HA2032
Corporate Accounting

HOLMES INSTITUTE

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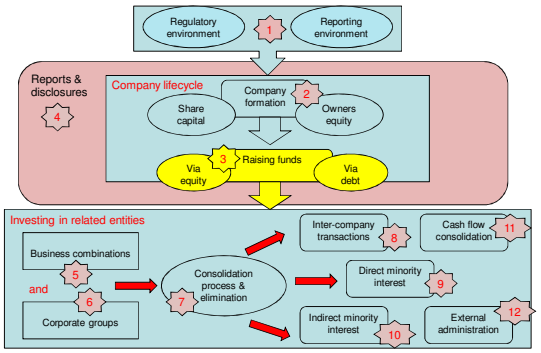
Topic 3
Raising Company Funds

Studying Corporate Accounting



Introduction

- Share capital can be reorganised by:
  - an increase, decrease or alteration to paid-up capital/number of shares issued.
- Two classifications of share reorganisation:
  1. alter the number of shares without a change in amount of paid-up capital
  2. decrease the amount or composition of share capital e.g. share buyback.

Altering the number of shares

- Reorganisaton that don't result in capital reduction
- It is regulated by the Act (s.254H)
- Either convert the company's shares into:
  - Smaller no. (consolidation of shares)
  - Larger no. (subdivision of shares)

Altering the number of shares (cont)

- Consolidation of shares: fewer rather than more
  - To facilitate share transfers
  - By decreasing number of shares, EPS will increase
  - New class of shares can be created.
- Subdivision of shares: more rather than fewer
  - Attempt to spread equity among a greater number of shareholders
  - New class of shares can be created.

1. Changing the existing composition

- Total amount of share capital is unchanged
- Take place in two ways:
  1. changing the rights attached to shares – change in class
  2. redemption of redeemable preference shares.
- Converting shares from one class to another
  - The Act restricts conversion of preference shares to ordinary shares and vice versa
  - Changes in share class affects the rights of shareholders, special provisions of the Act must be followed.

1. Changing the existing composition

- Redemption of preference shares
  - Can be redeemed at a fixed date or on the happening of a particular event, at company's or holder's option.
  - Legal form: owners' equity
  - In substance: frequently debt
  - Thus, within the scope of AASB 132 *Financial Instruments: Disclosure and Presentation* and AASB 139: *Financial Instruments: Recognition and Measurement*
  - A redeemable preference share is classified using the 'substance of contractual arrangement and the definitions of financial liability, financial asset and equity instrument', not their legal form.

1. Changing the existing composition

- Redemption of preference shares (cont.)
  - Regulated by the Act (ss. 254J & 254K)
    - Share must be fully paid before redemption
    - Redemption shall be: out of profits or by the issue of new preference/ordinary shares issued for the purpose of redeeming the shares.
  - Treatment of any premium
    - Premium is not a return of contributed capital
    - It is either (a) a distribution by appropriating profit or (b) an expense.

Decreasing the amount of share capital

- Under ordinary circumstances, capital maintenance principle precludes a company from reducing its share capital, except the company:
  - has excess assets and no prospect of being able to use them
  - has accumulated losses or assets that cannot realise their carrying amount.
- Under the Act, two categories for share capital reduction:
  1. Reductions of share capital
  2. Share buybacks.

Decreasing the amount of share capital

- Ways to reduce share capital alone:
  - Authorised by the Act
    - Any reduction by unlimited company (s 258A)
    - Cancellation of shares under a share buyback (ss.257H & 258E (b))
    - Cancellation of shares previously forfeited (s 258D)
    - Cancellation of redeemable preference shares that have been redeemed out of proceeds of new issue of shares (s. 258E(1))
    - Cancellation of paid-up capital that is 'lost or not represented by available assets' (s 258F).

