Financial Statement Analysis and Reporting

Dr. Anil Kumar Sharma
Department of Management Studies
Indian Institute of Technology, Roorkee

Lecture – 26
Corporate Financial Statements Part-II

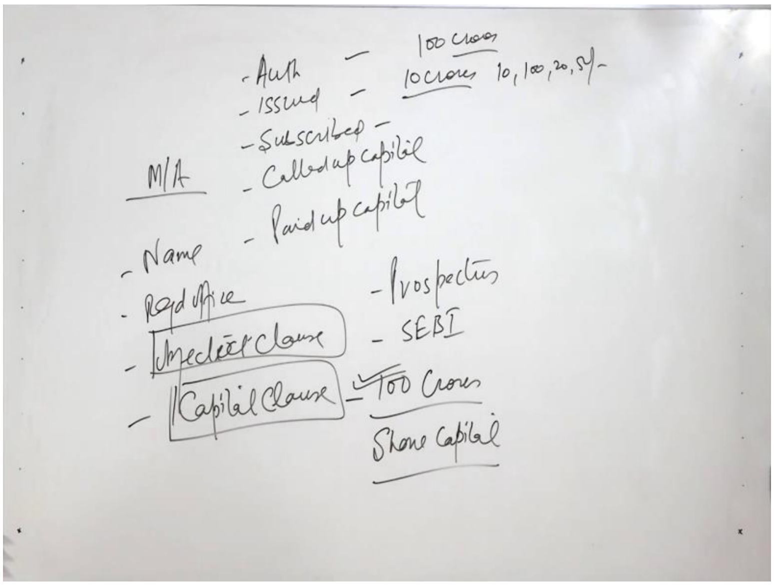
Welcome students. So, we were talking about the company accounts or the financial statements of the public limited companies, and in my previous lecture I was discussing with you, that what are the prerequisites of issuing the capital to the public, because that is the first item in the balance sheet of the public limited companies, that share capital we have to take. So, share capital is a complex item to have to understand that what is the share capital, how to take it, how to calculate it. So, we will have to understand all the related issues to the share capital in detail.

So, I was talking to that when we are the companies have to issue the capital in the market to say, generate the capital from the market and issue the shares, to the general public in the market. There are some formalities some requirements to be completed, and in the previous lecture we discussed that the companies must be registered as a public limited company, with the registrar of companies in the state in which the registered office of the company will be located. And when the company goes for the registration, they register ask for certain documents, first documents, two documents are important one is the memorandum of association, and second is the article of association.

And once the company is registered on the basis of these two documents, then the company can continue it is business, can start its business, can continue, if it is converted from the private limited company to public limited company. It can continue the business; even as a public limited company also what it was doing was a private limited company. And when later on at the later stage, when the need more capital, and want to go to the public in that case, they can issue the shares to the general public in the market, and they can raise the capital why should the shares; that is called as the share capital. And then I was talking to you about that there are certain requirements about the share capital, that before issuing the shares to the general public in the market.

The most important document which the company has to prepare, and say submit it to the two offices; that is to the concerned registrar of the state, where the register head office of the company is located that is one, and second that document, that is the prospect has to go to the second offices; the SEBI. The SEBI has to be given that document and the document is prospectus.

(Refer Slide Time: 03:01)



So, we were talking about the prospectus. For issuing the capital through shares, or for issue shares to the general public and raising the capital through shares; first and the foremost document or most important document is the prospectus. The companies have to issue the prospectus, is prepare the prospectors, give a copy of that to the registrar of the companies in the same state, and then second copy goes to the SEBI; SEBI is the regulator of the securities market in India.

And after the scrutiny of the SEBI, if they find everything in the right earnest, then that document is put on the number one of the site of the SEBI for the public, say scrutiny, or maybe if somebody will not to refer whether it is a genuine company, or they going to raise the capital with the due permission from SEBI, and it is fulfilling almost all the requirements. In that case we will have to, people can go and people can check on the SEBI website, and they can be sure about, that yes this companies going to issue the shares has come out with an IPO in the market or FBO in the market, and they are going to issue the shares for raising certain amount of the capital, and then people can be sure about it and they can follow the process as suggested by the company for buying their shares.

