value of the company will increase.

THE 2 EQUITY ACCOUNTS IN A COMPANY:

- **Ordinary Share Capital** (B1)
- **Retained income** (B2)

3 VALUES OF A SHARE:

- **Market value** is the latest price quoted on the JSE. This is the price which someone could buy or sell the shares for.
- **Net asset value** is what the company is worth if it were to be liquidated (assets sold for cash and all liabilities paid off).
- **Issue value** is the price for which the shares are sold.

ISSUING SHARES: Bookkeeping

Shares are issued (sold) to shareholders at a specific price, normally the market price on the JSE at that stage.

Journal: CRJ
Account debit: Bank
Account credit: Ordinary Share Capital (B1)

There is a new note in the Balance Sheet, note 7, where you show all the transactions regarding shares.

Example 1

The current financial period is 1 March 2019 – 28 February 2020.

Danike Traders Ltd are authorized to issue 120 000 ordinary shares. The company issued 60 000 shares at R12,50 per share during the previous year on 31 March 2018.

1 May 2019
Danike Traders Ltd decides to issue a further 40 000 ordinary shares at R13 per share

- Ordinary Share Capital +

	2019			
	Mar 1	Balance	b/d	990 000
	May 1	Bank	CRJ	338 000
				1 328 000

Note 7 to the Balance Sheet of Danjo Traders Ltd on 28 February 2020

NOTE 7: ORDINARY SHARE CAPITAL

Authorised		
Number of ordinary authorized shares: 120 000 shares		
Issued		
60 000	ordinary shares in issue at 1 March 2019 / beginning of year	750 000
40 000	ordinary shares issued during the year at **R13** each	520 000
100 000	ordinary shares in issue at 28 February 2020 / end of year	**1 270 000**

The average price of the 100 000 shares issued is:
R1 270 000 / 100 000 = **R12,70**

→ *Later more about the average price (pg 32).*

INCOME TAX

The company is a legal entity. The net profit therefore belongs to the company and the company has to pay income tax to the South African Revenue Services (SARS). The income tax of a company is calculated at a certain percentage of its net profit.

The **tax return form** has to be completed in order to file income taxes with SARS every year.

The **tax assessment form** is a form that SARS sends to the company to state the amount of income tax that is due.

In terms of existing legislation, companies are obliged to pay **provisional tax** during the tax period. Provisional tax payments are payments made in advance, where the calculations are based on the tax figures of the previous year in the books of the company

- The **1st provisional payment** is due six months after the beginning of the financial year.
- The **2nd and final provisional payment** is made to SARS on the last day of the year.
- A **final tax payment** is due after the financial statements are prepared and audited, and the tax assessment was received from SARS – if any, the outstanding income tax need to be paid in the beginning of the next financial year.

After receiving the tax assessment form from SARS, the transaction for Income tax must be shown. Income tax is considered a year-end adjustment in the General Journal.

Income tax is <u>not treated as an expense</u>, but rather that an <u>appropriation of profits</u>.

<u>Example 2</u>

The financial year of Danike Traders Ltd ends on 28 February.

Transactions for the financial year 1 March 2018 to 28 February 2019.

On 1 March 2018, the balance of the SARS (Income tax) account was nil – meaning the company paid the entire tax assessment amount during the previous year.

Provisional payments for income tax made during the year ended 28 February 2019 were as follows:

- First provisional payment on 31 August 2018, R70 000
- Second provisional payment on 28 February 2019, R90 000

Danike Traders Ltd calculate the profit before tax for the year ended 28 February 2019 to be R550 000. Tax should be provided for at 30% on the profit before tax.

- SARS (Income tax) +

2018					2019				
Aug 31	Bank	CPJ	70 000		Feb 28	Income tax	GJ	165 000
2019								
Feb 28	Bank	CPJ	90 000					
	Balance	c/d	5 000					
			165 000					**165 000**
					Mar 1	Balance	b/d	5 000

+ Income tax -

2019				2019		
Feb 28	SARS (Income tax)	165 000		Feb 28	Appropriation account	165 000

Example 3

The financial year of Danike Traders Ltd ends on 28 February.

