

# ACCT 101, Session 3: Financial statements; Equity

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<https://rmc.link/>

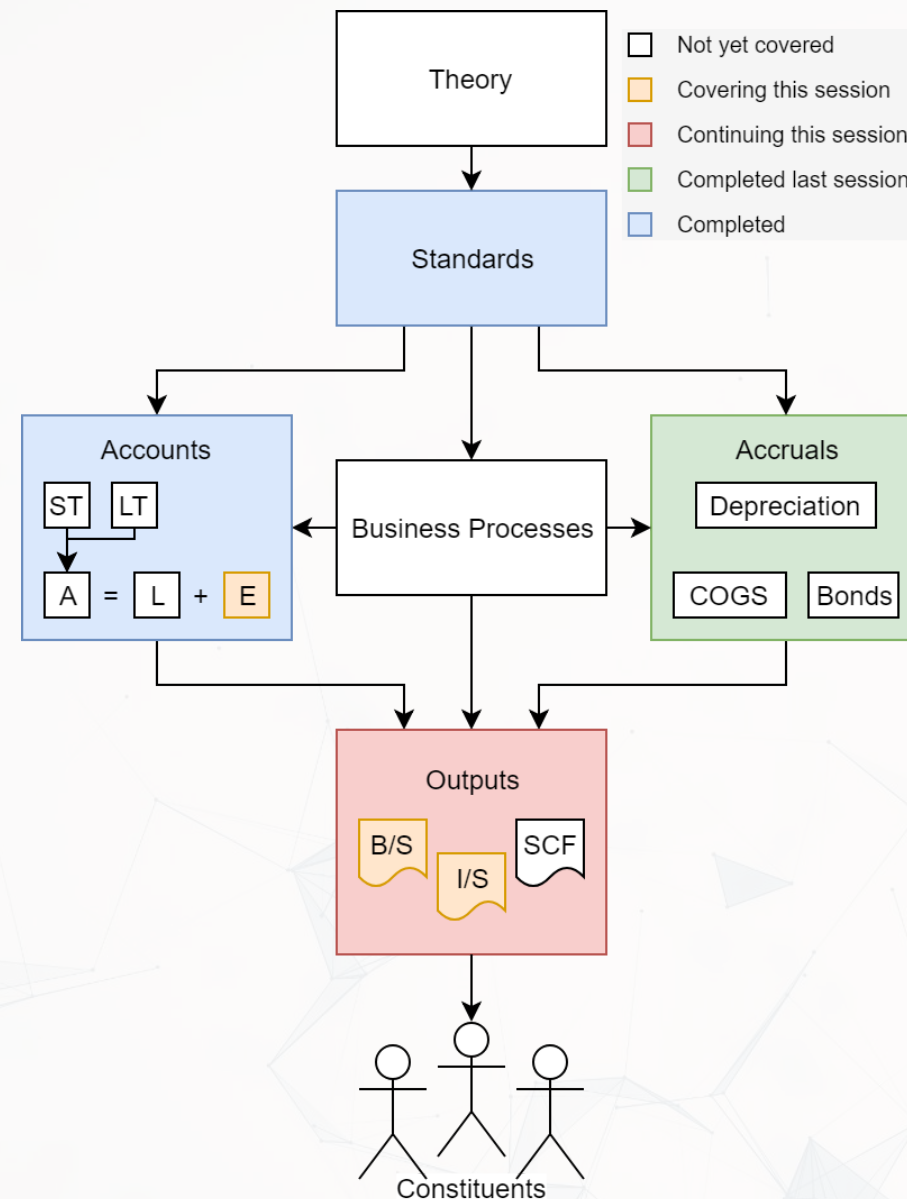
# Front matter

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- Homework 1 should be submitted soon
  - Submit on eLearn if you haven't
- Homework 2 due next week
  - Looking through real annual reports
  - Largely open ended and will be graded for completion
    - Some questions ask for your own opinion – there is no explicitly correct answer to these, since everyone has their own preferences
  - Look for it on eLearn



# Learning objectives



## Financial Statements (Ch 3)

1. Appreciate annual reports as a communication tool
2. Understand the presentation of the Statements of:
  - Financial Position
  - Comprehensive Income
  - Changes in Equity

## Equity (Chapter 10)

1. Learn about the share structure of a corporation
2. Account for changing capital structure and dividends

# Annual reports



# What's included

## 1. Corporate information

- Name(s), history, key management/directors, structure
- Awards, company description, operating statistics

## 2. Letter to shareholders

- Written by CEO

## 3. Management Discussion and Analysis (MD&A)

- Management writes this section
- Often discuss:
  - The year's performance
  - Possible future risks

# What's included

4. **Explicit and unreserved** statement of compliance to financial reporting standards.
5. Accounting statements
  - Statement of financial position
  - Statement of comprehensive income
  - Statement of changes in equity
  - Statement of cash flows
6. Statement notes
  - Often quite long, substance focused
  - Discusses important but difficult matters
  - Cannot rectify inappropriate accounting treatments
7. Acknowledgement of responsibility by management



# Why are these important?

- If you ever need information about a company's financial standing, the annual and quarterly reports are your primary source.
- If you get information elsewhere (Bloomberg, Morningstar, etc.)...
  - They got it from there
    - Or from someone else who got it from there
- Contains a lot of other useful information about the companies



# What you can find

- Financials
- Risks to the company going forward
- Legal issues
- Corporate strategy
- The company's major customers
  - Very helpful for checking out competitors...
- Plenty more!

# Case: A good report (DBS)

- [Full 2016 report here](#)
- [Web version here](#)



# Case: A bad report (Groupon)

SEC filing S-1 1 a2203913zs-1

We use **adjusted consolidated segment operating income**, or Adjusted CSOI, and free cash flow as key non-GAAP financial measures. Adjusted CSOI and free cash flow are used in addition to and in conjunction with results presented in accordance with GAAP and *should not be relied upon* to the exclusion of GAAP financial measures.