But here question arises that I was talking to you about the memorandum of association, but that is the first document which is required, by the registrar of the companies, where the companies going to be registered as a public limited company right. With the company is going to be adjusted as a public limited company, where the registered office of the company is going to be located, and when the companies going to be converted from private to public, or going to be formed as a public limited company at the first instance, when the company applies for the registration to the registrar. I told you in my previous lecture that register ask for certain documents, and the one document is the memorandum of association, which tells about, what the companies going to be.

So, different clauses are there, say for example, if say in the memorandum of association different clauses are there, is different kind of information has to be given, and one is the name clause that, what is going to be the name of the company. Second is going to be the registered office clause, registered office clause, and then is going to be the objects clause, that what object, means object clause, and one clauses is the capital clauses one clauses is the capital clause. This is the most important clause in the memorandum of association as far as the share capital, issuing of the shares to general public is concerned, and raising of the capital through shares is concerned that is a capital clause.

So, in the capital clause company has to specify certain amount, that they wish to, or the company which to raise later on, when it will be registered as a public limited company, and when they need more funds. They would like to raise funds from the market in the foreseeable life. Normally we say that in the total lifetime, but that is not the total life time in the foreseeable next 20 30 years, how much funds they would like to generate from the market, that figure they have to identify and they have to give the clause; that is called as the under the capital clause. So, for example, some company says, that in the next, say 20 years which is the foreseeable life of the company, or 10 years which is the foreseeable life of the company. Company want to raise maximum say 100 crores by the way of share capital, or by way of issuing shares to the potential shareholders in the market.

So, registrar will be asking certain questions, that why it is 100 crores how you have calculated this figure, and how you have sure that you need 100 crores and what are the. So, looking at the objective with which the companies going to adjusted on the basis of this object clause. Object clause means, objective of the company, but is the going to the main business of the company, and what is going to be the (Refer Time: 07:32) business of the company. So, relating to this subjective this capital clauses to be fulfilled, and an amount has to be given to the registrar, that we want that, this company should be allowed in this next foreseeable years or life, about 100 crores.

So, if the registrar is satisfied, then he would say that yes, you can be allowed to raise 100 crores capital from the market by issuing the shares in the different installments, or at the different points of time, as an when you need this amount or this capital or these funds, you can do that. So, that capital, I was talking to different kind of the capital, say for example, we talked about the authorized capital. Then we talked, we discussed in the previous lecture about the say issued capital. Then is the say subscribed capital, and then it is the called up capital, and then is the paid up capital.

So, these are the five categories, five subcategories of the total capital. So, that capital with which the company is allowed to be registered as a public limited company, and that maximum amount that can be raised by the company in it is foreseeable life, and register a loss and that amount is filled under the capital clause of the memorandum of association; that capital is called as the authorized capital. So, for example, in this case authorized capital is going to be 100 crores.

So, means this is that amount which is the maximum amount the company can rise, from the market by selling the shares to the general public, over it is foreseeable life that is 100 crores. So, 100 crores worth of the capital can be raised, and this figure will be filled under the capital clause in the memorandum of association, and with this relative to objectives and the requirement of the capital registrar will allow the registration of this company as a public limited company. First this company is allowed to register as a public limited company with 100 crores, that capital is called as authorized capital. Now what is the meaning of authorized capital, means this company has been authorized by the registrar of companies of the state in which the registered office of the company is located.

Today’s 100 crores of the capital by issuing the shares to the general public, in it is foreseeable life, maybe next 10 20 years. Later on this about can be revised also, means registrar can revise also. for example, in the next 10 years company successfully raised 100 crores from the market, and they have justified their raising of the funds, efficiently use the funds, and there paying good dividend to the people and they are how good profit making organization, they are growing at a desired rate, and that 100 crores capital they have issued to the people in the market buy IPOs and FPS, and that limit is over then that limit has to be revised.