Transactions for the financial year 1 March 2019 to 28 February 2020.

On 1 March 2019, the balance of the SARS (Income tax) account was R5 000 credit – meaning the company pays SARS R5 000 less than the tax assessment of the previous year – the company owes SARS.

The following payments were made to SARS during the financial year:

- Paid the amount owing to SARS on 31 May 2019
- First provisional payment on 31 August 2019, R85 000
- Second provisional payment on 28 February 2020, R75 000

Danjo Traders Ltd calculate the profit before tax for the year ended 28 February 2019 to be R520 000. Tax should be provided for at 30% on the profit before tax.

+ SARS (Income tax) -

2019					2019			
May	31	Bank	CPJ	5 000	Mar 1	Balance	b/d	5 000
Aug	31	Bank	CPJ	85 000	2020			
2020					Feb 28	Income tax	GJ	156 000
Feb	28	Bank	CPJ	75 000		Balance	c/d	4 000
				160 000				**160 000**
Mar	1	Balance	b/d	4 000				

+ Income tax -

2020			2020		
Feb 28	SARS (Income tax)	156 000	Feb 28	Appropriation account	156 000

On 1 March 2020, the balance of the SARS (Income tax) account was R4 000 debit – meaning the company pays SARS R4 000 more than the tax assessment of the previous year – SARS owes the company money.

For the financial period 1 March 2019 to 28 February 2020:

	Debit	Credit
Paid the amount owing to SARS from the previous accounting period → CPJ → R5 000	SARS (Income tax) (B-account)	Bank
1st provisional tax payment half way through the year → **CPJ → R85 000**	SARS (Income tax) (B-account)	Bank
2nd provisional tax payment on the last day of the year → **CPJ → R75 000**	SARS (Income tax) (B-account)	Bank
Year-end adjustment for the tax liability for the year – **final tax assessment → GJ → R156 000**	Income tax (N-account)	SARS (Income tax) (B-account)

Assets		**Owners Equity**		**Liabilities**	
- 5 000	Bank -			- 5 000	SARS (Income tax) -
- 85 000	Bank -			- 85 000	SARS (Income tax) -
- 75 000	Bank -			- 75 000	SARS (Income tax) -
		- 156 000	Income tax +	+ 156 000	SARS (Income tax) +

<u>NOTE!</u>

Should the provisional tax paid be less than the total tax due, the SARS (Income tax) account will have a credit balance. The company owes SARS money
→ Liability

Should the provisional tax paid exceed the total tax due, the SARS (Income tax) account will have a debit balance. SARS owes the company money
→ Asset

Income tax is <u>not treated as an expense</u>, but rather that an <u>appropriation of profits</u>.

Closing transfer

	Debit	**Credit**
The **total tax liability** (assessment) for the financial year **→ GJ → R156 000**	Appropriation account	Income tax (N-account)

DIVIDENDS

Instead of retaining/keeping all the net profit **after tax** for itself, a company may distribute some of it to shareholders as their reward for investing in the business. But only if it has made a profit this year of has retained profits from previous years, and if the company has sufficient cash in the bank.

Shareholders are compensated for their investments in the form of dividends. The directors of the company **recommend** the payment of dividends and this recommendation is approved by the shareholders at the annual general meeting (AGM).

When the dividend is approved by the shareholders, then it is said that the dividend is **declared** → promised to the shareholders → the shareholders are a **liability**.

A dividend can only be declared out of profits available for distribution **after** provision has been made for income tax due. If the company is in a sound financial position, the directors have the right to declare and pay dividends during the year.

Dividends may be distributed twice a year. Half way through the year the company may <u>declare and pay an **interim dividend**</u>. After the financial statements have been completed at the end of the year, a <u>**final dividend** may be declared</u>. This will only be paid in the following financial period.

