Company Accounts

Limited Companies

A limited company is a business owned by at least two people. The owners are called **members** or **shareholders** and their investment is in the form of **shares**. Limited companies came about because of the need for businesses to raise capital for expansion with the minimum risk to investors. These investors then receive protection by creating a business entity called a limited company.

Limited Liability

Protection to investors is in the form of **limited liability**. Limited liability means that the liability (legal responsibility) of the owners is confined to the amount they have invested in a company. The shareholders are not legally obliged to provide further assets over and above their investment in the company.

The majority of companies today are formed as limited liability companies and must include the word "Limited Company" after their names. This is so that creditors are aware that the shareholders liability is limited to their shares.

Classes of Limited Companies

There are two classes of limited company:

1. Private limited company (Ltd)
2. Public limited company (Plc)

Private limited companies

- Must have two or more shareholders but no more than 50
- May not offer shares to the public
- The company name must include the word "limited" or "Ltd".

Public limited companies

- Must have at least seven members
- Shares may be issued to the public
- Company name must include the words "Public Limited Company" or "Plc"

Sources of Capital

Share Capital

Share capital is the finance raised by a company by issuing shares to the shareholders.

Dividends

Dividends are the portion of the profits that are paid to shareholders. A dividend paid to shareholders during the year is called an **interim dividend**. A proposed or final dividend is provided for at the end of the year. Shareholders are generally satisfied wen part of the profits is kept by the company because this should increase the value of their shares.

Types of Shares

Shares can be divided into two main classes:

1. Preference shares
2. Ordinary shares

Preference shares

The preference shareholder receives a fixed dividend, expressed as a percentage of the nominal value of the share. This dividend must be accounted for before any dividend is paid to the ordinary shareholders. Preference shareholders do not have voting rights. If liquidation occurs, the preference shareholders are entitled to be repaid the nominal value of their shares before any repayment is made to ordinary shareholders.

Nearly all preference shares are **cumulative preference shares**. This means that if the dividend is not paid in one year it accumulates until the company makes enough profit to pay all arears of the dividend.

Redeemable preference shares are preference shares that the company reserves the right to buy back, on or before a certain date. This date should be shown on the balance sheet or in a note on the balance sheet.

Ordinary shares

Ordinary shares are the most important and common class of share. They are often referred to as equity shares. Ordinary shareholders are the owners of a company, they have voting rights and so control the company. They can appoint the directors and decide the amount of profits to be paid out each year.

Varieties of Share Capital

Authorised or **registered** or **nominal share capital** is the amount of share capital that company is entitled to issue, as stated in the Memorandum and Articles of Association.

Issued share capital is the amount of authorised capital that has actually been allotted to the public for subscription. The issued share capital must never exceed the authorised capital.

Reserves

Reserves belong to the ordinary shareholders and a part of the shareholders' funds. Reserves can be divided into two categories, **capital reserves** and **revenue reserves**. Capital and revenue reserves are part of the shareholders' funds in the balance sheet.

Capital reserves are non-trading profits earned by the company in some unusual way, for example;

- Selling shares at a premium
- Revaluation of fixed assets
- Profits earned prior to incorporation

Some examples of capital reserves include, share premium reserve, revaluation reserve and capital redemption reserve. They cannot be created through transfers from the profit and loss account and they cannot be used for the payment of dividends.

Revenue reserves are profits kept in the company. The profits are accumulated in the company rather than paid out as dividends to the shareholders. Examples of revenue reserves include general reserve, profit and loss balance and debenture redemption reserve. Revenue reserves can be used at a later stage to pay dividends.

Share premium is a profit gained by issuing shares at a price above their nominal value.

Debentures

These are long term loans received by the company. These loans carry a fixed rate of interest e.g. 8% debentures. This interest must be paid back each year.

Debentures usually last for a fixed period of time and are redeemable i.e. the money is paid back at the end of that period. For examples 8% debentures 2010/2012 means that the company can redeem he debenture in the years 2010, 2011 and 2012.

Debentures are usually secured by a fixed charge on a particular asset or by floating the charge on all the assets of the company. This means that the debenture holders have priority of payment if the company goes bankrupt.

Companies who are prudent transfer a portion of their annual profits into a **debenture redemption reserve**.

Remember

The finance raised by a company from selling hares is called **share capital**. There are two types of share capital:

1. **Authorised Share Capital**. This is laid down in the Memorandum of Association and Articles of Association. It is the total amount of shares the founder members of the company agreed to have within the company.
2. **Issued Share Capital**. This is the portion of the authorised share capital that has been sold to the public.

There are two types of **share**:

1. **Preference Shares**. This is where a preference shareholder receives a fixed dividend, which is a fixed percentage of the original value of the share out of the profits of a company. They have no voting rights.
2. **Ordinary Shares**. These shareholders have voting rights. They elect the Board of Directors at the AGM. The directors recommend the amount of profits, dividends to be paid out to the ordinary shareholders. They receive their dividends after the preference dividend has been paid; they are he last people to be repaid if a company goes bankrupt.