Decreasing the amount of share capital

- Ways to reduce share capital alone:
  - Not expressly authorised by the Act
    - Selective reduction
    - Equal reduction

Decreasing the amount of share capital

- Various types of capital reduction
  - Reducing uncalled capital
    - If company does not foresee any need to call up capital.
  - Canceling lost paid-up capital
    - When paid-up capital exceeds net assets, i.e. capital that is not represented by net assets.
  - Returning paid-up capital to members
    - Capital that is surplus to requirement
    - Less likely circumstance.

Decreasing the amount of share capital

- Share buybacks
  - An exception to capital maintenance principle
  - The Act permits this practice (ss.257A-257J)
  - Reasons to do this:
    - dispose of surplus assets by reducing capital
    - rearrange ownership structure
    - clean up 'odd lots' of shares
    - deal with employee share schemes.
- Various types of share buybacks:
  - Minimum holding buyback
  - Employee share scheme buyback
  - On-market buyback
  - Equal access buyback
  - Selective buyback.

Decreasing the amount of share capital

- Recognising buybacks
  - Under the Act, shares acquired in a buyback must be cancelled.
  - Amending share register
  - Proprietary view
    - Buyback as a transaction with shareholders in their capacity as shareholders, i.e. a distribution to owner.
  - An entity view
    - Buyback as a purchase by company of an asset, its own shares with simultaneous reduction in residual claims by owners

Disclosure

- Disclosure about share buybacks and capital reductions are an integral part of the statement of changes in equity (AASB 101, para. 97).

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Types of debt

- Debentures
  - No specific format, document indicating interest rate and payments interval
  - Must be fully secured by a charge over the company's assets, which are sufficient and available.
- Mortgages
  - A particular type of debenture
  - Payment of interest at specified periods and repayment of principal by installments
  - Property under charge is usually real estate
  - Restrictions on borrower's ability to transfer ownership.

Types of debt (contd)

- Mortgage debentures
  - Debenture secured by a first mortgage over real estate.
- Convertible notes
  - Enable the holder to convert the debt into paid-up shares in the company, at the holder's option.
- Unsecured notes and unsecured deposit notes
  - Debt not secured by a charge over company assets.
  - Higher risk i.e. higher interest payments.

Types of debt (contd)

- Leases
  - Periodic payments, rather than large initial outlays of capital
  - Ownership of asset remains with the supplier.

Regulation of debt

- Borrowing powers of company
  - Directors are free to enter into debt arrangements and to grant charges over company assets
  - Contractual relationships e.g. debt arrangement with external parties may restrict a company ability to raise debt.
- Regulation under the Act, a company required to:
  - Prepare disclosure document before proposed offer of debentures
  - Appoint trustee
  - Register debenture holders.

Accounting for issue of debt

- Factors affecting treatment include:
  - Par amount of debt
    - The face amount of a debt instrument that must be repaid on maturity.
  - Regulated / unregulated offers
    - Regulated debt issue: use of trust account – need to use a trust a/c for application
    - Unregulated debt issue: no cash received in trust a/c.
  - Different types of debt
    - This chapter focuses on debentures.

Issue at par – regulated offer

- On receipt of funds

Dr	Trust account	x	
Cr	Application		x

- On Issue of debentures

Dr	Application	x	
Cr	Debentures		x
Dr	Bank	x	
Cr	Trust account		x

Issue at par – regulated offer (contd)

- Interest

Dr	Interest expense	x	
Cr	Bank		x

- On repayment

Dr	Interest expense	x	
Dr	Debentures	x	
Cr	Bank		xx

Issue at premium or a discount

- Debentures must initially be recorded at fair value
- Premium or discount on issue should not be recognised as revenue or expense in the period when debenture is issued because:
  - premiums or discounts are offset during the lifespan of the debenture, the offsetting requirement of AASB 139 is allowed by AASB 101
  - premiums or discounts are incorporated into initial FV of debenture
  - amortisation of premiums, or discounts on the issue are treated as an adjustment to interest expense, not as a borrowing expense.

Extinguishment or discharge of debt

- Discharge of debt repayment under issue terms
  - At a discount
  - At a premium.
- Discharge of debt when open market redemption is allowed
  - In same way as a share buyback
  - Depends on market force, not debt contract terms.