Interim dividends must be taken into account when the final dividend for the year is determined. Dividends can be calculated **per share** or on the **total value** of the shares (Ordinary Share Capital).

If the directors decide not to declare a dividend, they must explain their reasons to the shareholders so that the share price does not fall. Shareholders may be happy with no dividend if they know that the company needs to do research to improve its products, or invent new products, or because it wants to expand it market by opening businesses in other areas.

Dividends are regarded as an <u>appropriation of profits</u>.

It is very important that the **share register** be properly updated when shares are bought by a shareholder. The shareholders registered in the company's books on the applicable date will be entitled to receive the interim or final dividends.

Example 4

The financial year of Danike Traders Ltd ends on 28 February. On 31 March 2018 Danike Traders Ltd had an issued capital of R750 000 consisting of 60 000 ordinary shares.

Transactions for the financial year 1 March 2018 to 28 February 2019.

The following transactions with regards to dividends took place during the financial year:

- Declared and paid interim dividends of 30 cents per share on 31 August 2018
- Declared a final dividend of 55 cents per share on 28 February 2019

- Shareholders for dividends +

				2019			
				Feb 28	Dividends on ordinary shares	GJ	33 000

+ Dividends on ordinary shares -

2018				2019			
Aug 31	Bank	CPJ	18 000	Feb 28	Appropriation account		51 000
2019							
Feb 28	Shareholders for dividends	GJ	33 000				
			$\boxed{51\ 000}$				$\boxed{51\ 000}$

Example 5

The financial year of Danike Traders Ltd ends on 28 February. On 1 March 2019 Danike Traders Ltd had an issued capital of R750 000 consisting of 60 000 ordinary shares.

Transactions for the financial year 1 March 2019 to 28 February 2020.

The following transactions with regards to dividends took place during the financial year:

- Pay the amount owed to shareholders from the previous financial year, thus the **final dividends declared on the last day of the previous year of R33 000**, on 2 April 2019
- The company decides to issue a further 40 000 ordinary shares at R13 per share on 1 May 2019
- Declared and paid interim dividends of 42 cents per share on 31 August 2019
- Declared a final dividend of 105 cents per share on 28 February 2020

- Shareholders for dividends +

2019				2019			
Apr 2	Bank	CPJ	<u>33 000</u>	Mar 1	Balance	b/d	<u>33 000</u>
				2020			
				Feb 28	Dividends on ordinary shares	GJ	105 000

+ Dividends on ordinary shares -

2019				2019			
Aug 31	Bank	CPJ	42 000	Feb 28	Appropriation account		147 000
2020							
Feb 28	Shareholders for dividends	GJ	105 000				
			$\boxed{147\ 000}$				$\boxed{147\ 000}$

Because of the new shares issued, the dividends will be calculated as follows:

Interim dividends = 100 000 shares (60 000 + 40 000) x R0,42
= R42 000
Final dividends = 100 000 shares x R1,05 = R105 000

For the financial period 1 March 2019 to 28 February 2020:

	Debit	**Credit**
Pay the amount **owing to shareholders** from the previous year → **CPJ** → **R33 000**	Shareholders from dividends	Bank
Issue more shares → **CRJ** → **R520 000**	Bank	Ordinary Share Capital
Paid interim dividends halfway through the year → **CPJ** → **R42 000**	Dividends on ordinary shares (N-account)	Bank
Year-end adjustment for the **final dividend declared** to the shareholders, not paid → **GJ** → **R105 000**	Dividends on ordinary shares (N-account)	Shareholders for dividends (B-account)

Assets		**Owners Equity**		**Liabilities**	
- 33 000	Bank -			- 33 000	Shareholders for dividends -
+ 520 000	Bank +	+ 520 000	Ordinary Share Capital +		

Assets		**Owners Equity**		**Liabilities**	
- 42 000	Bank -	- 42 000	Dividends on ordinary shares +		
		- 105 000	Dividends on ordinary shares +	+ 105 000	Shareholders for dividends +

Dividends are regarded as an appropriation of profits.

