Financial Statements Analysis and Reporting

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

Lecture – 27
Corporate Financial Statements Part-III

Welcome students. So, we are discussing the process of issuing the shares in the market and about the different types of the share capital that is authorized capital, issued capital, and subscribed capital. Now, we will be talking about that is the called up capital. So, I was talking to you in my previous discussion that first installment is the application money. So, 2 rupees will go with the application and remaining 8 rupees, now the company has to ask for. So, 3 rupees they are asking with the allotment and remaining 5 rupees will be asked for 2.5 rupees and the first call and 2.5 rupees under the second call.

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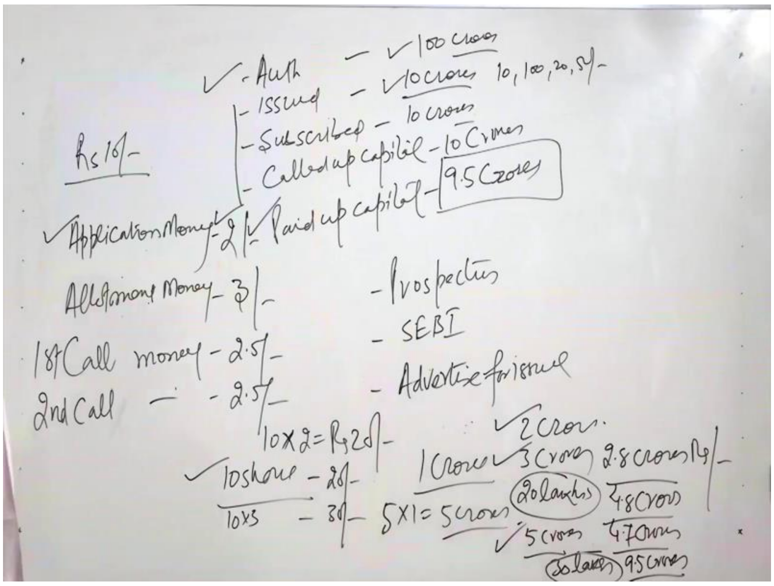

So, now they are asking for this and in this case the total amounts of 10 rupees have to be paid by the people, so that the shareholders they have to pay that total 10 rupees. So, here in this case 3 rupees with the allotment they have to pay. So, 20 rupees they have already paid somebody has got the 10 shares. So, he has already paid 20 rupees and 30 rupees he is going to pay, when he is allotted the shares, he received the allotment letter and he has to pay for 30 rupees for 10 shares. So, we assume that the total number of shares out of the 10 crores there is the rate of rupees 10 this I am going to be 1 crore.

So, it means when people perceive the allotment letter when people received the allotment letter, so companies asking for so called up money will become now 5 rupees per share multiplied by the 1 crores it will become 5 crores. Company is going to receive till the completion of allotment process companies going to receive 5 crores and remaining 5 crores will be received later on under the first and the second call by 50 percent under the second first call and 50 percent under the second call. So, here total say for example, we talk about the allotment money. And in the allotment money, people who have been asked total shareholders 1 crore shareholders have been asked to pay 3 rupees each. So, it means companies want to collect 3 crores rupees.

Here some people say decide that though have applied for the shares 10 shares may be 1 percent is there who may say that I have applied for 10 shares of this company. I have given 20 rupees; I have got the shares also. Now, the companies asking for 30 more rupees and then there will be asking for 50 more rupees for the remaining two calls, and total I have to pay for the 10 shares I have to pay 100 rupees.

So, he may change his mind at the later date, he may say that I applied that was a different scenario, but now then I got the shares allotted, I am not interested to carry on as the shareholder of this company. I do not want to means continue as the shareholder of this company. Now, what you can do he can choose not to pay the call money sorry allotment money, yes, pay 20 rupees, but when you receive the allotment letter and company is asking him to pay 30 more rupees under allotment. He may choose that I will not pay the allotment money, and I am not interested in the shares of this company. So, he will not send the allotment money.

