HA2032
Corporate Accounting

HOLMES INSTITUTE

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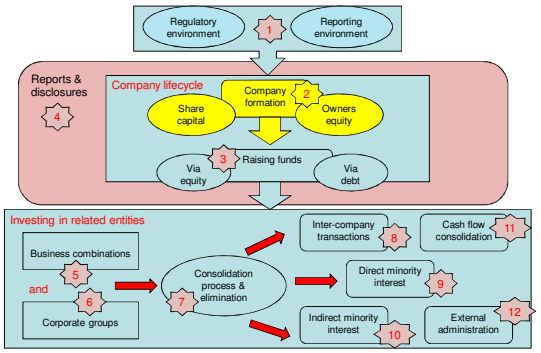
Topic 2
Company Formation & Operations

Studying Corporate Accounting



Formation of Companies

- Registration with ASIC
  - Subscribers application and registration of a company by ASIC
  - Details, including type of company proposed, company name, address, members of company, number and classes of shares taken up by each member.
- The company constitution
  - The Act provides the company with a ready-made constitution, the set of *replaceable rules*
  - A company can have a specially drafted constitution, if they don't, the replaceable rules apply.

Formation of Companies (contd)

- Appointment of officers and record-keeping
  - The first director is appointed by subscribers
  - Proprietary co: at least one director
  - Public co: at least three directors.
- A company must:
  - appoint company secretaries
  - appoint an auditor
  - record minutes of directors' meetings and shareholders meeting
  - register members, debenture holders, option holders.

Raising Equity Capital

- Regulated and unregulated offers
  - They are primary share issue regulated and not regulated by the Act respectively
  - An unregulated offer is made on a small scale to fewer than 20 investors
  - For a regulated offer, potential investors must be given a copy of a disclosure document; the disclosure must be lodged with ASIC before it is distributed; content of disclosure document is governed by the Act.

Raising Equity Capital (cont)

- Underwriting
  - An agreement with a stockbroker or financial institution in which underwriters guarantee to purchase any shares that the company cannot sell during the issue period.
- Secondary trading in shares
  - Buying and selling of shares after they have been issued.

Share Capital

- Types of shares
  - Ordinary
    - Full voting rights
    - Right to receive dividends.
  - Preference
    - Receive dividend based on fixed percentage
    - Reduced voting right
    - May be redeemable.
  - Founder share
  - Deferred share.

Components of Share Capital

- Components of share capital
  - Issue price
    - Full price allocated to a share
  - Called-up amount
    - Cumulative amount of installments payable
  - Paid-up amount
    - Holder in arrears for payment of a call, then paid-up amount is less than called-up amount.
- Share issue procedure
  - Offer
  - Application
  - Allotment of shares.

Accounting for Initial Share Capital

- Application – Public applies for shares via prospectus

Dr Trust account	xx	
Cr Application		xx

- Monies are held in trust with a financial institution, as they do not belong to the company until after the allotment (Act, s.722(1)).

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Accounting for Share Capital (contd)

- Allotment – Directors approve share allocation

Dr Application	xx	
Cr Paid-up capital		xx
Dr Bank	xx	
Cr Trust account		xx

- The shares are considered issued only when allotment is made
- Company legally owns the application monies at the point.

Accounting for Share Capital (contd)

- Additional amount payable on allotment

Dr Allotment	xx	
Cr Paid-up capital		xx
Dr Bank	xx	
Cr Allotment		xx

- Allotment a/c is similar to account receivable, to record amount payable on allotment.

Accounting for Share Capital (contd)

- Calls – call made on partly paid shares

Dr Call	xx	
Cr Paid-up capital		xx
Dr Bank	xx	
Cr Call		xx

Undersubscription

- Too few applicants. Shares can still be allotted, provided minimum subscription condition is met. If not, within four months after the disclosure document is issued, share issue must be abandoned
- No accounting complications.

Oversubscription

- Directors decide who and how much applicants are to receive
- When applicant is allotted fewer shares than applied:
  1. company may keep the excess application monies and apply them to allotment or future calls; or
  2. return monies to unsuccessful applicants.

Oversubscription (contd)

1. Excess monies retained and offset against amount due on allotment

Dr Application	xx	
Cr Allotment		xx
Dr Bank	xx	
Cr Trust account		xx

2. Excess application monies returned

Dr Application	xx	
Cr Trust account		xx

Oversubscription (contd)

- Excess monies retained and offset against amount due on calls

Dr Application	xx	
Cr Calls in advance		xx
Dr Calls in advance	xx	
Cr Paid-up capital		xx

Issue of different types of shares

- Issue of both preference and ordinary shares
- No different, only recorded separately

Dr Trust account	xxx	
Cr Application - ordinary		xx
Cr Application - preference	xx	

- Allotment

Dr Application - ordinary	xx	
Dr Application - preference	xx	
Cr Paid-up capital - ordinary		xx
Cr Paid-up capital - preference		xx
Dr Bank	xxx	
Cr Trust account		xxx

Subsequent share issues

- Right issues
  - Shares are offered in a ratio to a member's existing holding, usually below market price
  - Members can sell 'the right' of purchase: *renounceable rights issue.*
- Unregulated share issues
  - Company offer shares directly to other persons or entities without making them available to the general public.