Closing transfer

	Debit	**Credit**
The **total dividends (interim + final)** for the financial year → **GJ** → **R42 000 + R105 000 = R147 000**	Appropriation account	Dividends on ordinary shares (N-account)

RETAINED INCOME (Accumulated profits)

Retained Income is the portion of the earnings (net profit) that is not distributed to the shareholders in the form of dividends during the current financial year, after the total tax payable was taking into account.

The money is kept in reserve (saving) in the Retained Income account to use for future payments of dividends or it can be used for expansion in the future.

Example 6

The current financial period is 1 March 2018 – 28 February 2019.

The financial year of Danike Traders Ltd ends on 28 February. On 28 February 2018 Danike Traders Ltd had an issued share capital of R750 000 consisting of 60 000 ordinary shares.

On 28 February 2019 the following information was given:

- Net profit for the accounting period, according to the Profit and Loss account, was R550 000.
- Income tax for the financial year amounted to R165 000.
- Total dividends declared and paid during the financial year amounted to R51 000.

General Ledger – Closing transfers end of the year

	Debit	**Credit**
Gross profit	Trading account	Profit and Loss account
Net profit → R550 000	Profit and Loss account	Appropriation account
The **total tax liability** for the financial year → R165 000	Appropriation account	Income tax (N-account)
The **total dividends** (interim + final) for the financial year → R51 000	Appropriation account	Dividends on ordinary shares (N-account)
Close off the **remainder of the net profit not allocated to income tax or dividends → Retained income** → R330 000	Appropriation account	Retained income (B-account)

There is another new note in the Balance Sheet, note 8, which is a combination of the Retained Income account and the Appropriation account.

Appropriation account

2019				2019			
Feb	28	Income tax	165 000	Feb	28	Profit and Loss	550 000
		Dividends on ordinary shares	51 000				
		Retained income	334 000				
			550 000				**550 000**

\- Retained Income +

				2019			
				Feb	28	Appropriation account	334 000

<u>Note 8</u> to the Balance Sheet of Danike Traders Ltd on 28 February 2019

NOTE 8: RETAINED INCOME

Balance on 1 March 2018 / beginning of year	0
Net profit after tax (550 000 – 165 000)	385 000
Buy back shares	(0)
Dividends	(51 000)
Balance on 28 February 2019 / end of year	**334 000**

→ **Retained Income** is an owner's equity account (B2), as it is the part of the profit that was not distributed to the shareholders.

In the following financial year, the R334 000 will be the balance in the Retained Income account on the first day of the year.

This amount can be transferred back to the Appropriation account on the first day of the new financial year (Study & Master). This can be used to create a bigger profit and therefore it could affect the amount of dividends declared in the new financial year.

<u>Example 7</u>

The current financial period is 1 March 2019 – 28 February 2020.

The financial year of Danike Traders Ltd ends on 28 February. On 28 February 2019 Danike Traders Ltd had an issued share capital of R750 000 consisting of 60 000 ordinary shares.

On 28 February 2020 the following information was given:

- Net profit for the accounting period, according to the Profit and Loss account, was R520 000.
- Income tax for the financial year amounted to R156 000.
- **Interim dividends declared and paid** during the financial year amounted to R42 000.
- **Final dividends declared** during the financial year amounted to R105 000

(As per New Era textbook)

Appropriation account

2020			2020		
Feb 28	Income tax	156 000	Feb 28	Profit and Loss	520 000
	Dividends on ordinary shares	147 000			
	Retained income	217 000			
		520 000			**520 000**

\- Retained Income +

			2019			
			Mar 1	Balance	b/d	334 000
			2020			
			Feb 28	Appropriation account		217 000
						551 000

OR

(As per Study & Master textbook)

Appropriation account

2020			2020		
Feb 28	Income tax	156 000	Feb 28	Profit and Loss	520 000
	Dividends on ordinary shares	147 000		Appropriation account	334 000
	Retained income	551 000			
		854 000			**854 000**

\- Retained Income +

2020			2019			
Feb 28	Appropriation Account	<u>334 000</u>	Mar 1	Balance	b/d	<u>334 000</u>
			2020			
			Feb 28	Appropriation account		551 000

Retained Income (B2) is an **owner's equity account**, as it is the part of the net profit that was not distributed for income tax and for dividends to the shareholders.