So, again the company has to go to the registrar, they have to apply that our authorized capital of 100 crores we have raised from the market over a period of time, may be in the past 10 years, and you should be allowed to raise further more capital from the market. So, registrar if feels good, and justified then he can allow the revision of the limits. So, this limit can be later on revise from 100 crore to 200 crores for the next 10 years, or something like that. So, that capital with which a company is registered, and which is mentioned in the under the capital clause of memorandum of association, submitted to the registrar of the companies is called as the authorized capital and that is the 100 crore right.

Now, company is authorized to raise 100 crores of the capital by issuing the shares in the market to the general public, but they do not issue these shares worth rupees 100 crores in one core, they cannot do it also. They have to divide it to different installments, because everybody knows, that no company in the beginning itself requires the total capital, authorized capital of 100 crores. lets them come with the first IPO of its, say 10 crores and then if they are successfully using that money, they can come out with the any number of the following public offers, and then can exhausted 100 crores limit, but in one go they cannot ask for selling of the shares to general public for 100 crores, they have to divided into different installments.

Now, authorized capital is one 100 crore, this will also be mentioned in the balance sheet. When we prepare the balance sheet, we will mention in the balance sheet that the authorized capital of this company is 100 crores. Now out of the 100 crores, first IPO company comes out with; that is of 10 crores; that is of the 10 crores, it means company would like to issues the shares to the public for raising a sum of rupees 10 crores; that is a first issue, IPO initial public offer, and they want to sell the shares to general public or they want to raise 10 crores by selling the shares of any denomination. It can be the share of 10 rupees each, it can be shares of 100 rupees, it can be share of 20 rupees, it can be share of 50 rupees. Any amount of the share can be should, but they have to split this 10 crores into the number of shares, and the one share price they have to fix up.

So, out of the authorized capital, that part of the capital which is put forward by the company in IPO, for selling the shares in the market, and raising the capital by selling the shares, in the first installment; that is called as the issued capital. It means, issued capital means company going to issue shares worth rupees 10 crores, they want to raise the capital worth 10 crores, and they want to generate capital of 10 crores. So, that capital which is going to be raised by the company through initial public offer; first public offer, out of the total authorize limit of 100 crores is known as the issued capital.

So, that is say, we are assuming hear that the company comes out or wishes to come come out with an IPO of 10 crores, they want to issue the shares of 10 crores. Now what will be done. Say out of this 10 crores capital, and then the one share is of 10 rupees, how it will be done, as I told you. lets now come back to the same point where we started, that now company want to issue shares worth rupees 10 crores, one tenth of the authorized capital they want to raise by selling the shares in the market now they will be required to prepare the third document of after memorandum of association and article of association. Third document required to be prepared is the prospectus, as I was talking to you that is the prospectus.

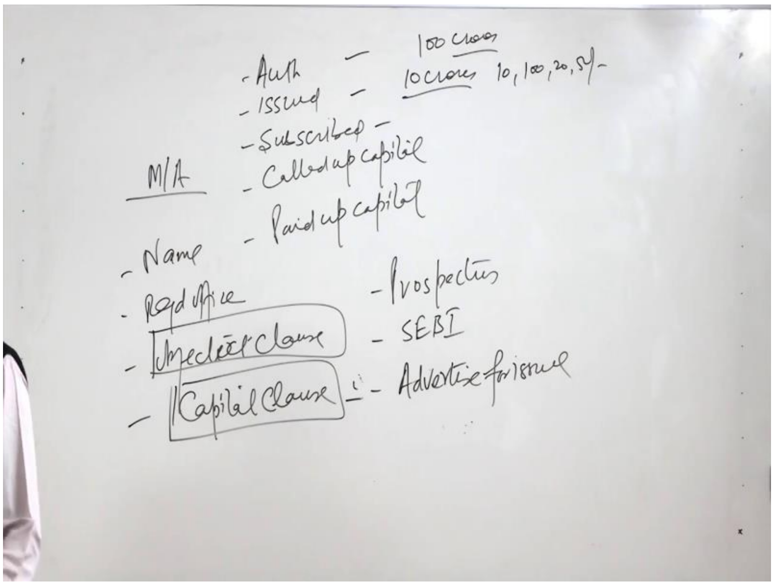
Now, they will prepare the prospectus and attached with the prospectus, they will attach the copy of the memorandum of association, which justifies that registrar of the companies in which the state in which the state of the company is registered or the head office is located, or the registered office is located, has allowed this company to, registrar has allowed this company to raise 100 crores in it is foreseeable life. So, they will prepare a prospectus. They will give the details that we are a company, involved into this particular sector of the business. We were a private limited company in the past, we have recently converted into the public limited company. We want to now raise the capital for additional, our requirements financial requirements. We want to raise the capital additional capital of 10 crores, by way of issuing the shares to the general public in the market.