So, why this with the total amount companies asking is they have already received 2 crores with the application, so 2 crores they have received with the application they are asking for three more crores and with the allotment. But out of this the shareholders worth of the capital of say 20 lakhs, 20 lakhs they may decide that we will not continue to be the shareholder. We do not want to continue to be the shareholders of this company; we do not want to continue as a shareholder of this company. It means and when the allotment money sending the date for the allotment money was over by that date company received here 2.8 crores of rupees.

It means 20 lakh rupees means 20 lakhs say divided by the one share of 10 rupees, and 3 rupees per share people holding that much number of shares they have decided not to pay the allotment money. So, company did not receive against the total demand of 3 crores company received only 2.8 crores and company did not receive 20 lakh rupees. So, it means that much number of shareholders decided not to continue as the shareholder company and we do not want to pay we have wasted 2 rupees with the application no problem, but we do not know base remaining 8 rupees we do not want to pay remaining 8 rupees. So, my two rupees are gone I am, but I want to pay 8 more rupees because I do not think this is going to be a good investment, I do not think this company is going to be a very bible organizations. So, he will decide like that. So, in total worth of 20 lakhs allotment money was not received by the company.

So, till now against the demand of 5 crore company is going to receive or company has received is how much 4.8 crore, 4 crore and 8 lakhs the company has received it means there is a shortfall and default because of the default company has now receive the 20 lakhs. After that company carries on the process, and after receiving allotment money utilizing it for some period time of time company asked during that one year company ask for the first call 2.5 and one month after the company ask for the second call. So, in total his company is asking for the remaining 5 crore also at the interval of one month. So, they are asking for the 5 crore, remaining 5 crore, they are asking for the remaining five crore.

Now, again this demand a 5 crore there may be another set of shareholders who have paid the application money who have paid the allotment money. But at the call money stage, they decide in total for both the calls that shareholders miss worth of investment of another say 30 lakhs, another of 30 lakhs total capital amount into rupees 30 lakhs at the time of call from company for paying the call money first and second call. Shareholders having the shares worth 30 lakh, they now decide that we also do not want to continue as the shareholders of this company.

It means we have already paid them 5 rupees 2 rupees on application and 3 rupees on allotment per share, so that money is already gone. I have already paid 50 percent that is gone down in the drain, I will forget that, but I do not want to pay my remaining 5 rupees. So, 50 percent my loss, but I do not want to make it is a loss of 10 rupees, because this investment is not going to be a viable investment. So, I am not pay the remaining. So, this way total number of shareholders or for the number of shares people decided not to pay the calls money in total comes up as 30 lakh rupees. So, against the total demand of 5 crore, now the company is going to receive how much that is 4.7 crore, it means total till the end of year company will be receiving 9.5 crore and capital worth 50 lakhs will not be received by the company, because shareholders at different stages.

Some at the allotment stage, some at the first call stage, some at the second call stage; they decided not to continue as the shareholder of the company. Forget my 2 rupees or forget my 5 rupees or forget my 7.5 rupees, I can say 2.5 rupees I would like to say I have paid 7.5 may be people who dropped at the level of the second call. They have already paid 7.5 rupees, but they would not they do not want to pay the remaining 2.5. So, they want it to save that 2.5. So, the total amount works out as 30 lakhs. So, this company has not received. So, in total till the end of the year or the total period during which that share money was asked by the company the company is going to receive now or finally, the company has received 9.5 crore.

So, it means company will be here it is saying that at under different installments how the company ask for 2 crores here, 3 crores here and 5 crore here company ask for 10 crores. So, the called up capital will also become 10 crore, called up capital is also 10 crores. But how much people have paid then people have paid them only 9.5 crores. So, this is how the five types of the capital is divided and described we have authorized capital 100 crore with which the company is authorized to be the company has been registered and company is authorized by the registrar of companies today's during its foreseeable life. Out of that company decided to raise 10 crores from the market under the first issue that is first IPO and shares means one share of 10 rupees and for issuing 1 crores shares in the market.

