Limited Liability Companies

A Limited Company is a business where the shareholders (Owners) have separate legal identity from the firm itself. As a result shareholders can only loose the value of their shares and are not liable (responsible) for the debts of the business from their own assets.

There are two types of Limited Liability Company:

Public Limited Company:

a. The company can offer its shares to the public and its shares which are traded on the stock exchange

c. The company name must end with "public limited company" or "plc."

d. The authorized capital by the stock exchange must be greater than $50,000

Private Limited Company:

a. The company may only offer shares to business associates, friends and family. Once the company is started no new shares can be sold to new shareholders without the agreement of all existing shareholders

b. Shares will not be traded on the stock exchange

c. The company name will end with "limited" or "ltd."

d. The authorized share capital will be $50,000 or less

Raising Capital

One of the main reasons for forming a limited company is to raise large amounts of capital to finance the business. The way in which companies raise capital is by issuing (selling) two types of shares to investors:

1- ***Preference Shares*** – owners of preference shares will:
   - receive a fixed rate of dividend.
   - not be entitled to vote in the shareholders' annual general meeting.
   - receive their dividends of profit before the ordinary share dividend (higher priority).
   - receive capital before ordinary shareholders in the event the company is closed down.

2- **Ordinary Shares** – owners of ordinary shares will:
   - receive variable dividends each year.
   - be entitled to vote in shareholders' meetings with one vote per share.
   - be given their dividends of profit after the preference share dividend.
   - be the last to receive their share capital if the company goes bankrupt.

Share Capital

The share capital is the capital of a company which is divided into preference and ordinary shares which are then bought and owned by the shareholders. There are two main types of share capital:

1- **Authorized share capital** is the maximum amount of share capital a company is allowed to sell to shareholders.
2- **Issued share capital** is the amount of share capital actually issued (sold)

Furthermore the issued share capital falls into two categories:

a- **Called-up capital** is the total amount of capital a company has asked for from its preference and ordinary shareholders.
b- **Paid-up capital** is the part of the called-up capital where money has actually been received from the ordinary and preference shareholders.
c- **Calls in arrears** the part of the called-up capital where money has still **not** been received from shareholders.

Share Capital Example:

Trotter Enterprises Ltd

Trotter Enterprises Ltd was started with the authorised right to sell 100,000 ordinary shares of $1 each and 25,000 preference shares of $1 each. The company has actually issued 50,000 ordinary shares and 25,000 preference shares. None of the shares has yet been fully paid; so far the company has made calls of $0.80 per share, All of the calls have been paid by shareholders, except for $200 owing from one particular shareholder. The share capital of Trotter Ltd will therefore be:

Authorised Share Capital (100,000 ordinary x $1 + 25,000 Preference x $1)	**$125,000**
Issued Share Capital (50,000 Ordinary x $1 + 25,000 Preference x $1)	**$75,000**
Called-up Share Capital ($0.80 x $50,000 + $0.80 x $25,000)	**$60,000**
Paid-up Share Capital ($60,000 - $200)	**$59,800**
Calls in Arrears	**$200**

Dividends

Dividends are paid to shareholders as a way of distributing the profits of the company.

Dividends are normally expressed as “dollars per share” eg $0.10 for every share held.

Directors decide if a company will be paying out a dividend or not. They look at factors such as:

1. the availability of profits
2. the availability of cash to pay the dividend
3. whether it would be better to keep the profits in the company to allow it to grow
4. whether the market price of the shares will be affected or not

Directors may pay out a dividend more than once per year. A dividend paid half way through the year is called an **INTERIM** dividend, and at the end of the year it is called a **FINAL** dividend.

Dividends payable at the end of the year are entered in the *Profit and Loss Appropriation Account (Income Statement) and as a Current Liability in the Balance Sheet*. This is because at the end of the year when the Balance Sheet is drawn up the dividend payable to the shareholder will not have yet been paid and so the company is still liable in the short term.

Retained Profit and Reserves

Retained profit - is the profit that is not appropriated (divided) for dividends or reserves and remains as a balance on the profit and loss appropriation account and is carried forward to the next year to help fund business plans in the future.

Revenue Reserves – are created by ploughing profits back into the company

Examples: General Reserve – created for general purposes in future

Fixed Asset Reserve – created to purchase fixed assets

Revenue reserves and retained profit are recorded in the balance sheet under the heading "Share Capital and Reserves" or “Shareholders’ Funds”.