One share will be of 10 rupees, and people may subscribe to the shares of this company, and with all that details how much capital, their name, and all that copies of memorandum of association, article of association, and that detailed prospectus about, containing all the details about the capital going to be generated there, they will submit all these things along with the application forms to the security market regulator SEBI.

So, first step is preparation of the prospectus, second is submitting all the details to the securities market regulator, securities and exchange board of India; SEBI. SEBI will now scrutinize a whole process. SEBI will look at the memorandum of association, registration certificate issued by the registrar, all of the related documents application firm and the prospectors. And if SEBI satisfied that this company is raising 10 crores, it is duly authorized by the registrar of the companies, it is a registered company, public limited company, their objective is this, they are justifying why they want to raise 10 crores, and how they will be utilizing what is the per share price, everything. After the scrutiny of the SEBI, SEBI will approve this issue, and they will do two things.

One is they will give the permission to the company who is going to raise the stocks is going to capital, going to raise the capital by selling the stocks in the market. Second is they will put their, this company's prospectus on it is own website. Now once it is done and SEBI has allowed this company to issue the shares in the market, and generate 10 crores rupees. Now the next step is, the company will now come out with then advertisement, in the reading, means both in the print and electronic media. They can come out with an advertisement. So, they have to advertise for the issue, they have to advertise, means the company has to go for the advertising of the issue.

(Refer Slide Time: 18:18)



They will given advertisement in the leading newspapers, giving all the details, that we are a company, we were a private limited company now a public limited company, recently converted into, we are, say coming out with our initial public offer first issue.

Other offer is approved by SEBI, and kept, this is the authorized capital of the company approved by the registrar of companies, and the first issue we are going to come up by this duly approved, the copy of the prospectus is given in the newspaper as brought parts, and they say that this a prospectus is approved by SEBI, and once sure we are going to sell for 10 rupees, and total amount we are going to raise, generate from the market is, 10 crores. So, if anybody is interested in rising, means if anybody is interested in buying the shares of this company, they will come forward, and they may subscribe to the shares.

So, with all those details, they can given add in the newspapers, they can given add in the TV, I means electronic media, or wherever they want to inform the general public. So, that they received the maximum number of applications. So, that they received the maximum number of applications, or at least there received the sufficient applications, at least for that some which they want to raise by selling the stocks in the market to the general public. So, people may be verify all the credentials of the company. They can verify from the, say SEBIs office, because prospectus will be there on the SEBIs website. They can verify this from the, may be if somebody wants they can ask for the registration certificate of the company. If somebody wants they can, and call from the registrar of the companies office also or the website of the registrar of companies office also.