Company gave the advertisement and completed the process then said that means, the issued capital became 10 crores, then the subscribe people applied for the shares one crore shares the worth 10 crores, at the rate of rupees 10 per share it means the subscribed capital also became 10 crores. Then over the different installments and calls, application, allotment, first call, second call company asked for a different intervals for 10 crore that became the called up capital. And finally, 9.5 crores worth of the capital was received by the company and shareholders holding the shares worth of 50 lakh share capital, they decided at different stages not to pay the remaining balance of the money somebody decided not to pay the allotment money they. So, he lost 2 rupees per share somebody decided not to pay the first calls, he lost 5 rupees per share somebody decided not to pay the second call money. So, he lost 7.5 rupees per share. So, finally, the shareholders worth of capital of 50 lakhs, they refuse to pay the subsequent calls.

So, it means finally, the company could get the capital could get the capital collected that was 9.5 crore. So, there is a shortfall of the 50 lakhs because a new company people do not know about it and people are not interested to carry on as a shareholder or continuous the shareholder of the company. So, they have decided not to pay some money at some stage and this way the company has not been able to get 10 crores against the 10 crores demand call it means the company has been able to get 9.5 crores against the call of 10 crores. So, this is how we talk about the different types of the capital.

So, when you will preparing the balance sheet of the company form of organizations or joint stock companies we do not need to show all kind of the capitals in the balance sheet at least this authorized capital and paid up capital these two capitals should be there. These two capitals, it should be there in the balance sheet, so that everybody knows that. Then when this balance sheet will be reported to the different stakeholders, government, tax authorities, shareholders or maybe and any general public, anybody in the general public when they will be given the copy of the balance sheet they get to know that the company is authorized to raise 100 crore in its foreseeable life. First issue came for 10 crores and against 10 crores, the company has now got the paid up capital of 9.5 crores.

So, these two capitals have to be shown in the balance sheet authorized capital of 100 crores and the paid of capital of 9.5 crores. These 9.5 crores will become now the final share capital of the company with which the company will carry on the business and this will be shown in the balance sheet. So, this is the share capital of 9.5 crores and different type of the different types of the capitals, and how they are to be divided.

Now, before we start preparing the financial statements I will discuss with you certain other important concepts, which are important here that is different types of the shares. Different types of the shares, largely we have two broad categories of the shares which the companies in India can issue. All the companies are allowed to issue in the market, these shares are preference shares and equity shares.

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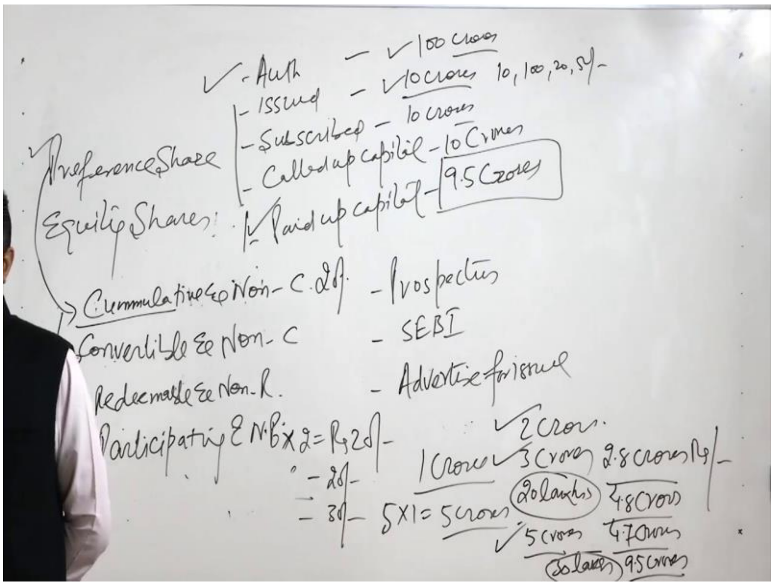

Preference shares and equity shares, these are the two broad categories. Preference shares their why they are called as preference shares because they get some kind of the preferences; they get some kind of the preferences over the equity shareholders. When somebody is holding the preference share, he will be getting some preference against his equity counterpart that is why these shareholders or people subscribing to these shares are called as preference shareholders.

