SHARE CAPITAL AND RETAINED INCOME

Grade 12 Accounting

Companies and Financial Statements

CHAPTER OUTCOMES

After studying this chapter, you should be able to:

✓ Explain Share Capital

✓ Distinguish between authorised and issued shares

✓ Prepare an Ordinary Share Capital Note

✓ Account for share issues

✓ Account for share repurchases

✓ Explain Retained Income

✓ Calculate Retained Income

✓ Prepare a Retained Income Note

√ Answer NSC examination questions involving companies

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1. INTRODUCTION

One of the biggest differences between a company and other forms of business ownership is that companies raise capital by selling shares.

In Grade 12 Accounting, learners are expected to understand:

- Share Capital

- Retained Income
- Dividends
- Share Repurchases
- Ordinary Share Capital Notes

These concepts form the foundation of Company Financial Statements and are tested almost every year in the NSC examinations.

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2. WHAT IS SHARE CAPITAL?

Definition

Share Capital is the amount invested by shareholders in exchange for ownership shares in a company.

Simply put:

Investors give money to the company.

The company gives shares to investors.

The money received becomes Share Capital.

EXAMPLE

StudyPack Ltd issues:

100 000 shares

at R10 per share

Calculation:

100 000 × R10

= R1 000 000

Therefore:

Share Capital = R1 000 000

REMEMBER THIS

Share Capital comes from investors.

Retained Income comes from profits.

Many learners lose marks because they confuse these two concepts.

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3. WHY DO COMPANIES ISSUE SHARES?

Companies need money to:

✓ Buy buildings

✓ Purchase equipment

✓ Expand operations

✓ Open new branches

✓ Develop products

✓ Improve cash flow

Instead of borrowing money, companies can sell shares to investors.

EXAM TIP

The examiner may ask:

"Why would a company issue new shares?"

Possible answers:

- To raise capital
- To finance expansion
- To reduce borrowing
- To improve liquidity

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4. AUTHORISED SHARES

Definition

The maximum number of shares that a company is allowed to issue according to its Memorandum of Incorporation (MOI).

EXAMPLE

Authorised Shares:

5 000 000

This means:

The company cannot issue more than 5 000 000 shares without changing its registration documents.

THINK OF IT LIKE THIS

Authorised Shares

=

Maximum Capacity

Similar to a stadium that can hold 50 000 people.

The stadium may hold 50 000 people.

But not all seats are necessarily occupied.

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5. ISSUED SHARES

Definition

Shares that have actually been sold to shareholders.

EXAMPLE

Authorised Shares = 5 000 000

Issued Shares = 3 000 000

The company may still issue:

2 000 000 shares

in future.

EXAM TRAP

Question:

Can issued shares exceed authorised shares?

Answer:

NO

Issued shares can never exceed authorised shares.

EASY MEMORY TRICK

Authorised = Allowed

Issued = Sold

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6. ORDINARY SHARES

Ordinary shares are the most common type of shares.

Ordinary shareholders:

✓ Own the company

✓ Vote at meetings

✓ Receive dividends

✓ Share in profits

✓ Share in risks

EXAM QUESTION

Why are ordinary shareholders regarded as risk bearers?

Because they receive dividends only after all obligations have been met.

If profits decrease, dividends may decrease.

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7. ISSUING NEW SHARES

When a company sells new shares, it increases its Share Capital.

EXAMPLE

Shares in issue:

2 000 000

New shares issued:

500 000

Shares in issue now:

2 500 000

EXAM TIP

Whenever new shares are issued:

Share Capital increases

Shares in Issue increases

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8. SHARE REPURCHASES

One of the most important Grade 12 Accounting topics.

WHAT IS A SHARE REPURCHASE?

A company buys back its own shares from shareholders.

This reduces:

- Shares in issue
- Shareholders' equity

WHY WOULD A COMPANY REPURCHASE SHARES?

Possible reasons:

✓ Increase earnings per share

✓ Reward shareholders

✓ Remove unwanted shareholders

✓ Improve control

✓ Increase shareholder value

EXAMPLE

Shares in issue:

3 000 000

Repurchased:

200 000

Remaining shares:

2 800 000

EXAM TRAP

Many learners think:

Repurchase = Expense

WRONG

Repurchases affect equity, not expenses.

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9. AVERAGE SHARE PRICE (ASP)

When shares are repurchased, the examiner often requires the Average Share Price.

FORMULA

Average Share Price

=

Share Capital

÷

Number of Shares in Issue

EXAMPLE

Share Capital:

R12 000 000

Shares in issue:

2 000 000

ASP

=

R12 000 000 ÷ 2 000 000

=

R6 per share

NSC-STYLE EXAMPLE

The company repurchased:

150 000 shares

for R975 000

Average Share Price:

R975 000 ÷ 150 000

=

R6,50 per share

This is similar to calculations examined in recent NSC papers.

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10. ORDINARY SHARE CAPITAL NOTE

This note explains movements in Share Capital during the year.