- End result
- Follow up analysis



# Financial statements

# General requirements

- Name of reporting entity, date ended, currency used, level of rounding
  - Or individual entity (“Consolidated report for...”)
- Can group similar accounts together if immaterial
  - Not disclosing separately has no impact on F/S users
  - Cannot offset liabilities with assets, unless allowed
    - IAS 16, IAS 18
    - Foreign exchange gains and losses
- Must be done *at least* yearly (fiscal year)
- Usually provide comparative information for the past two periods



# Statement of financial position

- Also known as a Balance Sheet (B/S)
- Presents:
  - Non-current assets (> 1 year in life)
    - PP&E, intangible assets
  - Current assets
    - Cash (and equiv), trade, other financial assets, biological assets, typical inventory items (e.g., t-shirts), receivables
  - Long term (> 1 year until paid off), then current liabilities
    - Provisions, other financial liabilities
  - Equity
    - Non-controlling equity interests, issued capital, reserves
    - Retained earnings

Presents companies' *stock* of assets, liabilities, and equity

Technically inventory that usually takes more than 1 year to sell (e.g., a nuclear submarine) can be considered as a non-current asset



# How to construct a SFP

1. Start with an adjusted trial balance
2. List all long term assets and sum
3. List all short term assets and sum
4. Total all assets
5. List all long term liabilities and sum
6. List all short term liabilities and sum
7. Total all liabilities
8. List retained earnings
9. List capital accounts
10. Total all equity accounts
11. Sum Total liabilities and equities
12. Verify  $A = L + E$

Statement of Financial Position for Coffee Company	
In Singapore dollars.	Dec 31, 20X9
Assets	
2 Non-current assets	
2 Total non-current assets	\$XX
3 Current assets	
3 Total current assets	\$XX
4 Total assets	\$XX
Liabilities	
5 Non-current liabilities	
5 Total non-current liabilities	\$XX
6 Current liabilities	
6 Total current liabilities	\$XX
7 Total liabilities	\$XX
Equity	
8 Retained earnings	\$XX
9 Share capital	\$XX
9 Additional paid in capital	\$XX
10 Total Equity	\$XX
11 Total Liabilities and Equity	\$XX

12 These two must be equal

# Statement of Comprehensive Income

- Also known as an Income Statement (I/S)
- Presents:
  - Revenue
  - Expenses, categorized by nature or function
    - Operating expenses
    - Non operating expenses
  - Net income
  - Below or separately it presents:
    - Gains and Losses
    - Called other comprehensive income (OCI)

While taxes are always included, you will not be asked to calculate taxes for this course. If no taxes are mentioned, assume they are 0.

# Constructing an SCI

1. Start with an adjusted trial balance
2. List revenue
3. List cost of goods sold (COGS)
4. Calculate *gross profit* (revenue - COGS)
5. List other expenses (exc. interest & taxes)
6. List other revenues (exc. interest & other holdings)
7. Calculate *operating profit*
8. List other non-tax expenses and incomes
  - Those that aren't included above
9. Calculate *income before taxes*
10. List taxes
11. Calculate *net income (loss)*
12. [Optional] start a new page
13. List OCI items (gains and losses)
14. List tax on OCI
15. Calculate *OCI, net of tax*
16. Calculate *total comprehensive income*
  - OCI, net of tax + net income (loss)

## Statement of Comprehensive Income for Coffee Company

In Singapore dollars	Dec 31, 20X9
② Revenue	\$XX
③ Cost of goods sold	\$XX
④ Gross profit	\$XX
⑤ Other expenses (excluding interest and taxes)	
⑥ Other incomes (excluding interest and other holdings)	
⑦ Operating profit	\$XX
⑧ Other expenses: interest expense	
⑧ Other incomes: interest, other holdings	
⑨ Income before taxes	\$XX
⑩ Expense: Taxes	
⑪ Net income (loss)	\$XX
<hr/>	
⑫ Other Comprehensive income	
⑬ OCI items (gains and losses)	
⑭ Tax on OCI	
⑮ OCI, net of tax	\$XX
⑯ Total comprehensive income	\$XX



# Statement of Changes in Equity

- Reconciles from period start to end
  - Per IAS 1, must reconcile each equity item separately as well as the total
- Shows all transactions with owners
- Shows all dividends paid (can be as a note to the statement)
- This statement often relies on information that is contained outside the adjusted trial balance

You won't be required to construct this statement for exams.

# Constructing an SCE

1. List all equity items across the top as columns
  - Generally includes: share capital, APIC, retained earnings, treasury stock, total equity
2. Put “balance as of [beginning date]” as the first row
3. List all items that effected 1 of the columns values for the year as the rows
  - Generally includes: share issuance, treasury share sales, dividends paid, net income
4. Put “balance as of [ending date]” as the last row
5. Fill out all changes
6. Often includes the prior year as well

Statement of Changes in Equity for Coffee Company			
In Singapore dollars		Dec 31, 20X9	
	①	Equity items	Total equity
Balance as of [start]	②		Balance as of [start]
③		⑤	
Items causing changes			Calculate changes
Balance as of [end]	④		Balance as of [end]

# Statement of Cash Flows

- We'll get back to this...
  - Sessions 10 and 11
  - Chapter 11



# Practice

- Practice problem on eLearn for Coffee Corp (last week's company)