Now, what are those preferences which they get? These preferences are first preference normally, they get two preferences, first preferences that at the end of the year, when the company will calculate its profit, or loss and company has a sizable amount of the profit sufficient profit and company want to pay the dividend then the first right on the dividend will be of preference shareholders. So, first preference is in terms of the payment of dividend to the shareholders, when the companies declare the dividend first right on the dividend is of the preference shareholders. So, this is the first preference they get. But here the rate of the dividend remains fixed that is pre decided, when their preference share is issued it is written on the share certificate that say for example, 10 percent or 12 percent or 15 percent.

Whatever the dividend company want to pay preference share or 12 percent or 15 percent preference share company amount to issue or sell in the market. So, it means 10 percent preference share means the rate of dividend is 10 percent, 12 percent means the rate of dividend is 12 percent, 15 percent means the rate of dividend is 15 percent. So, they will be paid the dividend at the pre specified rate which is written on the share certificate and at that percentage nothing more nothing less will be paid by the company to them as a dividend to these shareholders, but they will get the preference. So, over there equity counterparts and this is the first preference.

Second preference is the return of capital, return of capital means when the capital is returned by the company. For example, company is dissolved, it is broken down companies dissolved, and because of any reason maybe the objective with which the company was created is over the company. So, now the company does not want to carry on the same business or companies' business prospects are not good. So, it means same company under the same business objective they do not want to continue or because of any other reason or the companies not able to carry on the business, so financial health is not good. So, when the company is dissolved, it is broken down is has to be removed from the distance. At that time, if some by selling the assets of the companies in the market if some capital is there, what will happen first the assets? All the assets - land, plant, building, machinery, furniture, patents everything will be sold in the market.

After selling those assets in the market whatever the sale proceeds will be available to the say we can call it as the in the hands of authorized person, he is it will the claim of dead suppliers. Say for example, financial institutions, they will be paid first, then for example, bond subscribers or debenture subscribed they will be paid after that. After that still some capital is left then and that has to be returned now to the shareholders. First, right on that receiving the capital first of all will be of the preference shareholders. So, this is the second reference they get. First preference they get in case of getting the dividend second preference they get in case of getting the capital back it, because of any reason if the company has to be closed down, dissolved, and the capital has to be returned back to the shareholders. First claim on that is first try to on that capital is of the preference shareholders, these are the two preferences they get.

But against these two preferences, they have some disadvantages also. What are the disadvantages that number one the rate of dividend is fixed? Whereas it is not the case with the equity shareholders; equity shareholders if there is a high amount of the profit, then the equity shareholders may sometimes get 50 percent of the dividend also. But if there is no profit then equity shareholders or there is a less profit equity shareholders will not get any dividend, they do not have any right on the dividend. But if there is a huge profit or the company say performance is very good in that case equity shareholders the stand at gain and the preference shareholders stand at a loss because the dividend to be paid to the preference shareholders remains fixed. This is a first disadvantage.

Second disadvantage is these shareholders preference shareholders have no voting right. They have no voting right, they cannot vote on any particular issue. Say for example, at least as per the Indian Companies Act 1956, and then the amendments further in 2013 at least once in a year, every company is required to mobilize to call a general meeting of shareholders, all the shareholders that is called as AGM - annual general meeting. Annual general meeting, they are companies required to call of all the shareholders and explain to the shareholders about the affairs of the company, how the companies running, how the company's business is going on, but are the future plans and prospects everything is shared and explain to the shareholders at least once in year. It can be more than once also, but minimum once in a year AGM is must annual general meeting of the shareholders is must.