Subsequent share issues (contd)

- Bonus issues
  - Company gives existing shareholders additional shares without requiring any payment
  - Amounts are transferred to paid-up capital a/c from other owners' equity a/c e.g. reserves.
- Share options
  - To give the holder the right to purchase an agreed number of shares at a later date, and at a fixed exercise price.

Forfeiture of shares

- Cancellation of a shareholder's rights as a member, with respect of particular shares
- Under common law, company may forfeit shares only for reason of non-payment of calls
- The effect:
  - It nullifies holder's ownership of shares
  - The shares per se are not cancelled
  - Forfeiture reverses if outstanding call is paid or share is transferred to another person.

Accounting for forfeiture

- Call made by directors

Dr	Call	xx	
Cr	Paid-up capital		xx

- Call monies mostly received

Dr	Bank	xx	
Cr	Call		xx

- Forfeiture of share with calls outstanding

Dr	Paid-up capital (amt called up)	xx	
Cr	Call (amt unpaid)		x
Cr	Paid-up cap. – forfeited shares (amt paid)		x

Reissue of forfeiture shares

- They are not new shares, reissued to aim at obtaining at least the amount of the unpaid calls prior to forfeiture.
- Reissue of Shares

Dr	Bank		
Dr	Paid-up capital- forfeited shares		
Cr	Paid-up capital-ordinary shares.		

- Return of surplus to original shareholder

Dr	Paid-up capital	xx	
Cr	Bank		xx

Owners equity

- Owners' equity (OE) = Assets – Liabilities
- The equation represents:
  - a firm's assets are owned, funded or financed by shareholders or by creditors
  - source of asset: share capital→ amount provided by shareholders (contribution); retained profit→ amount generated through an entity's activities.
- Restrictions on distribution
  - Principle of company law: company must protect its liquidity by restricting distributions to owners.

Profits

- Per AASB 101 all income and expenses must be recognised in profit or loss.
- However, there are exclusions, i.e. certain increment and decrements directly to equity not recorded in period profit.

Reserves

- Reserves: restricted on the ability of directors to make a distribution to the owner.
- Discretionary reserves
  - Created by management's wish.
- Obligatory reserve
  - Statutory reserves
  - Contractual reserves
  - Reserves required by accounting standards e.g. ARR by AASB 116.

Distributions to owners

- Distribution to owners can be done:
  - Capital gains from changes in market price of shares
  - Dividend
  - Distribution giving increased equity i.e. bonus share
  - Return of contributions
- Under insolvent trading provisions of the Act, before directors pay a dividend they must ascertain the company is able to pay debts → *capital maintenance concept*

Distributions to owners (contd)

- Capital maintenance concept
  - Requires dividends be paid only out of profits, not out of capital.
- Peculiarities of profit distributions
  - Profit accumulation
  - Previous years' loss
  - Dividend equalisation reserve
  - Interest on capital.

Distributions to owners (contd)

- Payment of dividends
  - Governed by contract law (company's constitution), the *Corporations Act*, replaceable rule and case law
  - Right to receive
  - When a declaration of dividend is made, a non-revokable debt arises. Declared dividends will be paid as soon as administratively convenient.
  - Basis for payment
    - Public companies: same entitlements for all shares within a class
    - Proprietary companies: replaceable rule applies where directors may pay dividends as they see fit
    - No-liability companies: all ordinary shares have same entitlement, other shares are paid according to constitution.

Distributions to owners (contd)

- Recognition and disclosure of dividends
  - Simultaneous appropriation of profit and recognition of a liability.
  - Timing of dividend affects its recognition:
    - Dividends already paid must be recognised
    - Dividends proposed before reporting date but not yet paid: will not be recognised for the financial period just passed. A contingent liability recorded in notes during the next period
    - Dividends proposed after reporting date: will not be recognised for the financial period just passed but recorded as a contingent liability in notes

Acctg for distribution: Cash Dividend

- Approved by Directors

Dr	Interim/Final dividend	x	
Cr	Interim/Final Dividend payable		x

- Payment

Dr	Interim/Final Dividend payable	x	
Cr	Bank		x

Acctg for distribution: Cash Dividend

- Approved by Directors

Dr	Interim/Final dividend	x	
Cr	Interim/Final Dividend payable		x

- Payment

Dr	Interim/Final Dividend payable	x	
Cr	Bank		x

- At year end

Dr	Profit and loss	x	
Cr	Retained profits		x
Dr	Retained profits	x	
Cr	Interim/Final Dividend		x

Acctg for distribution: Non-Cash Divid'd

- Bonus shares
  - Give existing shareholders new, fully paid-up bonus shares in a ratio to their existing holding
  - No difference between the new bonus shares and existing shares
- Journal entry

Dr	Retained Profits	x	
Cr	Paid-up capital		x

Acctg for distribution: Non-Cash Divid'd

- Capitalisation of profits and reserves
  - Issuing bonus shares
  - Apply profit to reduce liability on existing shares
  - Transferring profits to a reserve.
- Other non-cash dividends
  - Shareholders can take their dividend entitlement by issue of new fully paid shares, instead of cash dividend, under a dividend reinvestment plan.