REVISION: COMPANIES 21 MARCH 2013

Lesson Description

In this lesson we revise:

- The concept of a company and compare the differences between private & public companies
- The eight important ledger accounts for companies – specifically the Appropriation Account
- The format of an Income Statement and Balance Sheet of a company.
- GAAP principles.

Key Concepts

What is a "Company"?

In general terms, a company can be defined as a society of persons working together to make a profit. A company is a legal person distinct from its owners, and is incorporated in accordance with the stipulations of the Companies Act 61 of 1973.

Distinctive Features

- The entity exists independently from its owners, the shareholders.
- The owners of a company (the shareholders) have limited liability as far as the debts of the business is concerned.
- The company can do everything that a person with contractual capacity can do, in its own name. This includes the buying and selling of non-current assets, entering into contracts, etc.
- A company can sue and can be sued.
- A company is liable to pay income tax.

The following are some of the advantages of Companies over Sole Proprietorships and Partnership:

- More capital can be accumulated.
- The continued existence of the business is independent of its owners.
- Ownership can be exchanged.
- Financial liability of the owners is limited.

Differences between Private and Public Companies

The following are some of the differences between Private and Public companies:

Private Companies	Public Companies
Name ends with the letters (Pty) Ltd	Name ends with the letters Ltd
Minimum of 1 shareholder to a maximum of 50.	Minimum of 7 shareholders and limited to the number of shares issued.
Raises capital by issuing shares to founder members.	Raises capital by issuing shares to members of the public.
Financial statements need not be audited or published	Financial statements need to be audited and published
Minimum of 1 director appointed	Minimum of 2 directors appointed
Is not compelled to hold Annual General Meetings	Is compelled to hold Annual General Meetings

Terms

Term	Definition	Calculation where applicable
Authorised Shares/Capital	The number of shares a company is **allowed** to sell in order to raise capital.	Number of authorised shares x par value = Authorised capital
Issued Shares/Capital	The number of shares a company **has already sold** in order to raise capital.	Number of issued shares x par value = Issued share capital. **OR** Issued share capital divided by par value = Number of issued shares
Ordinary Share Capital	Capital raised through the issue of ordinary shares. (The curriculum only deals with the issue of ordinary shares, therefore the Issued and the Ordinary Share Capital would be the same amount).	Same calculation as above applies.
Par Value	The nominal or initial price of a share as stipulated in the Memorandum of Association.	Issued share capital divided by number of shares issued = Par value
Share premium	Shares sold at a price higher than the par value.	E.g. Par value of a share is R2 and the share is sold for R3, therefore the premium is R1.
Dividends	The portion of a companies profits declared by directors to be given to shareholders. The dividends are always declared as a number of cents per share. • Interim dividends: Dividends declared during the financial year. • Final dividends: Dividends declared at the end of the financial year.	Number of shares issued x dividends per share = Amount of dividend
Income tax	Portion of the net income payable to SARS as tax for the year.	Net income (before tax) x rate of tax = Income tax for the year.
Provisional tax	Payment of an estimated amount of tax during the year to SARS.	

Directors fee	Fees paid to directors for services rendered. This is an expense for the company.	
Audit fee	Fees paid to auditors for services rendered. This is an expense for the company.	
Retained Income	The portion of the company profits which are not given out.	Retained income (at beginning) + Net profit before tax – dividends – income tax = Retained income at the end.

Check List

You need to know how to draw up the following ledger accounts:

- Ordinary share capital
- Share premium
- Retained income / Accumulated profits
- Ordinary share dividends
- Shareholders for dividends
- SARS (income tax)
- Income tax
- Appropriation (Learn this one well!)

Appropriation

Income tax	GJ	(c)	Profit and loss	GJ	(a)
Ordinary share dividends	GJ	(d)	Retained income	GJ	(b)
Retained income	GJ	(e)			

a.) Net profit **before tax** for the year
b.) Retained income **at the beginning of the year**
c.) Income tax for the year (the income tax account gets closed off here)
d.) Total dividends paid and declared = interim and final (the ordinary share dividends account gets closed off here)
e.) Retained income **at the end of the year** (this is usually the balancing figure)

This account is important as you will often use it to answer other questions!