<u>Note 8</u> to the Balance Sheet of Danjo Traders Ltd on 28 February 2020

	Balance on 1 March 2019	334 000
+	Net profit **AFTER TAX** (520 000 – 156 000)	364 000
-	Dividends	(147 000)
	Paid (Interim)	42 000
	Recommended (Final)	105 000
=	Balance on 28 February 2020	**551 000**

LOANS AND INTEREST CAPITALISED

BALANCE SHEET:

Non-current Liabilities → Liabilities payable within any period longer than 12 months from the end of the financial year.
E.g. *Loan: AB Bank*

Current Liabilities → A liability/an amount that needs to be settled within 12 months of financial year-end becomes a Current Liability.
E.g. *Short term loan*

INCOME STATEMENT:

Note 2: Interest expense
Total interest on the loan

INTEREST ON LOAN CAPITALISED

Interest on loan is the cost of borrowed money.

There are two ways to calculate interest:

- **Simple interest** is calculated on the original amount. The original amount of the loan will become less as loan repayments were made from time to time.

Therefore, the amount of interest that is not paid for the current accounting period, will be payable (accrued expenses) at the end of the year.
Journal: GJ
Account debit: Interest on loan (expense)
Account credit: Accrued expenses

- **Compound interest** is calculated on the original amount as well as the interest accumulated (capitalised) during past periods. Thus, interest is earned on interest.

Therefore, the amount of interest that is capitalised at the end of the financial period, will be added to the loan itself.
Journal: GJ
Account debit: Interest on loan (expense)
Account credit: Loan: AB Bank

Interest on loan is capitalised most of the times by lending institutions. In the school syllabus, the amount of the capitalised interest will be given.

Although the interest on loan is capitalised, the company <u>must pay the interest in that specific accounting period, with an instalment on the loan</u>.

LOAN STATEMENT received from AB Bank on 28 February 2018

Balance on 1 March 2017	R80 000
Loan increased	R20 000
Interest on loan capitalised	**?**
Monthly payment in terms of the loan agreement. These monthly payments **include interest and capital repayments** of the loan	(18 000)
Balance on 28 February 2018	**R92 500**
The capital repayment of the loan will remain constant on R18 000 per annum until the loan is fully repaid.	

Solve the ? by preparing a Loan account:

-		Loan: AB Bank	+		
Bank	CPJ	18 000	Balance	b/d	80 000
Balance	c/d	92 500	Bank	CRJ	20 000
			Interest on loan**?**	GJ	$\boxed{10\ 500}$
		110 500			**110 500**
			Balance	b/d	92 500

The **Loan Statement** reflected the following:

1. The balance on the first day of the accounting period, R80 000
2. The company borrowed another R20 000 during the year.
3. Interest capitalised during the year was R10 500
4. The total amount paid on the loan was R18 000, which included the interest → you first paid interest, and then you pay back on the loan.
5. The balance on the last day of the accounting period, R92 500

Conclusion, the company <u>only paid back R7 500 on the loan</u>

⟶ R80 000 + R20 000 – R92 500 = R7 500

But we paid R18 000?
Yes, but the R18 000 included the R10 500 interest that was capitalized, therefore the loan only decreased by R7 500!