## 1. Construct a Statement of Financial Position

- Use the adjusted trial balance
- Do for 2018

## 2. Construct a Statement of Comprehensive income

- Use the adjusted trial balance
- Do for 2018
- Ignore taxes

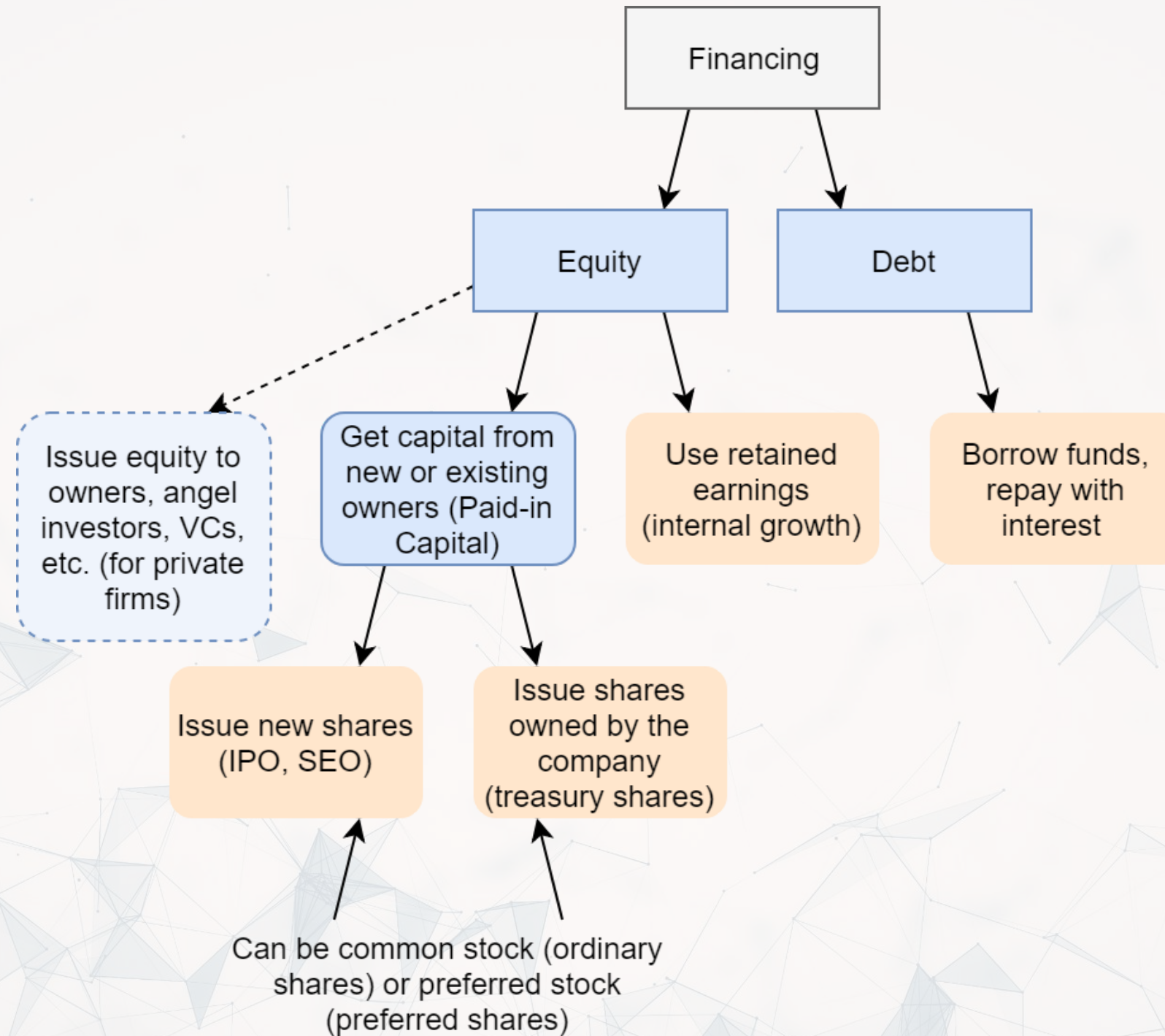
## 3. If you have time, go back and do for 2019 too!

There is an Excel file on eLearn with the adjusted trial balances for 20X8 and 20X9.