BASIC FORMAT

NUMBER

DETAILS

AMOUNT

Shares in issue at beginning

+

Shares issued

-

Shares repurchased

=

Shares in issue at end

EXAMPLE

Beginning:

2 000 000

Issued:

500 000

Repurchased:

100 000

End:

2 400 000

EXAM TIP

Always complete the NUMBER column first.

Many learners find the AMOUNT column easier afterwards.

WORKED EXAMPLE

Beginning Shares

2 000 000

Issued

300 000

Repurchased

50 000

Ending Shares

?

Solution:

2 000 000

- 300 000
- 50 000

=

2 250 000

shares

COMMON MISTAKE

Learners often:

Add repurchased shares

instead of

subtracting them.

Remember:

Repurchased shares leave the market.

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11. RETAINED INCOME

Retained Income is one of the most important sections of Shareholders' Equity.

DEFINITION

Retained Income is accumulated profits that have not been distributed to shareholders.

SIMPLE EXAMPLE

Profit after tax

R1 000 000

Dividends

R250 000

Retained Income

R750 000

WHY RETAIN PROFITS?

Companies retain profits to:

✓ Expand operations

✓ Purchase assets

✓ Improve cash flow

✓ Reduce debt

√ Finance future growth

REMEMBER THIS

Retained Income

≠ Cash

Retained Income

=

Accumulated Profit

EXAM TRAP

A company may have:

High Retained Income

but

Low Cash

because profits may be invested in:

- Buildings
- Vehicles
- Equipment
- Inventory

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12. RETAINED INCOME NOTE

This note explains changes in Retained Income.

BASIC FORMAT

Balance at beginning

+

Net Profit After Tax

-

Dividends

=

Balance at end

EXAMPLE

Opening Balance

R2 000 000

Net Profit After Tax

R1 500 000

Dividends

R500 000

Closing Balance

R3 000 000

EXAM TIP

Read carefully:

Interim Dividend

Final Dividend

Dividends Declared

Dividends Paid

These are often confused.

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13. DIVIDENDS

Dividends are distributions of profits to shareholders.

INTERIM DIVIDEND

Paid during the financial year.

FINAL DIVIDEND

Declared at year-end.

Usually appears as:

Shareholders for Dividends

(Current Liability)

until paid.

EXAM QUESTION

Why do companies pay dividends?

Answer:

To reward shareholders for investing in the company.

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14. COMPLETE EQUITY SECTION

Shareholders' Equity consists mainly of:

Share Capital

+

Retained Income

=

Shareholders' Equity

EXAMPLE

Share Capital

R12 000 000

Retained Income

R3 000 000

Shareholders' Equity

R15 000 000

VISUAL SUMMARY

SHAREHOLDERS

↓

Invest Money

↓

SHARE CAPITAL

↓

Company Earns Profit

↓

NET PROFIT AFTER TAX

↓

DIVIDENDS + RETAINED INCOME

↓

SHAREHOLDERS' EQUITY

COMMON EXAM MISTAKES

❌ Confusing authorised shares and issued shares

✓ Authorised = Maximum allowed

✓ Issued = Actually sold

❌ Adding repurchased shares

✓ Subtract repurchased shares

❌ Retained Income = Cash

✓ Retained Income = Accumulated Profit

❌ Dividends are expenses

✓ Dividends are appropriations of profit

DISTINCTION TIPS

When answering company questions:

1. Start with the NUMBER column.
2. Calculate Average Share Price.
3. Check whether shares were issued or repurchased.

(3)

4. Distinguish between dividends declared and dividends paid.

5. Always show workings.

PRACTICE QUESTIONS

QUESTION 1

Define Share Capital.

(2)

QUESTION 2

Differentiate between authorised shares and issued shares.

(4)

QUESTION 3

A company has authorised shares of 6 000 000 and issued shares of 4 500 000.

How many shares may still be issued?

(2)

QUESTION 4

Shares in issue at beginning:

2 500 000

New shares issued:

400 000

Shares repurchased:

150 000

Calculate shares in issue at year-end.

(3)

QUESTION 5

A company earned net profit after tax of R2 500 000 and declared dividends of R800 000.

Calculate Retained Income.

(2)

QUESTION 6

Explain TWO reasons why a company may repurchase shares.

(4)

MEMORANDUM

QUESTION 1

Share Capital is the amount invested by shareholders in exchange for shares.

(2)

QUESTION 2

Authorised shares are the maximum number of shares allowed.

Issued shares are shares already sold.

(4)

QUESTION 3

6 000 000

– 4 500 000

=

1 500 000 shares

(2)

QUESTION 4

2 500 000

- 400 000

– 150 000

=

2 750 000 shares

(3)

QUESTION 5

R2 500 000

– R800 000

=

R1 700 000

(2)

QUESTION 6

Any TWO:

- Improve earnings per share
- Reward shareholders
- Improve control
- Increase shareholder value

(4)

CHAPTER SUMMARY

By the end of this chapter you should know:

✓ Share Capital

✓ Authorised Shares

✓ Issued Shares

✓ Share Repurchases

✓ Average Share Price

✓ Ordinary Share Capital Note

✓ Retained Income

✓ Dividends

✓ Shareholders' Equity

These concepts form the foundation of Question 1: Companies and Financial Statements in Grade 12 Accounting.