Now, for example, in that case the management of the company has decided that they want to diversify the business of the company into a new direction, and into different direction, and they want to take up the new projects. And then in that case, some of the shareholders are in favor of taking up those projects, and some of the shareholders are against taking up those projects. So, for example, situation becomes that now the company has to go for the voting that let see how many people with vote for the in favor of the decision of the management, how many shareholders vote against the decision of the management. And in that situation preference shareholders can be the mute spectators there, they have no right and they cannot vote. Only equity shareholders will have the voting right and they will be asked to vote in favor or against their decision of the company of diversification, and preference shareholders have no voting right.

So, some disadvantages is two disadvantages at the rate of dividend is fixed, and no voting right. And two advantages references that yes dividend will be given to them at a preference and if the capital has to be returned, they have the first right against their equity shares counterparts, equity shareholders or the equity shareholders holder counter parts. So, these are the two broad categories of the shares preference shares and equity shares. Now, we have further more say subdivisions of the preference shares we have further more subdivisions of the preference shares. These sub divisions are means the preference share are of the four category, preference shares are of the four category.

Now, we will be talking about the preference shares. First are cumulative and noncumulative preference shares, cumulative and noncumulative preference shares. Second category is convertible and nonconvertible preference shares. Third category is redeemable and nonredeemable preference shares. And fourth category is the participating preference shares and non participating preference shares. These are the four categories of the preference shares.

Cumulative and noncumulative preference shares as the name indicates cumulative, this cumulation or accumulation is in relation to the dividend. So, for example, company has issued 10 percent preference shares, and if they are cumulative preference shares in that case what will happen. If say in one particular year, company has no sufficient profits and company decides that this year no dividend will be paid. So, equity shareholders will go without dividend, but the preference shareholders because their cumulative preference shares and their 10 percent cumulative preference share shares. So, this year more dividend is being paid. So, their dividend payment will keep on accumulating.

Next year for example, the company has sufficient profits and company decides to pay the dividend to the shareholders, preference shareholders. And if their cumulative preference shares shareholders in that case they will get the dividend at the rate of 20 percent not at the rate of 10 percent, because the dividend of the previous year and the current year have has accumulated. And now they will be getting double amount of the dividend. So, it means for example, till first cumulative shares are issued for 5 years preference shares have issued for 5 years and for example, for the first four years company has not got the sufficient profits and they have not declared any dividend.

So, in the 5th year they will be paid dividend at the rate of 50 percent, 10 percentage each for the first fits four years and fifth year that will be 50 percent, but normally that is not allow to happen. So, normally it can happen in the one year, the company has no sufficient profits, so second year they are going to pay the dividend if they are cumulative preference shares then they will be paid the dividend for the current year as well as for the previous year.

And if it is a noncumulative preference shares in that case dividend will be paid at the fixed rate of 10 percent and only in which year the company has the profits sufficient profits and companies' management decides, board of director decides that they are going to pay the dividend to the shareholders. So, they will pay the dividend for that year only current year only nothing for the previous year because they are noncumulative preference shares.

Then second category is the convertible and nonconvertible. Convertible preference shares are those shares which can be converted into equity shares. Normally, preference shares in India are issued for a period of 5 years. So, after 5 years, even both the sides want to continue with the preference shares, it is not possible either they have to be redeemed means the shares have to purchased back bought back by the company and the money has to be paid back to the shareholder. And if shareholders do not want to get the money back add, even they could be the company also does not want to return the money back, in that case the shares can be preference shares can be converted into equity shares.

And when the preference shares will hold us will become equity shareholders their all rights and responsibilities will be of the equity shareholders, their all preferences of preference shareholders will go and all demerits will also go, and all merits and demerits of the equity shareholders will be having all those merits and demerits of the equity shareholders. So, they will become the equity shareholders of the company and as good as the other existing equity shareholders are they will also be the equity shareholders of the company.

After that, we have two more forms that is redeemable preference shares and nonredeemable preferred shares, and then the participating and the nonparticipating preference shares. So, these two types we will be also talking about knowing about learning about discussing about what that I will be talking in my next part of discussion.

Thank you very much.