# Financing

# Financing types





# Equity vs debt

## Equity

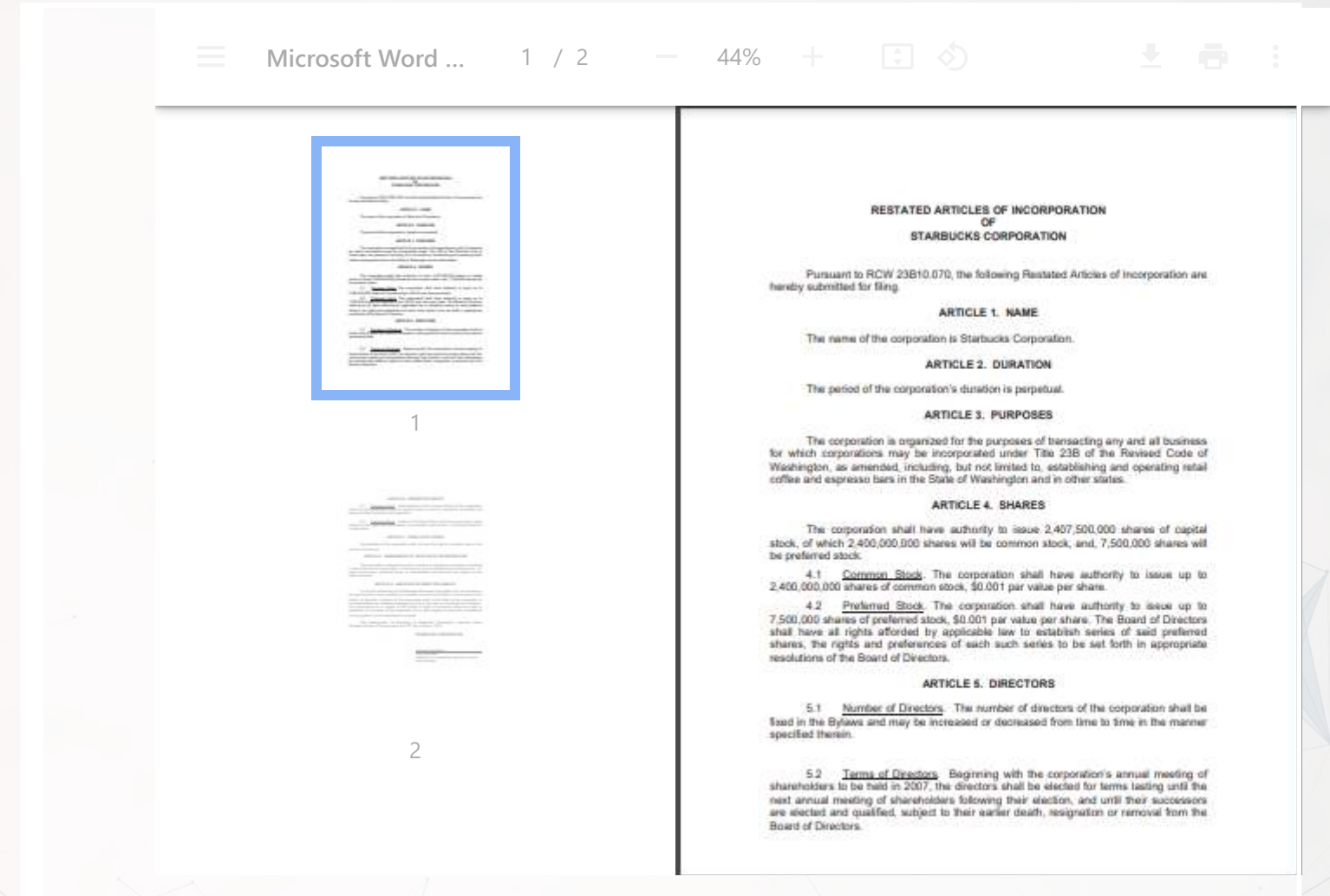
- Advantages:
  - No legal obligation to distribute profits
    - Great for growth
  - All profit can be reinvested
- Disadvantages:
  - Dilutes existing shareholders' ownership
    - Decreases the % of the company they own
  - More expensive
  - Can only be issued by a corporation

## Debt

- Advantages
  - Shareholders maintain ownership
  - Can be quicker to receive financing
- Disadvantages
  - Often need to pay periodic interest
    - Requires cash on hand to pay
    - Solvency risk  $\Rightarrow$  bankruptcy

# Articles of Incorporation

- Equity is governed by a corporation's *articles of incorporation*
  - Also known as a *corporate charter*
- Written at the time of incorporation
  - When the company is created
- Governs:
  - Nature of business activities
  - Number of shares of stock
  - Initial board of directors





# Corporations

## Advantages

- Can raise both equity and debt
- Continuous life
- Ownership is liquid
- Limited liability for owners

## Disadvantages

- Separation of ownership and management
  - Leads to conflicts of interest
- Other tax policies apply
  - *Double taxation*: A corporation's income is taxed and dividends to investors are taxed
    - Generally not an issue in Singapore
- More government regulation



# Corporations

## Public

- Public investment
- No cap on # of shareholders
- Increased regulation



## Private

- No public investment
  - Some exceptions to this
- Fewer shareholders
- Less regulated



# Shareholder rights

## Voting

- For board of directors
- For important events

## Dividends

- Right to share in profits (when dividends are declared)

## Liquidation

- Right to share in asset value if company liquidates
  - After lenders get their share of value

## Limited liability

- Can only lose what was originally invested

How shareholders protect themselves



# Share types

## Ordinary shares

- Standard share type (most common)
- Has the four basic shareholder rights
- Benefits the most if the company succeeds
  - Takes on the most risk

