

Module 5 - Accounting for Equity

Contents

5.1. Accounting Equation	2
5.2. What is Equity	2
5.3. Equity Components	2
5.4. Capital Contribution	3
5.4.1. Capital Contribution to a company	3
5.4.2. Capital Contribution to Sole Proprietorship	4
5.4.3. Capital Contribution to Partnership / LLP	4
5.5. Retained Earnings / Accumulated Profit	5
5.6. Profit Distribution	5
5.6.1. Sole Proprietorship	6
5.6.2. Partnership	6
5.6.3. Corporation/LLP	6
5.7. Drawings	7
5.8. Report Presentation Statement of Changes in Equity	7
5.8.1. Sole proprietorship	8
5.8.2. Partnership	9
5.8.3. Corporation / LLP	10

5.1. Accounting Equation

- Is a foundation of the double-entry accounting system.
- shows on a company's balance that a company's total assets are equal to the sum of the company's liabilities and shareholders' equity.
- Assets represent the valuable resources controlled by the company. The liabilities represent their obligations.
- Both liabilities and shareholders' equity represent how the assets of a company are financed.

$$\text{Assets} = \text{Liabilities} + \text{Equities}$$

5.2. What is Equity

Equity represent Capital / investment funds from shareholders or business owner plus profit earned. It is the accumulated wealth in a business.

This value would be returned to a company's shareholders if all the assets were liquidated and all of the company's debts were paid off.

5.3. Equity Components

$$\text{Equities} = \text{Shareholders' Money} + \text{Accumulated Profit}$$

- Shareholders' Money represent initial capital amount invested into the business.
- Accumulated Profit or Retained Earnings represent profit earned from first day of operation and these profits retained in the company for future expansion and not distribute to shareholders.
- It is permitted to distribute the retained earnings back to the shareholders if there is sufficient cash. This distribution is a return to investor.

5.4. Capital Contribution

Investors/shareholders make capital contributions when a company issues equity shares based on a price that **shareholders are willing to pay for them**.

The total amount of contributed capital or **paid-in-capital** represents their stake or ownership in the company.

5.4.1. Capital Contribution to a company

Contributed capital, also known as **paid-in capital**, is the **cash** and **other assets** that shareholders have given a company in exchange for share.

Contributed capital is reported in the **shareholder's equity** section of the **balance sheet**.

Example of Contributed Capital

A company issues **50,000 RM1 par value shares to investors**. The investors pay \$1 a share, so the company raises **\$50,000** in equity capital.

As a result, the company records \$50,000 to the Share Capital account

Dr	Bank	\$50,000	
	Cr	Share Capital	\$50,000

The process of **increase share capital** must lodge with **SSM** and normally executed by **Company Secretary**.

5.4.2. Capital Contribution to Sole Proprietorship

Original investment posted into capital account.

Example:

Ali starts his business by investing his money into a business account for RM50,000 in cash and RM30,000 in equipment.

Dr	Cash	RM50,000	
Dr	Equipment	RM30,000	
	Cr Capital		RM80,000

The process no need to lodge with SSM.

5.4.3. Capital Contribution to Partnership / LLP

The **capital account** of the partners is normally **fixed throughout** the partnership. Advisable to open a capital account for each partner. The process no need to lodge with SSM.

For example, if Allen invests \$10,000 and Ben invests \$20,000 into AB Business, then you will have the following double entries:

Dr	Cash/Bank		10,000
	Cr	Capital A/C - Allen	10,000
Dr	Cash/Bank		20,000
	Cr	Capital A/C - Ben	20,000

5.5. Retained Earnings / Accumulated Profit

Retained earnings are a portion of a company's profit that is held or retained from net income at the end of a reporting period and saved for future use and carried over to next year in balance sheet where it is reported under shareholder's equity.

It is a key component of shareholder's equity that helps a company determine its book value.

Retained Earnings is transfer from net profit earned for a period and calculated by subtracting all of the costs of doing business from a company's revenue.

Those costs may include COGS, as well as operating expenses such as mortgage payments, rent, utilities, payroll, and general costs. Other costs deducted from revenue to arrive at net profit can also include investment losses, debt interest payments, and taxes.

Any net profit that is not paid out to shareholders at the end of a reporting period becomes retained earnings.

$$\text{Retained Earnings} = \text{Profit Earned b/f} + \text{this year profit} - \text{Dividend}$$

5.6. Profit Distribution

refer to the allocation of company's retained earnings to shareholders, owners, or partners.

This is a form of return-on-investment payback to shareholders, owners or partners.

The process of distribution is different for every business entity. It all depends on whether your firm is registered under a sole proprietorship, partnership, or corporation.

5.6.1. Sole Proprietorship

the entire amount of profit belongs to the owner and will credit to Capital Account / Retained Earnings. Any profit distribution considers a drawing and will debited to Drawing Account.