A **dividend** is part of the profits that is paid to shareholders. There are two types of dividend:

1. **Interim Dividend**. These are the dividends that are paid during the financial year.
2. **Proposed Dividends**. These are final dividends that are proposed at the AGM, to be provided for at the end of the year.

Reserves are funds put aside out of the profits of the company. There are two types of reserves:

1. **Revenue Reserve**. These are also called retained profits. Examples are general reserve, profit and loss balance. These funds can be used at a later time to pay dividends.
2. **Capital Reserve**. These are non-trading profits. Examples include, share premium reserve and revaluation reserve. They are not part of the profits of the company and have been created from selling shares or revaluing assets. They cannot be used to pay dividends at a later time.

What's the difference between reserves and provisions?

- A reserve is an appropriation of profit that recognises past success and is put aside in order to strengthen the company against future challenges e.g. revenue reserve.
- A provision then is an expectation of a loss occurring e.g. expecting some of the debtors to go bad and so a provision for bad debts is created.

Net Worth

This is the amount by which the assets exceed liabilities. It is what the company is worth and is known as shareholders equity.

Company Specific Terms

The presentation of the trading profit and loss account and balance sheet of a company is similar to that of a sole trader. There are however some terms and items of value and expenditure that are specific to a company.

Preliminary Expenses/Formation Expenses

These expenses are incurred in forming a company and prior to trading. They should be written off as soon as possible through the profit and loss account or against a share premium account.

Auditors Remuneration

His is a fee paid to the auditor for carrying out an audit of the company's accounts. Although the work is carried out after the preparation of final accounts, it must be provided for in the accounts. It's treated as an expense in the profit and loss account and accumulated as a liability in the balance sheet.

Corporation Taxation

This is a tax paid on the current year's profits of a company. It is not an expense but is deducted from the profits earned for the year.

Directors Remuneration/Fees

These are fees, salaries and commissions paid by a company to the directors for the period; they are expenses and are charged to the profit and loss account.

Intangible Fixed Assets

These are items of value that are not visible and do not have a physical presence. Hey are assets that have long-term value to a business. Examples of intangible fixed assets include goodwill, patents, trademarks, trader's license and copyright. These assets have a limited useful economic life and should be written off over a number of years.

Financial Fixed Assets

These are long-term investments made by a business and loans given to other parties. Investments can be quoted or unquoted. Quoted investments can be bought an sold on the Stock Exchange.

Operating Profit

This is the profit calculated after deducting operating expensed and adding operating gains but before deducting interest payable.

Profit and Loss Balance

The retained profit at the end of the year for a company becomes a reserve. At the end of each year the profit retained from the previous year is added to the retained profit of the current year.

Expenses Classification

Expenses in the profit and loss account should be classified into two headings.

1. Selling and Distribution
2. Administration

Selling and Distribution	Administration
Commission	Directors fees
Advertising	Auditors fees
Carriage Out	Rent and Rates
Salaries sales staff	Office Salaries
Delivery van expenses	Light and Heat
Depreciation of delivery vans	Depreciation of other assets
Showroom expenses	Insurance
	Amounts written off intangible assets
	General expenses
	Discount allowed
	Bad debts provisions

Let's take a look at an example:

Q9.1

Kelly Ltd had an authorised capital of €500,000 made up of 400,000 ordinary shares of €1 each and 100,000 10% preference shares of €1 each. Kelly Ltd had already issued 300,000 ordinary shares at €1 each and all the preference shares. On 1/1/2010 the company had a credit balance in its profit and loss account of €300,000 and a balance of €40,000 in its general reserve account. During the year, an interim dividend of 5% had been paid to the ordinary shareholders and a preference dividend of €5,000. Profits before taxation amounted to €80,000.

On 31/12/2010 the directors recommend;

- That the preference dividend due be paid
- A final dividend of 3% be paid to ordinary shares
- That the general reserve be increases by €10,000

- Taxation of €25,000 to be provided for.

You are asked to show;

a) The profit and loss account for the year ended 31/12/2010

b) Prepare a balance sheet showing the relevant extracts after making the above adjustments

Profit and Loss Account of Kelly Ltd for the year ended 31/12/2010			
Net Profit			€ 80,000.00
Less Taxation			€ 25,000.00
Profit afer taxation			€ 55,000.00
Less Appropriation			
Transfer to genereal reserve		€ 10,000.00	
Interim ordinary dividend		€ 15,000.00	
Interim preference dividend		€ 5,000.00	
Proposed ordinary dividend		€ 9,000.00	
Proposed preference dividend		€ 5,000.00	€ 44,000.00
Retained profit for the year			€ 11,000.00
Profit and loss balance 1/1/2010			€ 30,000.00
Profit and loss balance 31/12/2010			€ 41,000.00

Balance Sheet Extracts as at 31/12/2010				
Less Creditors (amounts falling due within 1 year)				
Ordinary dividend due			€ 9,000.00	
Preference			€ 5,000.00	
Taxation			€ 25,000.00	€ 39,000.00
Financed By:				
Capital and Reserves				
Share Capital	**Authorised**	**Issued**		
Ordinary shares @ €1 each	€ 400,000.00	€ 300,000.00		
5% preference shares	€ 100,000.00	€ 100,000.00		
	€ 500,000.00	€ 400,000.00		
General reserve		€ 50,000.00		
Profit and loss balance 31/12/2010		€ 41,000.00		
Shareholders funds		€ 491,000.00		

Q9.2

The following was extracted from the books of M. Moore on 31/12/2011.