BALANCE SHEET end of the year:

Non-current Liabilities (Non-current = "not now")

Loan: AB Bank (92 500 – 18 000 → payable in the next financial year) = **R74 500**

Current Liabilities (Current = "now")

Short term loan = **R18 000** → payable within the next 12 months

INCOME STATEMENT:

Note 2: Interest expense
Interest on the loan = **R10 500**

DIRECTORS FEES

A company will have a remuneration committee that is responsible for the remuneration of non-executive directors as well as executive management.

The payment of directors fees during the financial year will be entered in the **CPJ**:

Debit Directors fees (Expense)
Credit Bank (Asset)

Directors fees that are in arrears (not paid yet) at the end of the financial year will be entered in the **GJ**:

Debit Directors fees (Expense)
Credit Accrued expenses (Liability)

AUDIT FEES

The duties of the audit committee included nominating an independent (external) auditor and determining the audit fee.

The payment of audit fees during the financial year will be entered in the **CPJ**:

Debit Audit fees (Expense)
Credit Bank (Asset)

If audit fees are still payable at the end of the financial year, the transaction will be entered in the **GJ**:

Debit Audit fees (Expense)
Credit Accrued expenses (Liability)**General Ledger –**

Closing transfers end of the year

	Debit	**Credit**
Directors fees	Profit and Loss account	Directors fees
Audit fees	Profit and Loss account	Audit fees

BUYING BACK SHARES

There are number of ways in which companies can return wealth to their shareholders. One way is paying dividends to share-holders. Another way is buying back shares from shareholders.

⟶ A company buys back its own shares on the stock exchange, almost like investing in itself.

How is a share buy-back carried out?

Shareholders will be presented with a tender offer to sell a portion of their shares back to the company within a certain time frame. Interested shareholders will then submit their tenders, stating the number of shares and the price they are willing to accept. Once the company has received all the tenders, they will find the right combination to **buy back shares at the lowest price**.

The company will sometimes have to buy back the shares for a higher price as the original/average selling price.

⟶ You can only show the buying back shares in the **Ordinary Share Capital account/note at the original/average selling price** – refer to page 12.

⟶ The remainder (difference between the buy-back price and the original/average selling price) must be subtracted from the

Retained Income account/note balance at the beginning of the year.

Example 8

The financial year of Engo Ltd ends on 28 February every year.

On 1 March 2015 Engo Ltd had an issued share capital of R975 000 consisting of 150 000 ordinary shares.

On 15 April 2015, 60 000 ordinary shares were issued at R7,20 each. Applications together with the payments were received.

This transaction will be entered in the **CRJ**:

Debit Bank, R432 000
Credit Ordinary Share Capital, R432 000

On 28 February 2016, the last day of the year, Engo Ltd bought back 20 000 shares at R8 each.

What is the average price of all the issued shares?

Balance b/d:	150 000 shares		=	R 975 000
New shares:	60 000 shares	x R7,20	=	R 432 000
	210 000 shares			**R1 407 000**

Average price = R1 407 000 / 210 000 = **R6,70**

R8

R6,70 per share is the amount available in the Ordinary Share capital account.
R1,30 per share must be subtracted from Retained Income at the beginning of the year.

Bookkeeping:

This transaction will be entered in the **CPJ:**

Debit Ordinary Share Capital, (20 000 x **R6,70**) = R134 000
Debit Retained Income, (20 000 x **R1,30**) = R26 000
Credit Bank, (20 000 x **R8**) = R160 000

\- Ordinary Share Capital +

2016					2015					
Feb	28	Bank	CPJ	134 000	Mar	1	Balance	b/d	975 000
		Balance	c/d	1 273 000	Apr	15	Bank	CRJ	432 000
				1 407 000					**1 407 000**
					2016				
					Mar	1	Balance	b/d	1 273 000

\- Retained Income +

2016					2015				
Feb	28	Bank	CPJ	26 000	Mar	1	Balance	b/d	xxx
					2016				
					Feb	28	Appropriation account		xxx

NOTE 7: ORDINARY SHARE CAPITAL

Authorised		
Number of ordinary authorized shares: xxx shares		
Issued		
150 000	ordinary shares in issue at 1 March 2015 / beginning of year	975 000
60 000	ordinary shares issued during the year at **R7,20** each	432 000
(20 000)	ordinary shares bought back during the year at **R6,70** each	(134 000)
190 000	ordinary shares in issue at 28 February 2016 / end of year (**at R6,70)	**1 273 000**

** When the last action was buy back shares at average price, the balance at the end of the year will also be at average price.