5.6.2. Partnership

In Partnership, the amount of profit will share among the partners according to agreed profit-sharing ratio. This profit sharing will be credited to Partners' Current Account.

Any profit distribution considers as drawing and debited to Partners' Current Account.

5.6.3. Corporation/LLP

In corporation, the amount of profit will be credited to Retained Earnings. Any profit distribution is made through dividend payment to shareholders. The dividend payment may reduce Retained Earnings and therefore to be debited from Retained Earnings.

5.7. Drawings

Personal withdrawals are **only allowed in sole proprietorship and partnership.**

Personal withdrawals are made by sole proprietors and partners for personal use, **not for business purposes.**

When they withdraw **cash or inventories** from business for personal use, Drawing Account **will be** debited accordingly.

A company **does not allowed** its shareholders to withdraws money for their personal use unless it is regarded as a loan to the shareholders and it will be debited to Other Receivables – Amount Due From Shareholders. If the shareholders are also directors, the company is prohibited to loan to directors as governed under Companies Act.

5.8. Report Presentation Statement of Changes in Equity

Equity, in the simplest terms is the money shareholders / owner or partners have invested in the business including all accumulated earnings.

An equity statement is a financial statement that a company is required to prepare along with other important financial documents at the end of the financial year.

The statement of owner's equity reports the changes in company equity, from an opening balance to and end of period balance. The changes include the earned profits, dividends, inflow of equity, withdrawal of equity, net loss, and so on.

5.8.1. Sole proprietorship

I.Lamb							
Balance Sheet As At 31 October 2019							
						RM	RM
Capital							
Opening Balance							65,535.00
Add: Net Profit							23,765.00
Less: Drawings							(4,200.00)
Net Capital							85,100.00
							93,900.00

Statement of changes in equity for the period ending 31 st of December 2010	
Balance at the beginning of the year	\$ 61,000
Capital contributed during the year	25,000
Profit for the year	34,820
Drawings	<u>(2,000)</u>
Balance at the end of the year	<u>118,820</u>

5.8.2. Partnership

<u>Nora, Osman and Nasir</u>		
<u>Balance Sheet as at 30 November 2010</u>		
	<u>RM</u>	<u>RM</u>
<u>Assets</u>		
<u>Non-current assets</u>		
Furniture and fittings	80,000	
Motor vehicles	60,000	140,000
	<hr/>	
<u>Current Assets</u>		
Inventory	30,000	
Receivables	50,000	
Bank	6,000	86,000
		<hr/>
		226,000
<u>Capital and Liabilities</u>		
<u>Partners' capital accounts</u>		
Nora	45,000	
Osman	30,000	
Nasir	15,000	90,000
	<hr/>	
<u>Partners' current accounts</u>		
Nora	20,000	
Osman	15,000	
Nasir	5,000	40,000
	<hr/>	
		40,000
<u>Long Term Liabilities</u>		
Loan		18,000
<u>Current Liabilities</u>		
Payables		78,000
		<hr/>
Total Capital and Liabilities		226,000
		<hr/>

Statement of Changes in Partners' Capital			
For the Year Ended December 31, 2008			
	<u>Tom</u>	<u>Julie</u>	<u>Total</u>
Capital balances, Jan. 1	\$ -	\$ -	\$ -
Add: Additional investments	51,000	25,000	76,000
Net income allocation	33,553	16,447	50,000
Totals	<hr/>	<hr/>	<hr/>
	84,553	41,447	126,000
Less: Withdrawals	15,000	12,000	27,000
Capital balances, Dec. 31	<hr/>	<hr/>	<hr/>
	\$69,553	\$29,447	\$99,000

5.8.3. Corporation / LLP

EQUITY AND LIABILITIES

EQUITY

Equity attributable to owners of the Company:-

Share capital	10	100,000	100,000
Retained earnings		<u>890,512</u>	<u>830,835</u>
Total equity		<u>990,512</u>	<u>930,835</u>

STATEMENT OF CHANGES IN EQUITY FOR THE FINANCIAL PERIOD FROM 1 JULY 2018 TO 31 DECEMBER 2019

	<u>Note</u>	<u>Share capital</u> RM	<u>Retained earnings</u> RM	<u>Total</u> RM
Balance at 1 October 2017		100,000	593,842	693,842
Total comprehensive income for the financial period		<u>-</u>	<u>236,993</u>	<u>236,993</u>
Balance at 30 June 2018		100,000	830,835	930,835
<u>Transaction with owners:-</u>				
Dividends paid	19	-	(200,000)	(200,000)
Total comprehensive income for the financial period		<u>-</u>	<u>259,677</u>	<u>259,677</u>
Balance at 31 December 2019		<u>100,000</u>	<u>890,512</u>	<u>990,512</u>