Sales		€640,000
Sales returns	€20,000	
Purchases	€305,000	
Stock at 1/1/2011	€35,000	
Salaries: sales staff	€50,000	
Carriage out	€2,000	
Salaries: administration	€32,000	
Directors fees	€5,000	
General expenses	€43,000	
Discount allowed	€6,000	
Audit fees	€15,000	
Legal fees	€30,000	
Interest paid	€7,000	
Discount received		€10,000
Dividends paid	€6,000	
Buildings at cost	€550,000	
Investments at cost	€100,000	
Patents	€50,000	
Trade debtors	€52,000	
Cash in hand at bank	€15,000	
Trade creditors		€37,000
7% Debentures		€100,000
Paid-up capital: Ordinary shares @ €1 each		€450,000
Profit and loss account balance 1/1/2011		€88,000
Provision for bad debts		€2,000
Motor vehicles	€120,000	
Provision for depreciation		
Buildings		€57,000
Delivery Vans		€59,000
	€1,443,000	€1,443,000

The following information and instructions are to be taken into account:

a) Stock at 31/12/2011 was valued at €40,000
b) Provide or depreciation as follows:

Buildings:	2% of cost
Motor vehicles:	25% of cost

c) Provide for corporation tax due €49,000
d) He directors proposed a final dividend of €4,000

You are asked to:

1. Prepare a trading, profit and loss account for the year ended 31/12/2011
2. Prepare a balance sheet as at 31/12/2011

Trading & Profit & Loss Account M. Moore for year ended 31/12/11			
Sales		€ 640,000.00	
Less Returns		€ 20,000.00	€ 620,000.00
Less Cost of goods sold			
Opening Stock		€ 35,000.00	
Purchases		€ 305,000.00	
		€ 340,000.00	
Less Closing Stock		€ 40,000.00	€ 300,000.00
Gross Profit			€ 320,000.00
Less Expenses			
Administration			
Salaries	€ 32,000.00		
Directors fees	€ 5,000.00		
General expenses	€ 43,000.00		
Depreciation: Buildings	€ 11,000.00		
Discount allowed	€ 6,000.00		
Audit fees	€ 15,000.00		
Legal fees	€ 30,000.00	€ 142,000.00	
Selling & Distribution			
Salaries: sales staff	€ 50,000.00		
Depreciation: delivery vans	€ 30,000.00		
Carriage out	€ 2,000.00	€ 82,000.00	€ 224,000.00
			€ 96,000.00
Add Gains/Operating income			
Discount received			€ 10,000.00
Operating profit			€ 106,000.00
Less Interest payable			€ 7,000.00
Profit before taxation			€ 99,000.00
Less Corporation tax			€ 49,000.00
Profit for year after taxation			€ 50,000.00
Appropriation of profits			
Dividend paid		€ 6,000.00	
Dividend proposed		€ 4,000.00	€ 10,000.00
Retained profit for the year			€ 40,000.00
Add profit balance 1/1/2011			€ 88,000.00
Profit balance carried forward			€ 128,000.00

Balance Sheet as at 31/12/2011				
Intangible Fixed Assets				
Patents				€ 50,000.00
Fixed Assets	**Cost**	**Depreciation**	**Book Value**	
Premises	€ 550,000.00	€ 68,000.00	€ 482,000.00	
Motor vehicles	€ 120,000.00	€ 89,000.00	€ 31,000.00	
	€ 670,000.00	€ 157,000.00	€ 513,000.00	€ 513,000.00
Current Assets				
Investments at cost				€ 100,000.00
				€ 663,000.00
Closing stock		€ 40,000.00		
Debtors	€ 52,000.00			
Less Bad debts provision	€ 2,000.00	€ 50,000.00		
Bank		€ 15,000.00	€ 105,000.00	
Less Curent Liabilites				
Trade creditors		€ 37,000.00		
Corporation tax due		€ 49,000.00		
Proposed dividends		€ 4,000.00	€ 90,000.00	
Working Capital				**€ 15,000.00**
Total Net Assets				**€ 678,000.00**
Financed By:				
7% Debentures				€ 100,000.00
Capital				
Ordinary shares capital			€ 450,000.00	
Profit and loss balance			€ 128,000.00	
Shareholders funds				€ 578,000.00
Capital Employed				**€ 678,000.00**