Chapter 15
Companies: Effects on retained earnings, share splits and buy-backs, and the income statement

Learning objectives

• Account for share dividends
• Account for share splits
• Account for share buy-backs
• Report transfers to reserves
• Complete a company income statement including earnings per share

Share dividends

• A share dividend (sometimes called a bonus share issue) is a distribution of a company’s own shares to its shareholders
• Unlike cash dividends, share dividends don’t give any of the company’s assets, like cash, to the shareholders
• They affect only shareholders’ equity accounts
• They have no effect on total shareholders’ equity
• They have no effect on assets or liabilities
Share dividends

Why issue share dividends?

• A company may wish to continue the distribution of dividends to keep shareholders happy, but may need to keep its cash for operations.
• Depending on its size, a share dividend may cause the company’s market price per share to fall because of the increased supply of the shares.
• Investors often feel as though they have received something of value when they get a share dividend.

Recording share dividends

• Three dates are important:
  - Declaration date
  - Record date
  - Distribution (payment) date
• Share dividends paid from retained earnings are said to be capitalised, because they transfer an amount from Retained earnings to Share capital.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account title</th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb 3</td>
<td>Retained earnings (Q-)</td>
<td>500000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ordinary share capital (Q+)</td>
<td></td>
<td>500000</td>
</tr>
<tr>
<td></td>
<td>Issued 100,000 ordinary shares in a share dividend.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Share splits

**SHARE SPLIT MEANING**

A share split is the division of shares into a larger number of smaller shares. It involves the division of the existing shares of a company into a larger number of shares by fractionalizing the existing shares. The value of the company's share price usually decreases proportionately to the number of new shares created.

**EXHIBIT 15-3**

<table>
<thead>
<tr>
<th>SMART TOUCH LEARNING LTD</th>
<th>SHAREHOLDERS' EQUITY—before</th>
<th>SHAREHOLDERS' EQUITY—after</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>$500,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>2,000 ordinary shares, fully paid</td>
<td>261,000</td>
<td>522,000</td>
</tr>
<tr>
<td>Total share capital</td>
<td>$261,000</td>
<td>$522,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>$4,000,000</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Total shareholders’ equity</td>
<td>$2,065,000</td>
<td>$2,580,000</td>
</tr>
</tbody>
</table>

**Share buy-backs**

- A company may purchase ('buy back') its own shares and cancel the shares.
- The company cannot then resell those shares.
- Reasons include:
  - The company has surplus cash but cannot see enough profitable investment opportunities for that cash.
  - Management wishes to replace a part of share capital with an increased amount of borrowings.
  - The directors believe that the shares are selling at a price below their true value.
  - Management wants to avoid a takeover by an outside party by reducing the number of issued shares that have voting rights.
Transfers to reserves

- Appropriations are transfers of retained earnings recorded by formal journal entries
- A company may appropriate a portion of retained earnings for a specific use or as a general reserve
- An appropriation does not decrease total retained earnings

<table>
<thead>
<tr>
<th>Date</th>
<th>Account title</th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 1</td>
<td>Retained earnings (Q-)</td>
<td>100000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>General reserve (Q+)</td>
<td></td>
<td>100000</td>
</tr>
<tr>
<td></td>
<td>Transferred portion of Retained earnings to General reserve.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The company income statement

- Accounting Standard AASB 101, Presentation of Financial Statements, specifies the information that must be shown in the income statement
- Variations in the format of the statement are allowed provided that it presents fairly the financial performance of the business
- The income statement also shows the company’s earnings per share (EPS)
- EPS reports the amount of profit (or loss) for each issued ordinary share
- \( \text{EPS} = \frac{\text{Profit after income tax} - \text{Preference dividends}}{\text{Weighted average number of ordinary shares issued}} \)
The company income statement

Prior period adjustments

- A company may make an accounting error, such as an error in recording revenues or expenses
- Corrections for errors of an earlier period are called prior period adjustments
- Accounting Standard AASB 108, Accounting Policies, Changes in Accounting Estimates and Errors, requires that the financial statements of earlier periods be amended to correct the error

Reporting comprehensive income

- Comprehensive income is the company’s change in total shareholders’ equity from all sources other than its owners
- Comprehensive income includes profit for the period plus some other specific items, including changes in Asset revaluation reserve, gains and losses on conversion of the financial reports of foreign operations, gains and losses on some types of superannuation plans
- The statement of comprehensive income is one of the financial statements that must be prepared under Accounting Standard AASB 101, Presentation of Financial Statements
Summary: Chapter 15

- A share dividend (sometimes called a bonus share issue) is a distribution of a company's own shares to its shareholders.
- Three dates are important: declaration date, record date, distribution (payment) date.
- A company may purchase ('buy back') its own shares and cancel the shares.
- Appropriations are transfers of retained earnings recorded by formal journal entries.
- Accounting Standard AASB 101, Presentation of Financial Statements, specifies the information that must be shown in the income statement.
- Another statement required by AASB 101 is the statement of changes in equity.