## Preferred shares

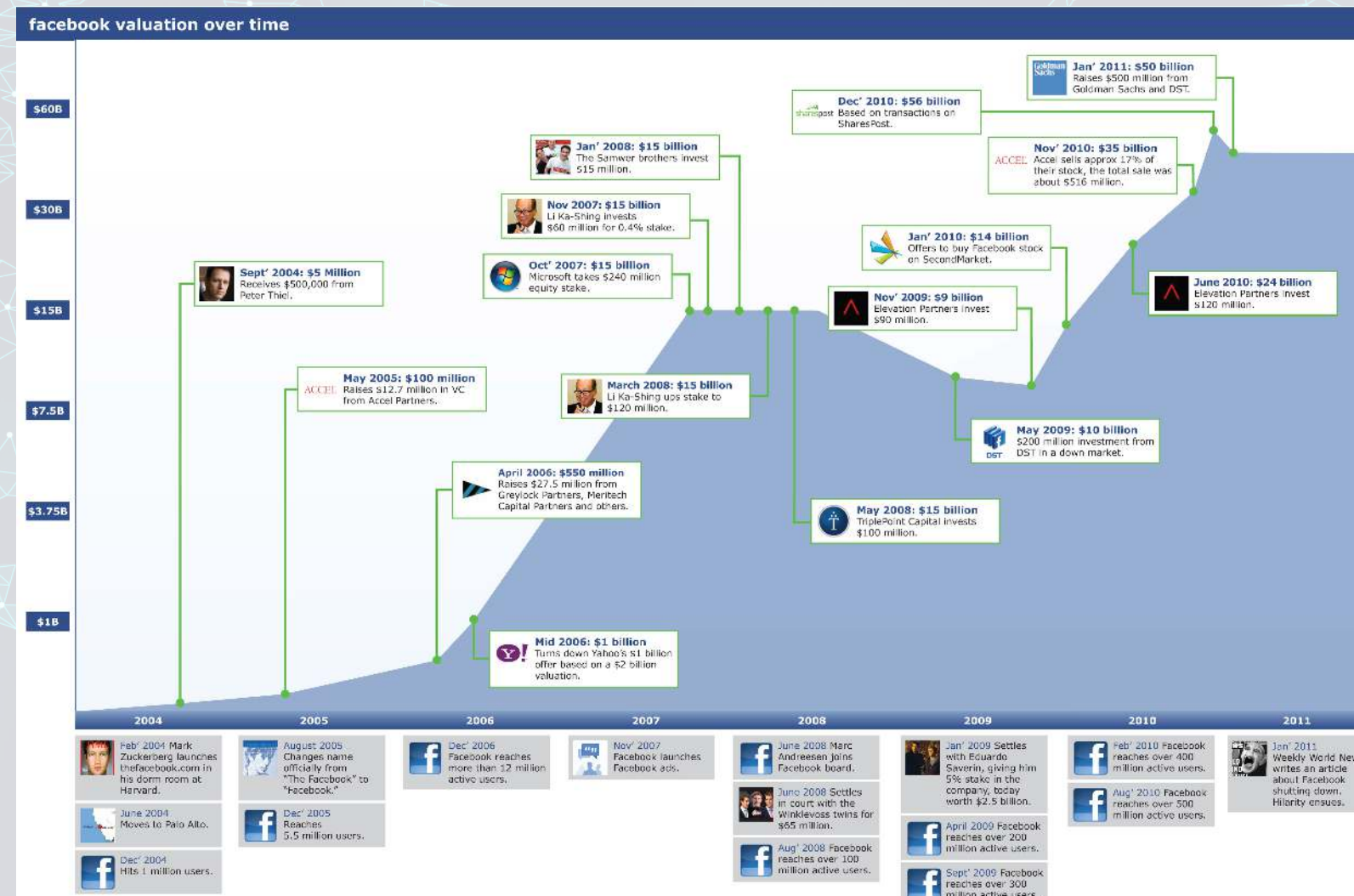
- Limited/no voting rights
- Earns a fixed dividend
  - Receives dividends before common shares
- Receives assets before common shares in liquidation
- May have other rights (convertible, redeemable, cumulative)
  - Varies from company to company



# Equity details

- Corporate charter stipulates the number of shares
  - Rare that a company has all such shares issued
- Investors hold shares
- The company holds treasury shares
  - Shares the company has bought back
- Unissued shares have never been issued
  - Can issue in an Initial Public Offering (IPO) or Secondary/Seasoned Equity Offering (SEO)
    - Requires government and exchange approval