Debentures

Prepared by D. El-Hoss

A debenture is a document given to someone who has loaned the company money. It states *the amount of the loan, the interest payable each year, and the date on which the loan is to be repaid.*

1- Debenture holders are liabilities of the company – NOT owners as it is with shareholders.
2- The interest must be paid regardless of the profitability of the company.
3- Debentures due to be paid within a year are shown on the balance sheet as CURRENT LIABILITIES.
4- Those due to be paid in more than one year are shown as LONG TERM LIABILITIES.
5- Debenture holders have no voting rights within the company's meetings.
6- Debenture holders receive a fixed rate of interest
7- Debenture holders are repaid before any shareholders in case the company is closed down.

Interest Payable on debentures is shown as an *expense in the Profit and Loss account* (Income Statement) and a *Current Liability in the Balance Sheet*. This is because at the end of the year when the Balance Sheet is drawn up the interest payable to the debenture holder will not have yet been paid and so the company is still liable in the short term.

Layout of a Limited Liability Income Statement

Example: B. Calm provides the following information for the year beginning on the 1 January 20X2

1 The issued share capital consisted of 150 000 ordinary shares of $0.50 each and 100,000 (8%) preference shares at $1. (c)

2 The company had issued 1000 5% debentures of $100 each.

3 On 1 January 20X2:

General reserve	$18 500
Retained profit	$7 050 (b)

4 The profit for the year ended 31 December 20X2 was $36 000.

5 During the year ended 31 December 20X2 an interim dividend of 7% on the ordinary shares was paid.

6 On 31 December 20X2 it was decided to transfer $10 000 (a) to general reserve and pay a dividend of 9% on the ordinary shares.

B. Calm

Trading, Profit and Loss & Appropriation Account for the year ended 31 12 20X2

	$	$
Sales Turnover		300,000
Less Returns Inwards		10,000
		290,000
Less Cost of Goods Sold		
Opening Stock	10,000	
Purchases	140,000	
	150,000	
Closing Stock	50,000	100,000
Gross Profit		190,000
Less Expenses		
Sales Staff Salaries	30,000	
Advertising	10,000	
Wages	30,000	
Depreciation of Motor Vehicle	4,000	
Provision for Bad Debts	1,000	
Rent	3,000	
Electricity	1,500	
Directors Remuneration (Salary)	69,500	
Debenture Interest	5,000	154,000
Profit for the year (Operating Profit)		**36,000**
Less Transfer to general reserve	10,000 (a)	
Preference Share Dividend - Proposed	8,000 (c)	
Ordinary share dividend – paid	5,250	
- proposed	6,750	30,000
Retained profit for the year		6,000
Retained profit brought down		7,050 (b)
Retained profit carried down		13,050

Directors Remuneration is the amount of salary directors will be paid for running the business. It is entered as a **<u>Profit and Loss expense</u>** and <u>not</u> in the appropriation account.	**Debenture Interest** is the cost of borrowing money from the general public through a debenture issue. Therefore it is included in the **Profit and Loss Account as an expense.**

B. Calm
Prepared by D. El-Hoss

Balance Sheet as at 31 December 20X2

	$	$	$
Non-Current Assets	**Historic Cost**	**Depreciation**	**Net Book Value**
Intangible Assets (a)			
Goodwill (b)			100,000
Tangible Fixed Assets			
Premises	94,000	-	94,000
Motor Vehicles	10,000	4,000	6,000
			200,000
Current Assets			
Stock	50,000		
Debtors	70,000		
Bank	10,000		
Cash	9,550		
		139,550	
Less **Current Liabilities**			
Creditors	3,250		
Proposed Ordinary Dividends	6,750		
Proposed Preference Dividends	8,000		
Debenture Interest	5,000		
		23,000	
Working Capital			**116,550**
			316,550
Less **Non-Current Liabilities**			
Debentures			**100,000**
			216,550
Capital & Reserves			
Ordinary Shares ($0.50 x 150,000 shares)			75,000
Preference Shares			100,000
Add General Reserves ($10,000 + $18,500) (d)			28,500
Add Retained Profit c/d (c)			13,050
			216,550

(a) Intangible Non-Current Asset – The value of a non-physical Fixed (Non-Current) Asset.

(b) Goodwill – The value of the company's brand name or image. It is valued as an Intangible Asset as it can be estimated but is non-physical.

(c) Retained Profit Balance b/d $7,050 + Retained Profit for the year $6,000.

(d) General Reserve Balance b/d $18,500 + General Reserves for the year $10,000.