Check: R1 273 000 / 190 000 = **R6,70** !

NOTE 8: RETAINED INCOME

Balance on 1 March 2015	xxx
Net profit after tax	xxx
Buy back shares (20 000 x R1,30)	(26 000)
Dividends	(xxx)
Paid (interim)	xxx
Recommended (final)	xxx
Balance on 28 February 2016	**xxx**

Summary of General Ledger

	Debit	**Credit**
For services rendered the directors are paid	Directors fees	Bank
Company financial statements have to be audited – external (independent) auditors are paid	Audit fees	Bank
Issue ordinary shares to shareholders, receive their payments	Bank	Ordinary Share Capital
1st provisional tax payment half way through the year	SARS (Income tax) (B-account)	Bank
Paid interim dividends half way through the year	Dividends on ordinary shares (N-account)	Bank
2nd provisional tax payment on the last day of the year	SARS (Income tax) (B-account)	Bank
Year-end adjustment for the **final dividend declared** to the shareholders	Dividends on ordinary shares (N-account)	Shareholders for dividends (B-account)
Year-end adjustment for the total tax liability for the year – **final tax assessment**	Income tax (N-account)	SARS (Income tax) (B-account)
Buy back shares from existing shareholders, make payments	Ordinary Share Capital → at average price	Bank
	Retained Income → at the difference of buy-back price and average price	Bank

General Ledger – Closing transfers end of the year

	Debit	**Credit**
Net profit	Profit and Loss account	Appropriation account
The **total tax liability** for the financial year	Appropriation account	Income tax (N-account)
The **total dividends** (interim + final) for the financial year	Appropriation account	Dividends on ordinary shares (N-account)
Close off the **remainder of the net profit not allocated to income tax or dividends → Retained income**	Appropriation account	Retained income (B-account)

Steps for doing the ledger accounts of Companies

1. Open the 4 B-accounts with balances

Debit	Credit
	Ordinary Share Capital
	Retained Income
SARS (Income tax) **OR**	SARS (Income tax)
	Shareholders for dividends

2. Paid the amount owed to the Shareholders (and sometimes to SARS).

Debit	Credit
Shareholders for dividends	Bank
SARS (Income tax)	Bank

3. Paid the interim dividend

Debit	Credit
Dividends on ordinary shares	Bank

4. Paid the 1st provisional tax payment

Debit	Credit
SARS (Income tax)	Bank

5. Sold more ordinary shares and received the money

Debit	Credit
Bank	Ordinary share capital

6. Bought back some of the shares – for more than the selling price

Debit	Credit
Ordinary Share Capital [@ the original / average selling price]	Bank
Retained Income [@ the difference between the average selling price and the “buy-back” price]	Bank

7. Paid the 2nd provisional tax payment

Debit	Credit
SARS (Income tax)	Bank

8. Net profit is given

Debit	Credit
Profit and Loss account	Appropriation account

9. Declared a final dividend

Debit	Credit
Dividends on ordinary shares	Shareholders for dividends

10. Tax assessment

Debit	Credit
Income tax	SARS (Income tax)

11. Close off the SARS (Income tax) account → the balance can be on the debit or credit side

12. Shareholders for dividends have an amount on the credit side which is the final dividend that we owe the shareholders

13. Closing transfers – close off the Income tax account (N) and Dividends on ordinary shares account (N) to the Appropriation account

Debit	Credit
Appropriation account	Income tax
Appropriation account	Dividends on ordinary shares

14. Close off the Appropriation account to the Retained Income

Debit	Credit
Appropriation account	Retained income