# Equity financing example: Facebook

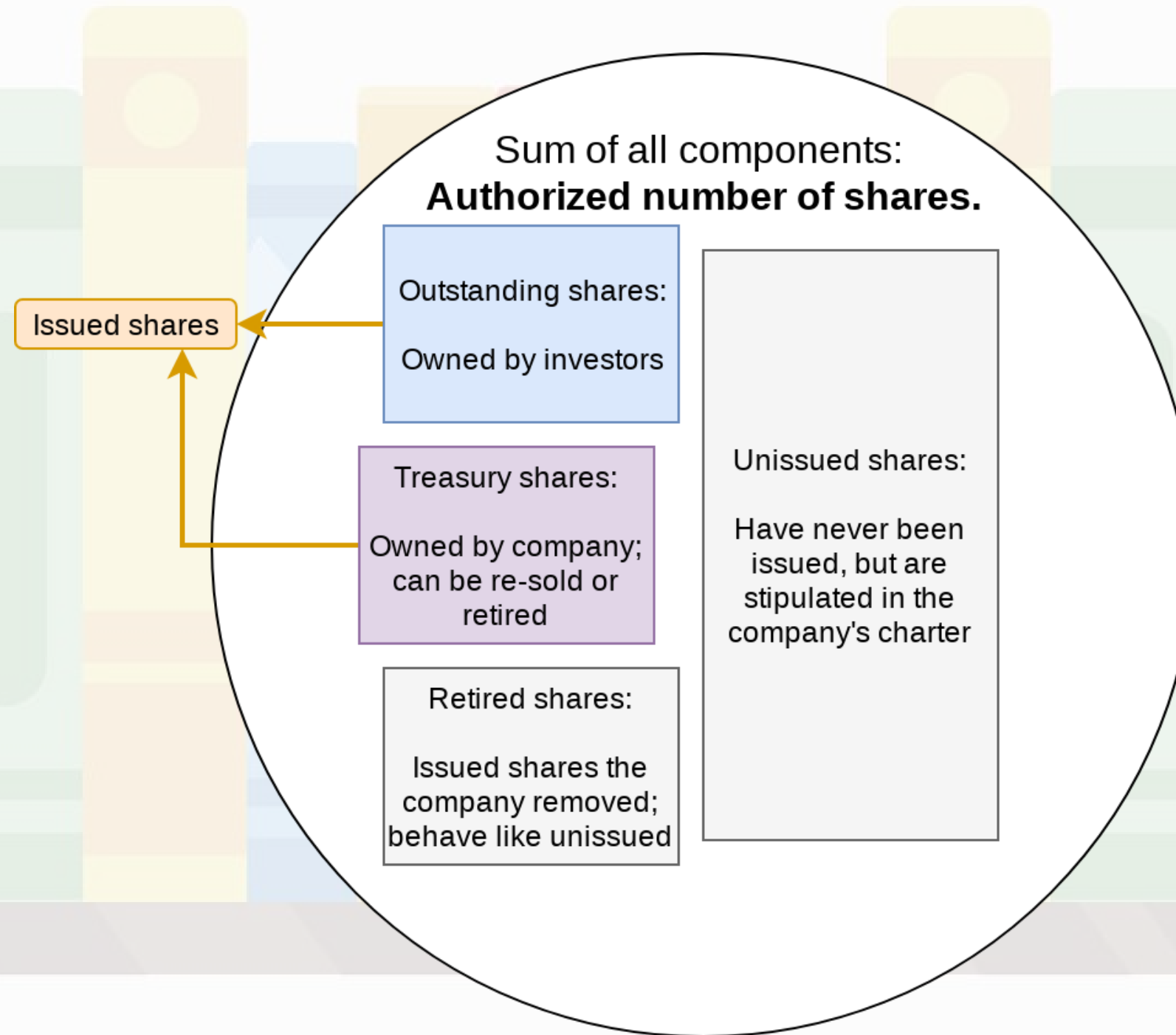


Source: <https://techcrunch.com/2011/01/10/facebook-5/>

# Accounting for equity



# Number of shares



# Accounting for common stock

- *Singapore does not allow the par value method*
  - Still allowed in many countries
  - The book uses this mostly, so ignore the book on this topic!!!
- Simpler treatment in Singapore
- Note: The book uses the account name *Common stock*, which is commonly used in the U.S.

Situation: The company issued 1 million ordinary shares at \$15 each.

## Example: Accounting for share issuance, Singapore

Date	Account	DR	CR
20YY.MM.DD	Cash	15,000,000	
	Share capital (ordinary shares)		15,000,000
Issued 1M ordinary shares for \$15 each			

OK to put "Ordinary shares" as the account, or just "Share capital" if the company has no preferred shares

# Par value method (NOT ALLOWED IN SG)

- Separate accounts for par capital and above-par capital
- Note: The book uses the account name *Additional Paid-in Capital*, which is common in the U.S.

Situation: 1) The company issued 1 million ordinary shares at \$15 each with par value of \$15.  
2) The company issued 1 million ordinary shares at \$15 each with par value of \$1.

## Example: Accounting for share issuance, Par value method

Date	Account	DR	CR
20YY.MM.DD	Cash	15,000,000	
	Ordinary shares		15,000,000
Issued 1M ordinary shares for \$15 each, \$15 par value			

20YY.MM.DD	Cash	15,000,000	
	Ordinary shares		1,000,000
	Paid-in capital in excess of par		14,000,000
Issued 1M ordinary shares for \$15 each, \$1 par value			

Capital at  
par value

Capital above  
par value



# Par value

- *Par value* is a value of a share of stock stipulated in the corporation's articles of incorporation
  - It has no relationship with the market value of the stock (stock price)
  - Ex.: Facebook has a par value of USD 0.000006/share
- Not used in Singapore since 2005

R1

#Quote('META')

	Trade	Time	Last	Change	% Change	Open	High	Low
META	2024-08-23	16:00:01	528	-3.929993	-0.7388176	536.92	539.8494	525.0601
	Volume							
META	11323936							

# Accounting for preferred stock

- Using the same numbers as the common stock example
- Note: The book uses the U.S. account name, *Preferred stock*

Situation: The company issued 1 million preferred shares at \$15 each.

## Example: Accounting for share issuance, preferred shares, Singapore

Date	Account	DR	CR
20YY.MM.DD	Cash	15,000,000	
	Share capital (preferred shares)		15,000,000
Issued 1M preferred shares for \$15 each			

Only change from common stock example

We almost always treat preferred shares as **equity**

The exception (IAS 32) is for redeemable shares with fixed redemption date and fixed dividend payments



# Treasury stock

- Common stock that has been repurchased
- Reasons for repurchasing:
  1. Issue incentive compensation
  2. Increase stock price
    - By distributing cash to shareholders
  3. Use in trading
  4. Increase EPS
  5. Remove a shareholder (defensive)

# Treasury stock: Retirement

- Retirement removes the shares from share capital entirely

Situation: The company purchased 20,000 shares at \$20 each, and then retired them.

## Example: Purchasing and retiring treasury stock

Date	Account	DR	CR
20YY.MM.01	Treasury shares	400,000	
	Cash		400,000

*Purchase 20,000 shares at \$20 each as treasury shares*

20YY.MM.02	Share capital (ordinary shares)	400,000	
	Treasury shares		400,000

*Retired 20,000 treasury shares originally purchased at \$20 each*

Removes shares  
from circulation

Reversed  
purchase

Treasury shares: *contra equity* account, decreasing equity



# Treasury stock: Reissuing at a profit

Situation: The company purchased 20,000 shares at \$20 each, and then sold them in 2 transactions: 10,000 for \$25 each and 10,000 for \$15 each.

## Example: Purchasing and reissuing treasury stock at a profit

Date	Account	DR	CR
20YY.MM.01	Treasury shares	400,000	
	Cash		400,000
Purchase 20,000 shares at \$20 each as treasury shares			

20YY.MM.02	Cash	250,000	
	Treasury shares		200,000
	Additional paid in capital		50,000
Sold 10,000 treasury shares at \$25 (purchased at \$20)			

Also known as "APIC"

Based on purchase price (\$20)

Based on difference in prices (\$25-\$20=\$5)

## Example: Reissuing treasury stock at a loss with sufficient APIC

20YY.MM.03	Cash	150,000	
	Additional paid in capital	50,000	
	Treasury shares		200,000
Sold remaining 10,000 treasury shares at \$15 (purchased at \$20)			

Based on difference in prices (\$15-\$20=-\$5)

Based on purchase price (\$20)

# Treasury stock: Reissuing at a loss

Situation: The company purchased 20,000 shares at \$20 each, and then sold them in 2 transactions: 10,000 for \$15 each and 10,000 for \$25 each.