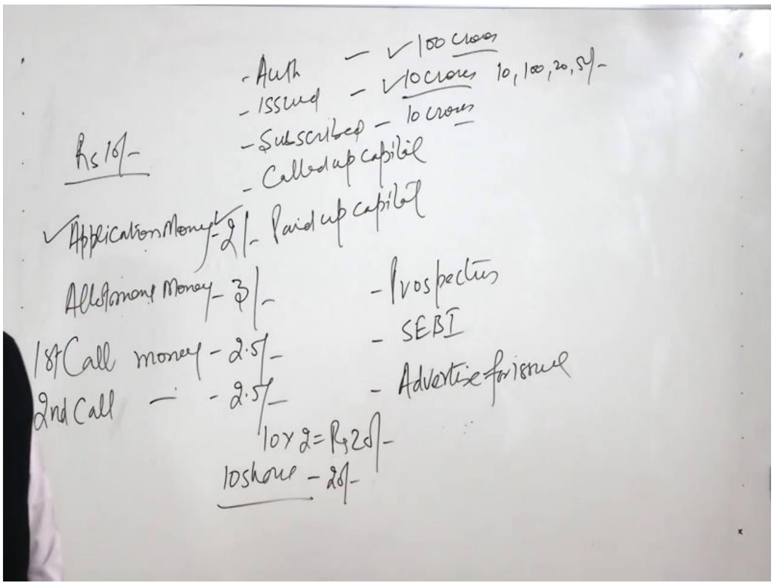
Anywhere it can be done, there is no problem. and once the potential shareholders if they are satisfied that yes, this company is good company going to be a, say civil successful organization if I get the shares of this company, I will be really making a very useful investment, in that case people may start applying for that, in that case people may start applying for the shares. So, it means if the company want to raise 10 crores, or share of rupees 10. So, it means total of capital was of 100crores, and now the company has issued, is intent to issue the capital means shares worth rupees 10 crores. So, this is called as the issued capital 10 crores, and because the reputation of the company is good, the name of the company is good.

So, many people are interested to buy. So, it means the company, buy the shares of the company. So, it means the company receives shares. Means applications for buying the shares equal and 2 or sometime more than 10 crores, in that case, subscribed capital will also become 10 crores. Company wants to raise 10 crores, they ask for the people to apply for the shares of the company, having a very good reputation, good name, company has received sufficient number of application for the entire sum of 10 crores. It means the applications are sufficient, and if company issues the shares to all the applicants, it is sufficient number of the applications, and applications worth 10 crore of the capital they have received, and the capital worth rupees 10 crore can be generated.

So, it means company wanted to sell the shares for 10 crore. people applied for buying the shares of 10 crores, it means the issued capital is 10 crores, and people have subscribed, applied means they have subscribed for 10 crores, it means company is having sufficient applications, and they are sure now, that they will be able to sell shares worth rupees 10 crore in the market, and they will be able to raise 10 crore of rupees of the capital firm the market. So, it means in this case, this becomes the same amount 10 crores they move to raise, and 10 crores applications have come people want to, give to the company and they want to subscribe to the shares worth rupees 10 crores of the company.

So, both the capitals are same. Now we talk to the fourth level; that is called up capital. So, what happens when people buy the shares of the companies through IPOs, when people buy the shares of the companies through IPOs, initial public offers. I am not talking about the secondary market sale, I am talking about the IPOs that is the initial public offers, when the people by the shares through IPOs, in that case, depending upon the price of one share. We are assuming here say rupees 10.

(Refer Slide Time: 23:21)



No company is authorized by anyone, any authority, may be the SEBI or any other regulator, to ask for this entire sum of 10 rupees, to pay to the company in one go. It means they have to divide the 10 rupees into different installments, and those different installments are normally four installments; first installment is the application money. These are the application money, then is the allotment money, then is the call money, calls money, and then it is the minimum, means three ways. So, calls can be the first call, and it can be second call. It can be miss any number of calls, but normally remains, means it is divided over two calls; first call and second call. So, this way in four installments that 10 rupees amount can be asked by the company to be paid by the shareholders, who have purchase the shares of the, or who have applied for the purchase of the shares of the company.

Now, the application money has to be a nominal sum, not a very big sum. And why they have, means why the companies keep the application money. So, that only serious people who are interested to buy the shares of the company, really interested to buy the shares of the company they apply for the shares, not means any tom dick and harry can apply for the shares, and when the company ask them to say I lost the shares, they are not now ready to pay for that. So, only serious people will apply, and when they apply to the company for the shares of the company, they have to apply with the application money.