You will be required to know how to record the following transactions for companies:

TRANSACTION	GENERAL LEDGER ENTRIES
The company issues ordinary shares at a premium	Dr Bank (no. of shares x [par value + premium]) Cr Ordinary share capital (no. of shares x par value) Cr Share premium (no. of shares x premium)
The company pays the tax owing at the beginning of the financial year	Dr SARS (income tax) Cr Bank
The company pays shareholders the final dividend that was declared last year	Dr Shareholders for dividends Cr Bank
The company pays provisional tax	Dr SARS (income tax) Cr Bank
The company pays an interim dividend	Dr Ordinary share dividends Cr Bank Remember to calculate the dividend! **Dividends per share x no. of shares** Make sure that you consider whether there were new shares issued during the year!
The company declares a final dividend	Dr Ordinary share dividends Cr Shareholders for dividends
The company receives its income tax assessment	Dr Income tax Cr SARS (income tax)

Income Statement

Definition

- The Income Statement will show the trading result i.e. has the business made a net profit or a loss for a specific accounting period (which is normally 1 year)
- Includes all income and expense accounts for a specific period (1 year)

Format

SALES (subtract debtors allowance)		
COST OF SALES		
GROSS PROFIT		
OTHER OPERATING INCOME		
GROSS OPERATING INCOME		

OPERATING EXPENSES		
OPERATING PROFIT		
Interest income	1	
OPERATING PROFIT BEFORE INTEREST EXPENSE		
Interest expense	2	
PROFIT BEFORE TAXATION		
Income Tax		
NET PROFIT FOR THE YEAR	9	

Balance Sheet

Definition

- A statement of the financial position of the business on a specified date.
- i.e. **A = OE + L**

ASSETS		
Non-current assets		
Tangible assets	**3**	
Financial assets		
Current assets		
Inventory	**4**	
Trade and other receivables	**5**	
Cash and cash equivalent	**6**	
Total Assets		
EQUITY AND LIABILITIES		
Ordinary shareholders equity		
Ordinary share capital	**7**	
Share Premium	**8**	
Retained income	**9**	
Non-current liabilities		
Mortgage loan		
Current liabilities		
Trade and other payables	**10**	
Bank overdraft		
Short-term loan *		
Total equity and laibilities		

*may be added to trade and other payables

Changes to the Notes (to the Financial Statements)

(Changes are in red)

Trade and Other Receivables (Note 5)

Trade debtors	Xx
Provision for bad debts	(xx)
Net trade debtors	XX
Accrued income	Xx
Prepaid expense	Xx
SARS (income tax) (DR balance i.e. if the receiver is owing the business)	xx

Ordinary Share Capital (Note 7)

Authorised	
Xxx ordinary shares @ Rxx each	Xx
Issued	
Xxx shares at Rxx each issued at the beginning of the year	Xx
Xxx shares at Rxx each issued during the year	X
Xxx shares at Rxx each issued at the end of the year	Xxx

Share Premium (Note 8)

Balance at the beginning of the financial year	Xxx
Xx shares issued during the year @ a premium of xx each	Xx
Balance at the end of the financial year	XX

Retained Income (Note 9)

Retained income @ beginning of the year	Xx
Net profit after tax	Xx
Ordinary share dividend	(xx)
Paid	X
Recommended	X

Trade and Other Payables (Note 10)

Trade creditors	Xx
Accrued expense	Xx
Income received in advance	Xx
Sars (paye)	Xx
Sars (income tax)	Xx
Shareholders for dividends	xx
Pension fund	Xx
UIF	xx

Generally Accepted Accounting Practice (GAAP)

Most important principles are:

MATCHING (Income Statement)

All income and expenses must be matched to the same period in which they incurred.
(regardless of whether the income has been received or not; or the expense has been paid or not paid)

PRUDENCE (Balance Sheet)

Financial results are reported in a conservative manner.

Historical Cost (Balance Sheet)

The general rule is that assets are valued at their historical cost. Land and Buildings and trading stock will be shown in the balance sheet at the original cost to the business. There are however exceptions, (trading stock that is de-valued)