## Example: Purchasing and reissuing treasury stock at a loss

Date	Account	DR	CR
20YY.MM.01	Treasury shares	400,000	
	Cash		400,000

*Purchase 20,000 shares at \$20 each as treasury shares*

20YY.MM.02	Cash	150,000	
	Retained earnings	50,000	
	Treasury shares		200,000

*Sold 10,000 treasury shares at \$15 (purchased at \$20)*

Holds excess losses

Based on difference in prices (\$15-\$20=-\$5)

Based on purchase price (\$20)

## Example: Reissuing treasury stock after a loss

20YY.MM.03	Cash	250,000	
	Retained earnings		50,000
	Treasury shares		200,000

*Sold remaining 10,000 treasury shares at \$25 (purchased at \$20)*

Based on difference in prices (\$15-\$20=-\$5)

Based on purchase price (\$20)



# Treasury shares: Summary

- *Treasury shares* represents the issued shares held by the firm itself
- It is a contra equity because it takes away from owners' ownership

## “Profit” from treasury shares

- Not considered actual profit (won't hit the I/S)
- Can fill in prior “losses” in retained earnings
- Can add to *Additional Paid-in Capital* (APIC)

## “Losses” from treasury shares

- Not considered an actual loss (won't hit the I/S)
- Subtracts from APIC
- If APIC hits 0, subtract from *Retained earnings*

All treasury shares transactions are based on actual amounts paid (market value)

# Treasury stock: Putting it all together

Situation: The company purchased 20,000 shares at \$20 each, and then sold them in 3 transactions: 5,000 for \$15 each, 5,000 for \$26 each, and 10,000 for \$18 each.

## Example: Purchasing and reissuing treasury shares, complex transactions

Date	Account	DR	CR
20YY.MM.01	Treasury shares	400,000	
	Cash		400,000

*Purchase 20,000 shares at \$20 each as treasury shares*

20YY.MM.02	Cash	75,000	
	Retained earnings	25,000	
	Treasury shares		100,000

*Sold 5,000 treasury shares at \$15 each (purchased at \$20)*

20YY.MM.02	Cash	130,000	
	Retained earnings		25,000
	Treasury shares		100,000
	Additional paid in capital		5,000

*Sold 5,000 treasury shares at \$26 each (purchased at \$20)*

20YY.MM.02	Cash	180,000	
	Retained earnings	15,000	
	Additional paid in capital	5,000	
	Treasury shares		200,000

*Sold remaining 10,000 treasury shares at \$18 each (purchased at \$20)*

Reverse only debits from treasury share sales

Holds excess profit

Holds excess loss

Reverse only APIC credits from treasury share sales

Treasury shares	
400,000	
	100,000
	100,000
	200,000
0	

Cash	
	400,000
75,000	
130,000	
180,000	
	15,000

APIC	
	5,000
5,000	
	0

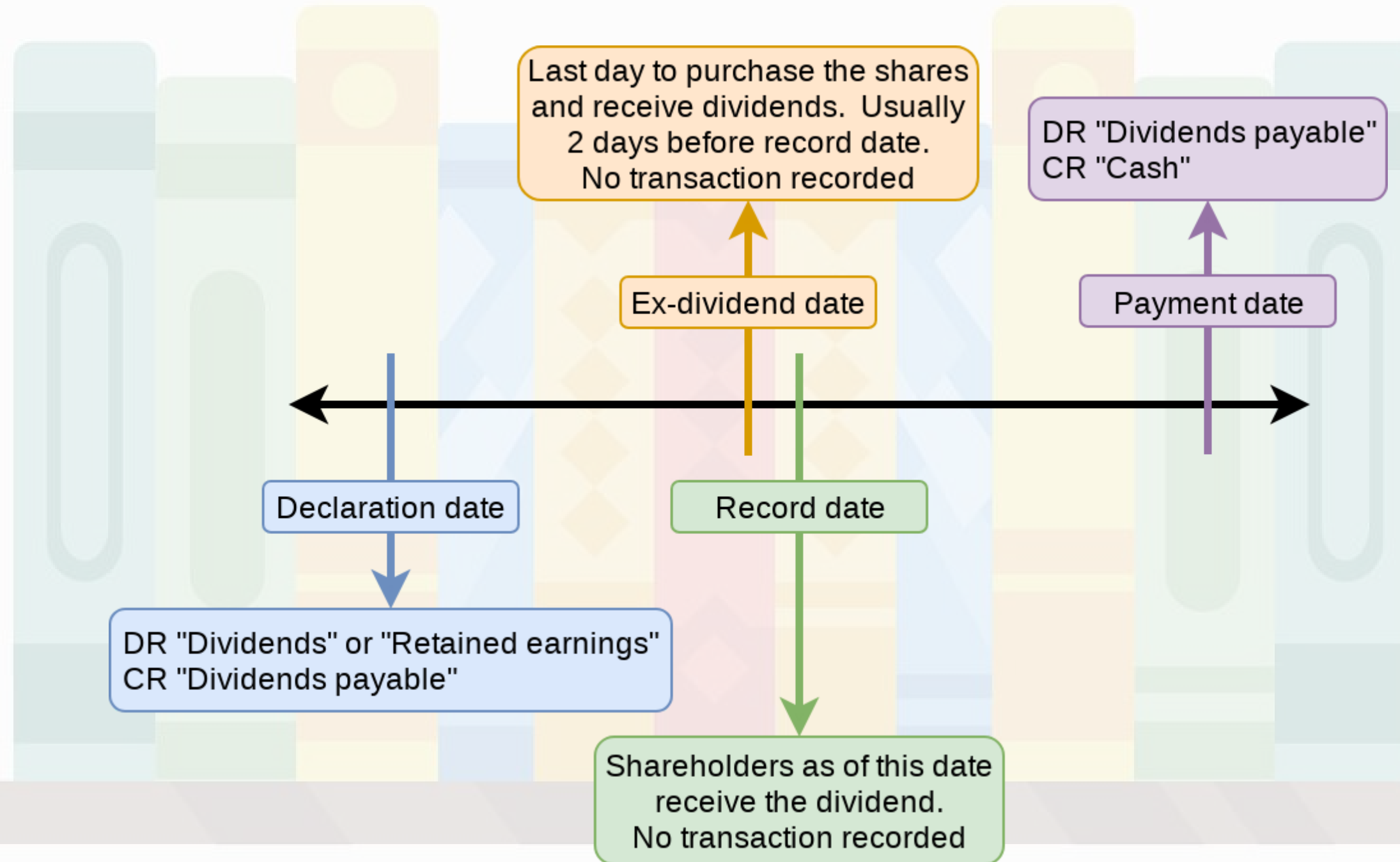
Retained earnings	
25,000	
	25,000
15,000	
	15,000