So, the application money normally remains five to 10 percent, or say it can be the, if the share price is small. So, it can be somewhere you can call it as up to 20 percent also. So, 20 percent amount can be asked with application. So, say for example, in this case after 10 rupees, we can say that the company has decided that they will raise 2 rupees big application, as application money they will receive 2 rupees. So, it means if anybody applies for any number of shares, he has to send the application with that, for that number of shares multiplied 2 rupees, it means somebody is applying for 10 shares of the company. So, it means he has to send the application with a draft or check of 20 rupees.

So, if 20 rupees are not there, then that application will not be valid application, or acceptable application. So, that company has. a normally it remains given in the prospectus that how much is application money, how much is the allotment money, and how they are going to receive the other installments, maybe only 1 call, 2 calls 3 calls. So, that everything is given in the prospectus in advance. So, when they have decided, say we are assuming that first company decides the 2 rupees, they will require with application, then 3 rupees they required with, at the time of allotment, and 2.5 rupees each they required with first and the second call, 2 rupees as application, 3 rupees at the time of allotment, and 2.5 at the as the first call, and 2.5 as the second call.

Now, you see that when people apply subscribe to the shares worth rupees 10 crores, it means everybody has paid that 2 rupees on with application for every share, it means out of 10 rupees company has already received the 2 rupees; that is for sure. Now after the last date, when the issue closes, means the last date for the application closes, company will have, board of directors of the company will have the meeting and looking at the number of applications for the number of shares they have received. They will decide and they will hold a meeting, and for example, coincidently the number of applications means application for the shares is same as the shares they want to issue in the market.

In that case there is no problem, and board meeting. In the board meeting it will be decided, that all the shareholders, who are supplied, who have applied for the number of shares they all are allotted they are applied number of shares. So, it means total number of shares they want to sell, application is amount is same, and they decide that, yes we want to sell 10 lakh shares, applications are also for the 10 lakh shares, and now we are going to allot, so the shares will be allotted. when the shares will be allotted by the company to this applicants for the shares, then every applicant for the shares with the c 1 a letter, and in that letter it will be written that constellations you that, you have become the shareholder of this company, the company has allotted you the desired number of shares, and say for example, somebody has applied for 10 shares.

So, company a letter would say that we have allotted you 10 shares that desired by you, and we have already received on this account rupees 20 from you as the application money, and now you are required to pay the allotment money at the rate of 3 rupees per share, a sum of rupees 30 rupees, you have to send to us by this date, by bank draft or maybe the online transfers, and if you do not send the allotment money by this due date, then which share allotment to you will be deemed as cancelled, and the application money received from you will be forfeited. So, if the person excepts the allotment, accept the shares and sends the allotment money of thirty rupees, till the last date then he is the valid, legitimate share holder of the company.

But if he does not send it, in that case his application of shares allotted to him will be forfeited means, will be cancelled by the company, and the application money received by the company that is 20 rupees will be forfeited, and that will never be given back to the person. So, it means they have the two installments; first installment is application money, second installment is the allotment money, and at the time of the allotment the company will allot the shares, and will ask for the allotment money in this case we have assumed that the allotment money is 3 rupees. So, the person will receive the letter and with the request that he has to immediately send, or till the last date of that particular, means time period, he has to send that 30 rupees.

So, that he has, means by the date of allotment money, he means stand has paid 50 rupees, and then the remaining 50 rupees will be ask from him at some later date. So, this way the two calls are completed, application money is also given by the person, and the allotment money is also given by the person. Then we talked about the other remaining 50 rupees, 50 percent of the amount, 5 remaining rupees he has to pay to the company. Now how that will be paid, and how that will be asked by the company, how the person will be paying it, and if say for example, if person decides not to pay the allotment money, but will happen to the shareholder, but will happen to the company, and how this called up capital will be calculated, this all I will be talking to you in my next part of discussion.

Thank you very much.