# Dividends

- Cash dividends
  - Final dividend: year end, policy voted on by shareholders
  - Interim dividends: declared by board of directors
  - Need to have enough retained earnings on hand to declare the dividend
  - Need to have enough cash on hand to pay the dividend
- Share dividends
  - Proportional distribution of shares to shareholders
  - Shifts retained earnings to share capital
    - Increases number of outstanding shares

# Dividends timeline





# Recording cash dividends

Situation: declared \$0.10 per share of dividends on Jan 1, with record date of Jan 15 and payment date of Jan 30. 100,000 shares are outstanding.

## Example: Cash dividends

Date	Account	DR	CR
20YY.01.01	Dividends ←	10,000	
	Dividends payable		10,000
<i>Declared \$10,000 in dividends</i>			

Or Retained earnings

*Dividend record date of 20YY.01.15 -- No journal entry needed*

20YY.01.30	Dividends payable	10,000	
	Cash		10,000
<i>Paid \$10,000 in dividends</i>			

# Recording share dividends

- Shifting of values within equity accounts only
  - Record at market value

Situation: declared 0.05 shares per share as a share dividend on Jan 1.  
100,000 shares are outstanding with a market value of \$10 each.

## Example: Share dividends

Date	Account	DR	CR
20YY.01.01	Retained earnings	50,000	
	Share capital (ordinary shares)		50,000
<i>Declared share dividend of 100,000 shares x \$10/share market price x 0.05 shares/share</i>			



# Stock split

- Exchange all common shares at a certain ratio
  - Such as a 2 for 1 stock split: receive an additional 1 share for every share owned
  - Not substantively different from a stock dividend
    - Just a larger change in the number of shares outstanding
- No accounting effects
- No journal entry

# Summary of transactions

Transaction	Asset (↑=DR)	Liability (↑=CR)	Equity (↑=CR)
Issue shares	↑	--	↑
Purchase treasury shares	↓	--	↓
Sell treasury shares	↑	--	↑
Declare dividends	--	↑	↓
Pay dividends	↓	↓	--
Issue share dividends	--	--	--
Stock split	--	--	--



# Practice questions

- Take 5-10 minutes to work on this in groups

Caffeine & Co had 50,000 shares outstanding as of Jan 1, 20X8. The following transactions occurred throughout the year. Prepare the journal entries for each transaction.

1. On January 30, Caffeine & Co purchased 10,000 shares for \$10 per share.
2. On March 30, Caffeine & Co sold 2,000 treasury shares at \$8 per share.
3. On April 1, Caffeine & Co declared a dividend of \$0.05 per share. The date of record was April 15th, with payment on May 30th.
4. On May 1, Caffeine & Co sold 6,000 treasury shares at \$15 per share.
5. On May 30, Caffeine & Co paid the previously declared dividend
6. On October 31, Caffeine & Co sold its remaining 2,000 treasury shares at \$8 per share.





# Practice questions

## Practice questions solution

Date	Account	DR	CR
20X8.01.30	Treasury shares	100,000	
	Cash		100,000
<i>Purchase 10,000 shares at \$10 each as treasury shares.</i>			
20X8.03.30	Cash	16,000	
	Retained earnings	4,000	
	Treasury shares		20,000
<i>Sold 2,000 treasury shares at \$8 per share.</i>			
20X8.04.01	Dividends	2,100	
	Dividends payable		2,100
<i>Declared a dividend of \$0.05 per share.</i>			
20X8.05.01	Cash	90,000	
	Treasury shares		60,000
	Retained earnings		4,000
	Additional paid in capital (APIC)		26,000
<i>Sold 6,000 treasury shares at \$15 per share.</i>			
20X8.05.30	Dividends Payable	2,100	
	Cash		2,100
<i>Paid the dividend declared on 20X8.04.01.</i>			
20X8.10.31	Cash	16,000	
	Additional paid in capital (APIC)	4,000	
	Treasury shares		20,000
<i>Sold 2,000 treasury shares at \$8 per share.</i>			

Decreased retained earnings because we have 0 balance in the additional paid in capital account.

[50,000 shares outstanding - 8,000 treasury shares] x \$0.05/share dividend = \$2,100

Technically not required; could be included in APIC instead.

This is the exact same transaction as on 20X8.03.30, but the journal entry is different because we have APIC.



End matter



# Wrap up

- For next week
  1. Recap the reading for this week
  2. Read the pages for next week
    - Control Systems (Chapter 4)
  3. Homework to *turn in next week*
    - Available on eLearn
    - Submit on eLearn
  4. Practice on eLearn
    - Extra Excel practice on B/S and I/S
    - Practice on both F/S and equity
    - Automatic feedback provided
- Survey on the class session at [rmc.link/101survey3](https://rmc.link/101survey3)





# Packages used for these slides

- curl
- kableExtra
- knitr
- quantmod
- revealjs